IOB

RESULTS OF INTERNATIONAL DEBT RELIEF IN NICARAGUA

Geske Dijkstra (Erasmus University Rotterdam) and Trevor Evans (University of Applied Science, Berlin)

Working Document | The Netherlands | January 2003

INSPECTIE ONTWIKKELINGSSAMENWERKING EN BELEIDSEVALUATIE

RESULTS OF INTERNATIONAL DEBT RELIEF IN NICARAGUA

CASE STUDY FOR THE IOB EVALUATION OF DUTCH DEBT RELIEF

GESKE DIJKSTRA (ERASMUS UNIVERSITY ROTTERDAM)
TREVOR EVANS (UNIVERSITY OF APPLIED SCIENCE, BERLIN)

IOB Working Document │ January 2003

PREFACE

This report contains the findings of one of the eight country studies and one of the three field studies for the Evaluation of Debt Relief of the Policy & Operations Evaluation Department (IOB) of the Ministry of Foreign Affairs of The Netherlands. As the results of Dutch contributions to debt relief cannot be distinguished from the effects produced by contributions from other donors and creditors, the eight country studies analyse the results of the combined efforts of all actors.

The field work was carried out in March 2002 – with the assistance of Mr Arturo Grigsby, director of Nitlapán in Nicaragua – by Dr A.G. Dijkstra and Dr T. Evans, who are responsible for the contents of this report. The study is now published in the context of the IOB 'Working Documents' series, comprising consultant studies of interest to a wider public.

Rob D. van den Berg
Director Policy and Operations Evaluation Department

Acknowledgements

The authors would like to thank the staff of the Dutch Embassy in Nicaragua, and in particular Mr Kees Rade, Mr Matthijs Wolters and Mr Rion Fleuren for their helpful cooperation in the organisation of the field visit and the meeting programme.

The authors would also like to thank Nicaraguan government officers, representatives of the private sector and of NGOs, and representatives of donors in Nicaragua for their willingness to answer questions and share their views. The staff of the Central Bank of Nicaragua was particularly helpful by providing extensive and specifically prepared information that was very useful and relevant for this evaluation. For the interpretation of what was happening in Nicaragua the authors are particularly grateful to Mr Arturo Grigsby, director of Nitlapán in Nicaragua, who participated during the full two weeks of the field work and to whom they owe many illuminating insights.

CONTENTS

TABLES

FIGURES

1 THE BUILDUP OF EXTERNAL DEBT, 1970–1990

1.1 The economic background

In 1970 Nicaragua had a small external debt, mainly with official institutions. During the 1950s and 60s, although much of the Nicaraguan population lived in poverty, the economy grew quite strongly by international standards, with real GDP rising at an average rate of 7 per cent a year.[1] This was made possible by the post-war boom in the advanced capitalist countries, which enabled Nicaragua to expand its production of agricultural exports. The output of the traditional export, coffee, increased, and several new products were developed, notably cotton in the 1950s, followed by sugar and beef in the 1960s. In the later 1960s, the country also began to develop a small sector of import-substituting industries within the framework of the Central American Common Market, which had been set up at the beginning of the decade. These new developments were actively promoted by the Nicaraguan government, and, together with investments in economic infrastructure, were financed with the assistance of loans obtained from official multilateral and bilateral organisations. As a result, Nicaragua's external debt slowly began to rise, and by 1970 it stood at 188 million US dollars. Nevertheless, even for a small country, this was still a quite modest amount, equal to only 24 per cent of GDP.

During the course of the 1970s a combination of political and economic developments led to a significant increase in Nicaragua's external debt. In 1972, an earthquake destroyed Managua, the country's capital city, and this led to an upsurge of opposition to the rule of the Somoza family, which had governed Nicaragua as a personal fiefdom since the 1930s. As the Somozas monopolised the international aid which was provided in the aftermath of the earthquake, parts of the middle class, who had previously benefited from the regime, began to side with the more radical opposition associated with urban trade unions and rural peasant organisations. This opposition culminated in three armed uprisings at the end of the decade, led by the Sandinista National Liberation Front. The first uprisings in 1977 and 1978 were suppressed by Somoza's National Guard, but the third led to the defeat of the regime in July 1979.

The decisive economic event was the end of the post-war boom in the advanced capitalist countries, and the onset of the first major post-war international recession in 1974-75. This led to a sharp deterioration in Nicaragua's terms of trade, as the price of the country's agricultural exports fell in relation to the price of imported manufactured goods and oil. As a result, the trade balance deteriorated sharply, registering deficits equal to 17 per cent of GDP in 1975 and 12 per cent in 1976. However, as investment collapsed in the developed capitalist countries, private international banks were eagerly seeking new customers to whom they could lend money. Faced with rising political opposition, the Somoza regime took advantage of the loans available from the international banks in an attempt to ease the economic constraints facing the embattled government. By 1978—the last full year of the Somoza regime—Nicaragua's external debt had increased to USD 961 millions, equal to 45 per cent of GDP. Some of this increase was a result of borrowing from official organisations, but the larger part involved borrowing from commercial banks. As a result, the share of the debt owed to commercial banks increased from 25 per cent at the start of the decade to 50 per cent in 1978.

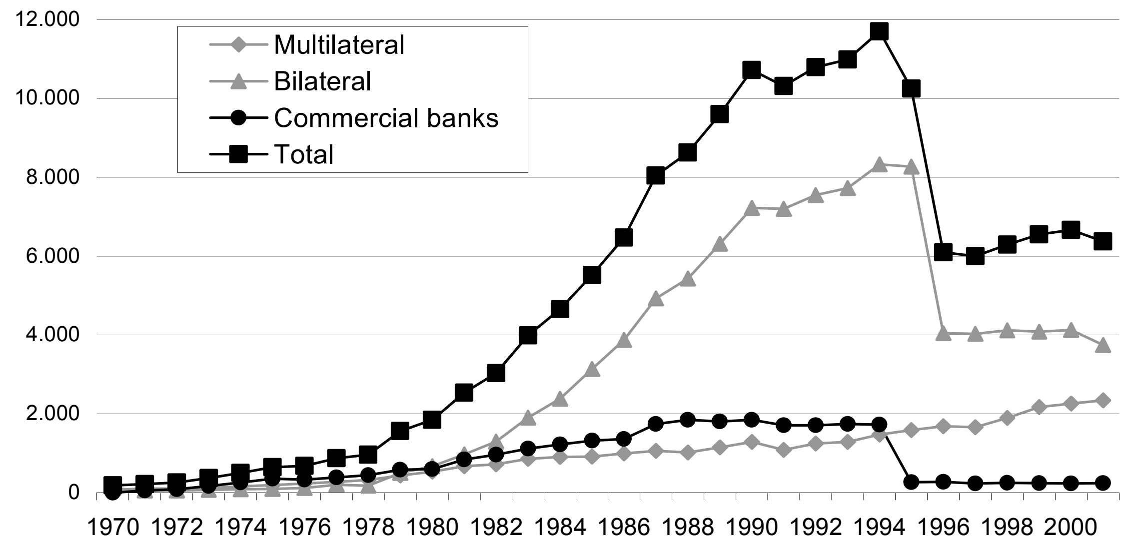
Between 1979 and 1990, Nicaragua was ruled by the left-wing Sandinistas, initially as part of a coalition with smaller political groupings, and, following elections in 1984, alone.

---

[1] Bulmer Thomas, 1987, Annex A.1, pp. 308-9.

During this period Nicaragua's external debt increased dramatically, with the largest part of the increase being accounted for by borrowing from bilateral organisations. The build-up of the debt can usefully be divided into two periods, 1980-84 and 1985-89.

Figure 1—1 Nicaragua's external public debt by creditor, 1970—2001 (USD million)



Source: Banco Central de Nicaragua

When the youthful revolutionary government first took office, it met with a great deal of international good will. Although the property of Somoza and his closest allies was nationalised, this left some two-thirds of the economy in private hands. The Sandinistas declared themselves in favour of a mixed economy, and won plaudits for their commitment to raising the living standards of the mass of the urban and rural poor. The World Bank and the Inter-American Development Bank significantly increased their lending to Nicaragua, and substantial bilateral support, both donations and loans, was forthcoming from many Western governments.

Almost immediately, however, Nicaragua was confronted with major economic difficulties. The output of the Nicaraguan economy had declined by over 30 per cent in 1978-79 as a result of the insurrections against Somoza, and although this was partially recuperated between 1980 and 1983, output in 1983 was still some 20 per cent down on that in 1977. One problem was that, from the outset, the Sandinista government was faced with widespread opposition from many of Nicaragua's business leaders, and there was a significant flight of capital out of the country. In addition, like all the countries in the region, Nicaragua was severely affected by the 1980-82 international recession, which led to another major decline in the price of its principal exports, and a deterioration of around 30 per cent in the country's terms of trade.
The greatest problems, though, arose as a result of a sharp deterioration in relations between the Sandinista government and the US authorities after the government of President Reagan took office in 1981. This led to the US government introducing restrictions on Nicaraguan trade with the US, hitherto the country's most important trading partner. A partial trade embargo was introduced in 1983, and a complete economic blockade was imposed in 1985. The US also used its influence to block further loans to

Nicaragua by multilateral organisations. Most serious of all, the US organised and financed the development of an armed opposition to the Sandinistas. As a result, from 1983 until the end of the decade, the country was engulfed by a war that disrupted agricultural production and drained resources from the rest of the economy.

Table 1–1 Nicaragua: Economic indicators, 1970–1990

	Growth of real GDP (%)	Inflation (%)	Fiscal balance (% GDP)	Exports (USD million)	Trade balance (USD million)	External debt (USD million)
1970	1.4	3.1	-1.5	179	1	188
1971	3.3	1.9	-2.5	187	-2	213
1972	2.2	1.3	-5.5	249	44	255
1973	6.4	27.0	-4.5	278	-48	368
1974	14.2	18.3	-8.2	381	-159	503
1975	-0.2	1.9	-8.0	375	-107	644
1976	5.2	6.2	-8.1	542	57	681
1977	8.4	10.2	-9.3	637	-67	874
1978	-7.8	4.3	-8.0	646	93	961
1979	-26.5	70.3	n.a.	567	237	1,562
1980	4.6	24.8	-8.7	445	-345	1,851
1981	5.4	23.9	-8.2	509	-380	2,537
1982	-0.8	24.8	-12.2	408	-282	3,033
1983	4.6	31.1	-21.6	452	-266	3,990
1984	-1.6	35.4	-22.1	413	-322	4,650
1985	-4.1	219.5	-23.0	305	-489	5,522
1986	-1.0	747.4	-15.8	248	-432	6,464
1987	-0.7	1,347.2	-17.6	273	-463	8,045
1988	-12.4	33,547.9	-27.7	233	-484	8,622
1989	-1.7	1,689.1	-8.1	311	-236	9,597
1990	-0.1	13,490.3	-17.7	331	-242	10,715

Source: Banco Cetral de Nicaragua

Under the Somoza regime, public spending had been relatively limited, averaging 26 per cent of GDP in the 1970s. However, under the Sandinistas public spending was substantially raised, and averaged 48 per cent of GDP between 1980 and 1989. In the early 1980s, spending on health-care and education was increased, and the government embarked on an ambitious investment programme in large public-sector projects designed to create jobs and income. But as defence expenditure also began to rise sharply, the fiscal deficit ballooned, rising to over 20 per cent of GDP.

From 1984 onwards, output declined in every year, and inflation accelerated, reaching hyper-inflationary levels in 1988. Faced with a large balance of payments current account deficit, the economy could only function with substantial external financing. By 1985, lending by multilateral and most Western bilateral organisations had ceased, and Nicaragua became dependent largely on bilateral loans and aid from the Soviet Union and other Soviet bloc countries. In 1988 and 1989 the Sandinista government introduced several stabilisation packages, each one more severe than the one before, and these had some success in curbing inflation, but at the cost of a further decline in output, and cutbacks in social spending.

Table 1–2 Nicaragua: Basic social indicators, 1970-1990

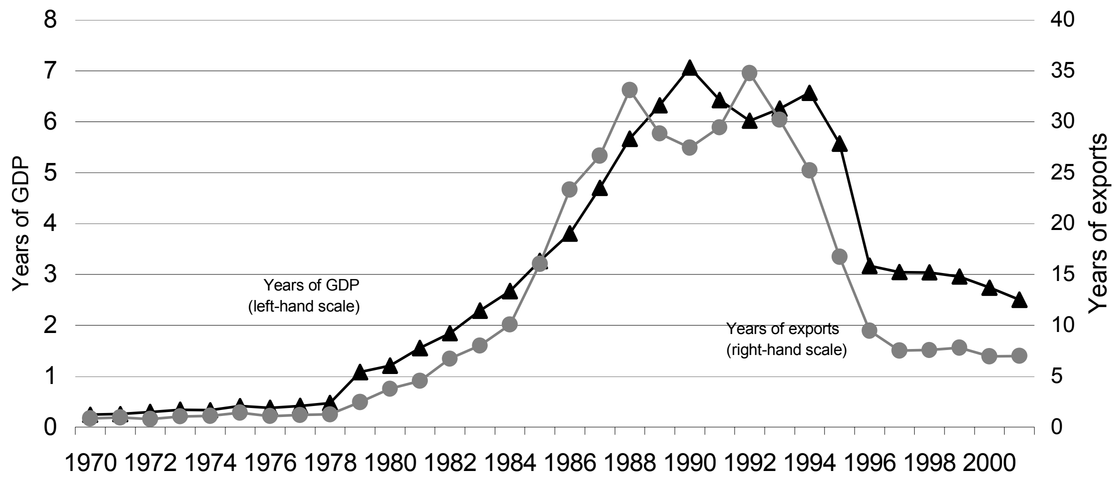
	1970	1980	1985	1990
Life expectancy	53.9	58.7	61.1	64.5
Infant mortality (per 1,000 births)	104.4	84.0	71.0	51.0
Immunisation, DPT (% children under 12 months)	n.a	15.0	35.0	66.0
Immunisation, measles (% children under 12 months)	n.a.	15.0	49.0	82.0
Primary school enrolment, gross (%)	77.5	94.3	96.9	93.5
Primary school enrolment, net (%)	60.5	70.4	73.0	72.2

Source: World Bank.

The social impact of the deteriorating economic situation is difficult to measure, because the available data are not very reliable. According to figures collected by the World Bank, shown in Table 1–2, both life expectancy and infant mortality, which had improved in the 1970s, continued to register significant improvements through the 1980s. Certainly, there was a significant increase in spending on social programmes in the early 1980s, and important advances were achieved, especially in the area of health care. One indicator of this is the steep rise in the coverage of immunisation programmes shown in the table. Nevertheless, the difficulty in sustaining the early advances in other areas is indicated by the figures for primary school enrolment, which register a slight reversal in the second half of the 1980s.

At all events, by 1990, the year in which the Sandinistas were voted out of office, Nicaragua's external debt had risen to USD 10.7 billion. As shown in Figure 1–2, this was equal to around seven times the country's GDP and twenty seven times the value of its exports. In terms of the size of its economy, Nicaragua had become one of the most indebted countries in the world.

Figure 1–2 Nicaragua: External debt in terms of GDP and exports

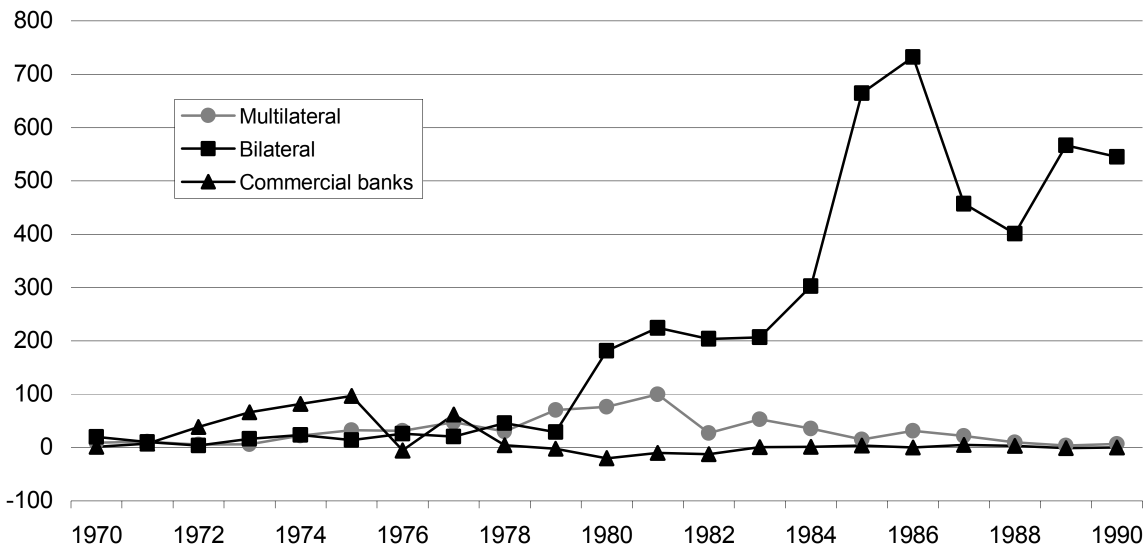


Source: Banco Central de Nicaragua. Exports include goods and services.

1.2 The composition of the debt

The build up of Nicaragua's external debt was determined by two main factors, the net flows of new capital (i.e. disbursements minus amortisation payments), and the accumulation of unpaid debt service charges. The net flows of long-term capital, as categorised in the World Bank's *Global Development Finance* tables, are shown in Figure 1—3. In the first half of the 1970s, the main source of long-term capital was borrowing from commercial banks. In the second half of the decade, commercial banks continued to be the main source of borrowing, but new loans were substantially offset by amortisation payments. In the 1980s, by contrast, official sources replaced commercial banks as the main source of long-term financing. In the first half of the decade, there was a significant rise in the net inflow from multilateral institutions, and an even more substantial increase in the inflow from bilateral sources. Then, in the second half of the decade, multilateral institutions considerably cut back their contribution, and bilateral sources became by far the most significant source of new capital.

Figure 1—3 Nicaragua: Net flows of long-term capital (USD million)



Source: World Bank, *Global Development Finance,* CD-ROM. Net flows are equal to disbursements minus amortisation payments.

The average net flow for the main categories of both long-term and short-term lending in each of three main periods is shown in Table 1—3. It can be seen that the total net flow increased strongly between the 1970s and the first half of the 1980s, and again between the first and second halves of the 1980s. It also shows the big increase in bilateral borrowing between each of the periods. The table indicates that the IMF was not a major source of net capital during the period under consideration. There were small disburse-ments through much of the 1970s, but these were partly offset by repayments. The main exception occurred in early 1979, when, somewhat controversially, the IMF provided the Somoza regime with an emergency loan of 55 million US dollars a few weeks before it was overthrown. It should be noted that the figures for short-term lending include arrears in interest payments.

Table 1—3 Nicaragua: Net flows of external lending, annual averages (USD million)

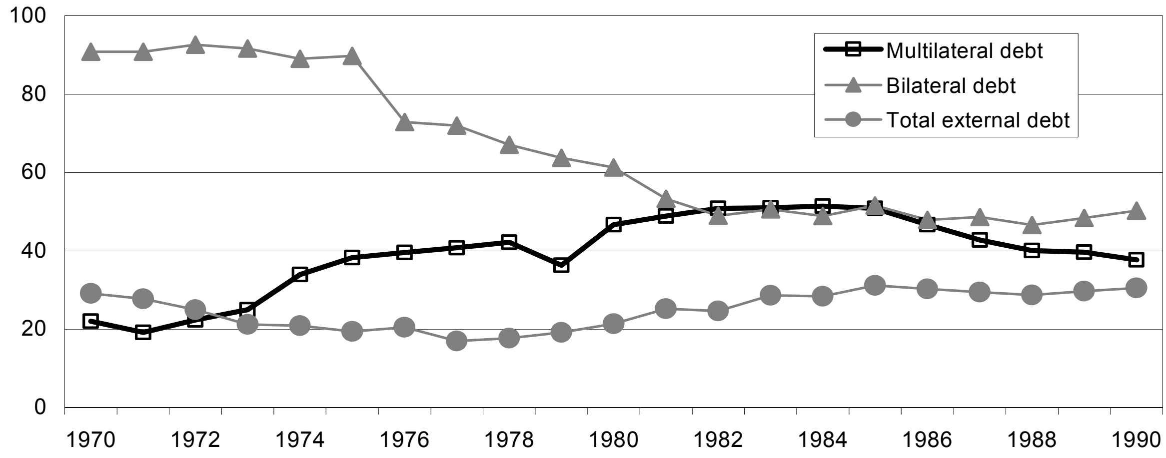
	Long term						
	Multilateral	Bilateral	Commercial	Other	IMF	Short-term	Total
1970-79	26.4	20.7	34.9	5.7	4.3	34.5	126.4
1980-84	58.3	223.7	-8.3	6.4	-6.9	36.0	309.3
1985-89	16.2	564.4	2.0	6.0	-1.8	66.2	652.8

Source: World Bank, *Global Development Finance,* CD-ROM. Net flows are equal to disbursements minus amortisation.

Despite the growing preponderance of borrowing from official sources, in a number of respects the terms of Nicaragua's debt became less favourable during the 1980s. This is, of course, related to the Sandinista government's desperate financial straits, and the need to accept whatever financing might be available. But it is also slightly surprising since most of the new borrowing in the second half of the 1980s was from Soviet-bloc countries who, supposedly, were supporting the Sandinista government.

The share of official debt that was granted on concessional terms is shown in Figure 1—4. It can be seen that the share of multilateral debt granted on concessional terms increased from around 20 per cent in 1970 to around 50 per cent in the mid-1980s, before then falling back to just below 40 per cent at the end of the 1980s. This is explained partly by the fact that borrowing from the World Bank shifted partially in the early 1980s from the IBRD, which lends on commercial terms, to IDA, which lends at more favourable interest rates. In the case of bilateral debt, the share granted on concessional terms stood at 90 per cent in the first half of the 1970s, but this declined in the second half of the decade. By 1982, only 50 per cent of bilateral debt was concessional, and this remained the case for the rest of the decade. Nevertheless, because of the declining importance of commercial debt, which is entirely non-concessional, the share of total debt conceded on concessional terms actually increased slightly, from 20 per cent in the first half of the 1980s to around 30 per cent in the second half of the decade.

Figure 1—4 Nicaragua: Share of external debt extended on concessional terms (per cent)

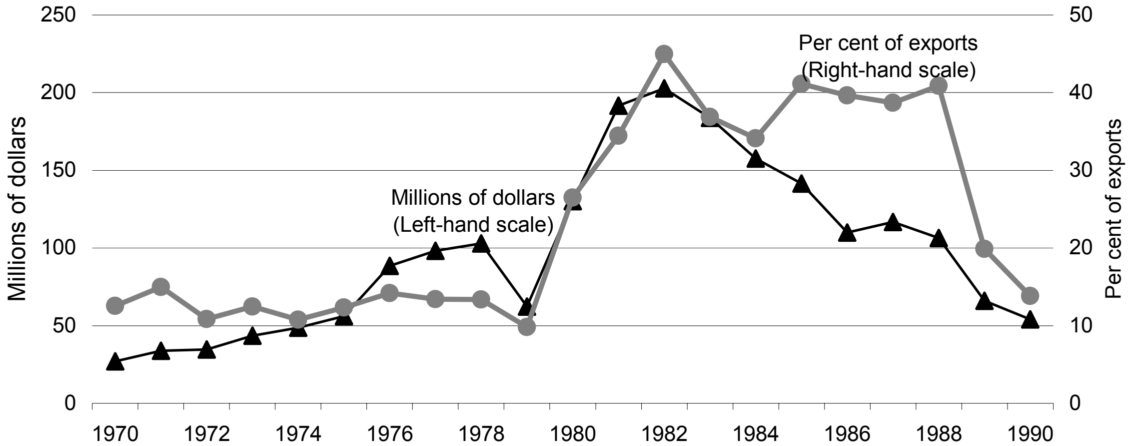


Source: World Bank, *Global Development Finance,* CD-ROM.

1.3 Debt service and the buildup of arrears

In the 1970s, as the size of the external debt increased, debt service payments also increased, rising from 27 million dollars in 1970 to 103 million dollars in 1978 (see Figure 1—5). Nevertheless, because the country's earnings from exports were also rising, the ratio of debt service payments to exports remained relatively unchanged at around 13 per cent during this period. Reflecting the composition of the debt, most of the debt service in the 1970s was paid to commercial banks.

Figure 1—5 Nicaragua: External debt service payments



Source: Banco Central de Nicaragua, *Nicaragua: Indicadores Económicos 1960-1999,* p. 125. Exports include goods and services.

In 1978, the Somoza government began to face difficulties in fulfilling payments on its external debt, and it suspended repayments of principal. Then in 1979 all debt service—interest and repayments of principal—were disrupted as a result of the uprisings against Somoza. To many people's surprise, however, the new Sandinista government declared its willingness to honour the debts incurred by the previous regime. In negotiations with the commercial banks, the Sandinistas succeeded in achieving rescheduling terms that, at the time, were hailed as innovatory and more favourable than those achieved by any other country.[2] In practice, though, this still involved a high cost for Nicaragua and debt service payments increased to some USD 200 million a year between 1981 and 1983, equal to about 40 per cent of export earnings. The main beneficiaries were, again, the commercial banks, although multilateral and, to a slightly lesser extent, bilateral institutions, also received significant payments.

From 1984 onwards, as the military situation began to dominate all other considerations, debt service payments fell sharply. The policy of the Sandinista government was, basically, only to pay creditors when this would assist in obtaining additional new credits. Nevertheless, because exports were also declining, debt service payments continued to account for a high share of export earnings. By 1989, the last full year of the Sandinista

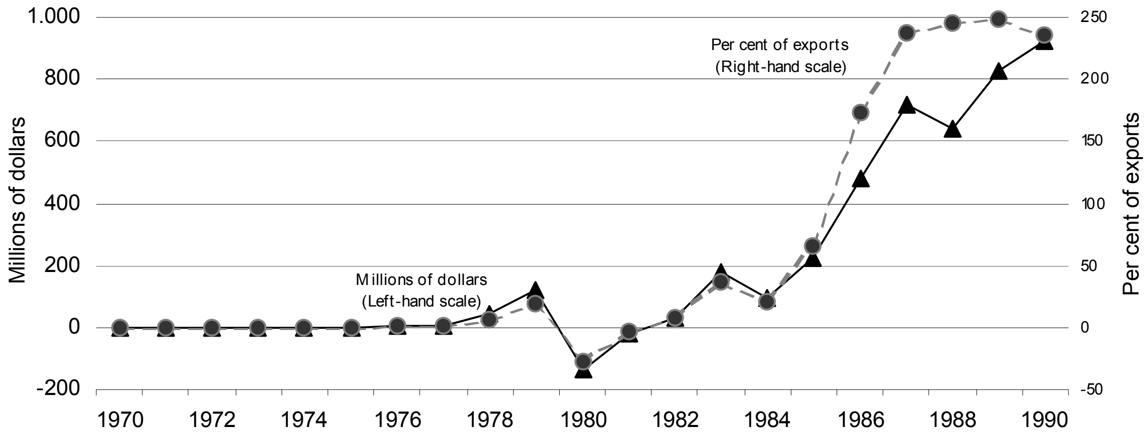
---

[2] For details of the negotiations, see Richard Weinert, 'Nicaragua's debt renegotiation', *Cambridge Journal of Economics,* vol. 5, 1981, pp. 187-94.

government, debt service payments had fallen to USD 66 million, equal to 20 per cent of exports.[3]

The amount of the unpaid debt service charges is shown in Figure 1–6. It can be seen that the unpaid debt service that accumulated in 1978 was 1979 was partly made good in 1980. However, from 1983 onwards, unpaid interest and amortisation payments increased dramatically. In 1983, unpaid service charges amounted to 180 million dollars, which was equal to 36 per cent of exports. By 1989, the annual amount of unpaid service charges had rocketed to 826 million dollars, the equivalent of 236 per cent of exports.

Figure 1—6 Nicaragua: Unpaid debt service



Source: World Bank, *Global Development Finance,* CD-ROM. Estimated from changes in net arrears.

The failure to meet the debt service charges led to a huge accumulation of arrears. In 1983, the arrears stood at a relatively modest USD 237 million; by 1990 the sum had increased to USD 4,139 million, of which USD 1,688 million was due to unpaid interest charges. In other words, of Nicaragua's total external debt in 1990, which amounted to USD 10,715 million, almost 40 per cent was accounted for by accumulated unpaid service charges.

Despite this huge build up of arrears, Nicaragua benefited from little formal debt forgiveness in the 1980s. The main exceptions, according to figures published by the Nicaraguan Central Bank, were cancellations by Cuba (USD 45 million in 1985), Sweden (USD 2.8 million in 1986) and Canada (USD 11.6 million in 1987).[4]

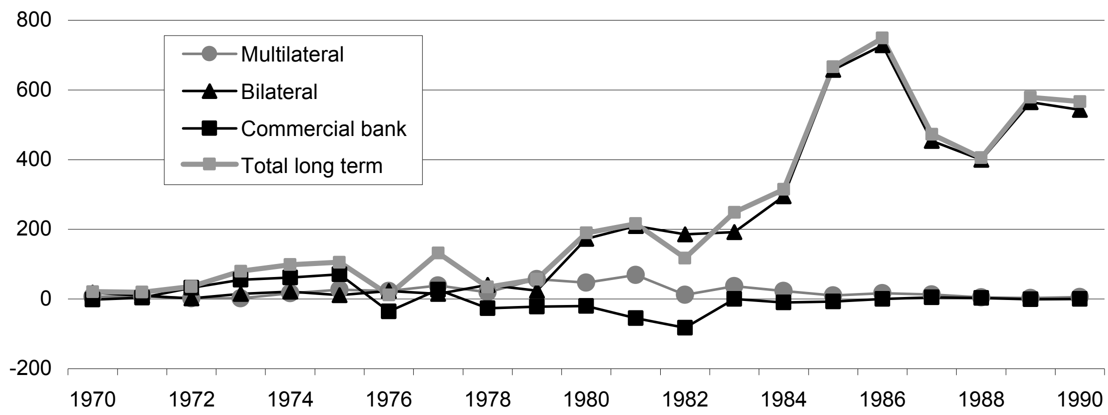
1.4 Net debt transfers and grants

Throughout the 1970s and 80s, Nicaragua's debt transactions resulted in net transfers of capital. In every year except 1979 disbursements of new capital exceeded debt service payments. However, as is to be expected from the figures in the previous section, the scale of the net transfers increased dramatically over time, as can be seen in Figure 1—7.

[3] The figures for external debt service in the World Bank's *Global Development Finance* are similar to those of the Nicaraguan Central Bank up to 1982. From 1983, however, the World Bank figures are significantly lower than those of the Central Bank: in 1983 they show debt service of USD 107 million (21.5 per cent of exports) and by 1989 this had fallen to just USD 11 million (3.4 per cent of exports).

[4] Banco Central de Nicaragua, *Nicaragua. Indicadores Económicos 1960-99,* 2001, Table VI-13.

Figure 1—7   Net transfers on long-term debt (USD million)



Source: World Bank, *Global Development Finance,* CD-ROM. Net transfers are equal to disbursements less amortisation and debt-service payments.

The average size of the net flows during the three main periods is shown in Table 1—4. In the 1970s under the Somoza regime, long-term net transfers averaged USD 68 million a year; in the first half of the 1980s, they increased to an average of USD 217 million a year; and by the second half of the 1980s, this had climbed to an average of USD 574 million a year. The predominance of bilateral flows stands out in both the first and second half of the 1980s. Multilateral net flows were of most significance in the first half of the 1980s, but this was balanced by a net outflow to commercial banks.

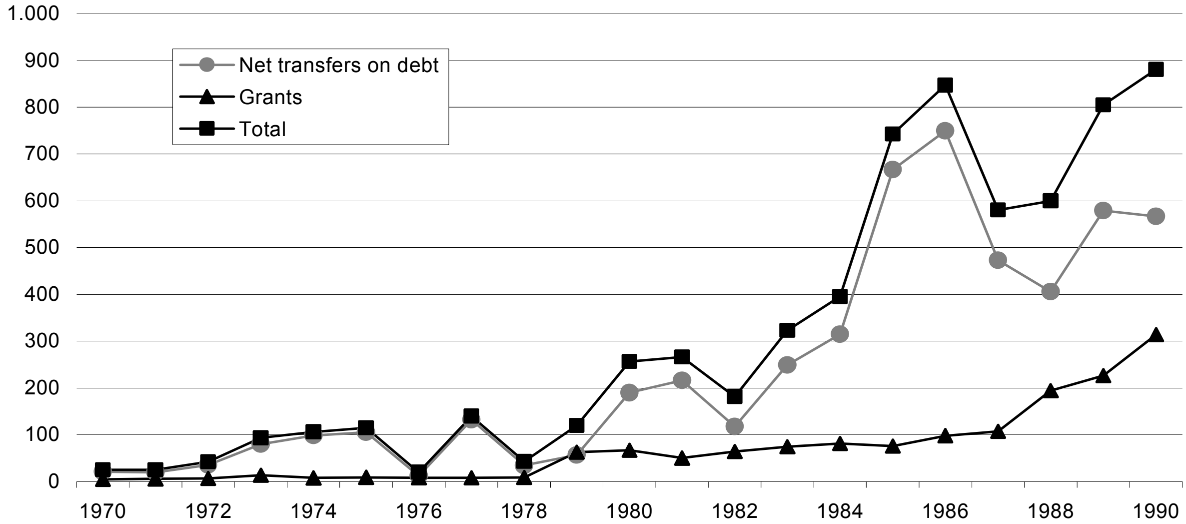
Table 1—4   Nicaragua: Net transfers on long-term debt, annual averages (USD million)

	Multilateral	Bilateral	Commercial	Other private	Total long term
1970-79	20.0	18.0	16.4	10.5	68.0
1980-84	37.5	211.0	-33.6	2.5	217.2
1985-89	9.5	561.1	-0.2	4.3	574.8

Source: World Bank, *Global Development Finance,* CD-ROM.

In addition to the net transfers on debt, Nicaragua also received grants from abroad. Under the Somoza regime these were rather limited, averaging only about USD 8 million a year. But from 1979, when the Sandinista government assumed office, grants increased significantly. Between 1979 and 1987 grants averaged USD 77 million a year; there was then a further increase at the end of the decade, and in 1988 and 1989 the average rose to USD 210 million. The large increase in grants at the end of the decade therefore served to offset the decline in the share of concessional lending by bilateral organisations noted above. At all events, in 1989, the last full year of the Sandinista government, the total external financing received by Nicaragua amounted to USD 856 million, of which 26 per cent was received in grants. The earnings from exports, by contrast, were equal to only USD 330 million.

Figure 1─8. Nicaragua: Net transfers on debt and grants (USD million)



Source: World Bank, Global Development Finance, CD-ROM.

1.5 Conclusion

Nicaragua's external debt increased under the Somoza regime in the 1970s, but the government had been able to meet its debt service payments up until 1978. In the first half of the 1980s, there was a marked increase in the external debt, which rose from 96 per cent of GDP in 1980, to 167 per cent in 1984. During this period the debt service payments increased very significantly, reaching around USD 200 million, or 40 per cent of export earnings for several years. In the second half of the 1980s, output and export earnings fell, and the country became ever more dependent on foreign financing. At the same time, debt service payments virtually ceased, so that arrears also accumulated. By 1990 Nicaragua had acquired a huge external debt, that was completely unsustainable.

2 INPUTS: DEBT RELIEF RECEIVED

2.1 Introduction

The aim of this chapter is to document the amounts of debt relief received by Nicaragua, and to describe the objectives and conditions that were attached. In addition, the chapter will analyze the extent to which debt relief received over the 1990s has been additional to other aid flows. In the last section, special attention is given to Dutch debt relief, its objectives and conditions, and the additionality of Dutch debt is examined.

After years of economic decline and stagnation, Nicaragua's economy was in a desparate state in 1990. The new government coalition under the leadership of Violeta Barrios de Chamorro that took office in that year faced enormous challenges. Stabilisation of the economy was among its first priorities. In March 1991 a successful stabilisation programme was implemented. In September 1991 the country concluded a Stand-by arrangement with the IMF. It took until 1994, however, before a positive growth rate was achieved. Despite the formal ending of the civil war, the early 1990s were characterised by a high level of political and to some extent also military instability. Although the FSLN had lost executive power, it was still strong in the National Assembly and among the popular organisations, including the unions. As structural adjustment measures brought massive lay-offs and reductions in real wages, they were accompanied by many strikes and other protests. In the countryside, the failure to provide land and jobs to former combatants, brought about new conflicts. The coalition that had brought Ms Chamorro to power soon fell apart, and Ms Chamorro and her influential son-in-law, minister of the Presidency Antonio Lacayo often had to rely on Sandinista support to carry our their policies. During the period of the Chamorro-Lacayo administration, Nicaragua received extensive aid inflows.

By 1996, the political and military situation had stabilised somewhat and several years of economic growth also helped to ease the tensions. New presidential and parliamentary elections were held, and Arnoldo Alemán of the Liberal party won the Presidency. He took office in January 1997. While the Chamorro government had maintained good relationships with donors, from the beginning the relations between the Alemán administration and the donors, in particular bilateral donors, were tense. Nevertheless, in early 1998 the government reached an agreement with the IMF on a second ESAF. This was accompanied by new loans from the multilateral institutions, but bilateral donors remained somewhat reluctant to support the government. In October 1998 the country was hit by hurricane Mitch, which led to extensive damage to agricultural production and to infrastructure and housing, in addition to 3,000 lost lives. This triggered a large aid flow to the country. However, there are many indications that at least part of this aid was not spent well and benefited Alemán and his close allies personally.

At the time of the fieldwork for this evaluation, another government change had taken place after the November 2001 elections. Former private sector spokesperson and former vice-President under Alemán, Enrique Bolaños, became President. Although he is of the same party as Mr Alemán, he came to power on an anti-corruption platform and he is engaged in a fierce battle against Alemán and his followers on corruption issues. Not surprisingly, Mr Bolaños appears to be popular with the donor community.

2.2 Amounts of debt relief

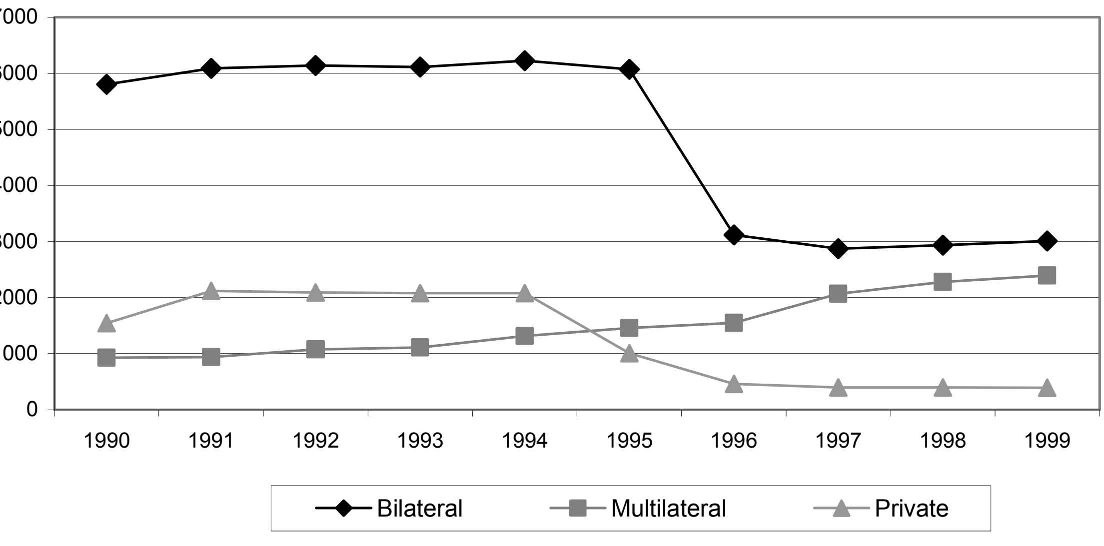
The Chamorro government gave high priority to finding a solution to its high foreign debt. Over the 1990s, Nicaragua received large amounts of debt relief. According to World Bank Global Development Finance (GDF) data, total forgiveness over the 1990s amounted to USD 7,319 million, while total rescheduling stood at USD 4,266 million (Table 2─1). The foreign debt stock declined from USD 10.7 billion in 1990 to USD 6.4 billion in 2001, despite large amounts of new loan inflows, in particular, from multilateral creditors. Figure 2─1 shows that debt stocks to bilateral and private creditors declined most, and that multilateral debts in fact increased over the decade. Multilateral creditors only began to grant debt relief after Nicaragua reached the Decision Point for the enhanced HIPC Initiative. This occurred in December 2000, so this relief began in 2001. In the following paragraphs, we describe the debt relief received by Nicaragua by type of debt, and using data from the Central Bank of Nicaragua.

Table 2─1. Debt relief received according to GDF, 1990-1999 (USD million)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Total
Principal rescheduled	0	474	53	62	4	204	303	36	45	53	1,234
Interest rescheduled	30	470	33	28	3	75	203	3	37	59	940
Debt stock rescheduled	0	644	0	2	0	0	668	734	44	0	2,093
Total rescheduling	30	1,588	86	92	7	278	1,174	773	126	112	4,266
Debt stock reduction	0	159	0	0	9	1,200	3,065	220	0	36	4,688
Of which: debt buyback	0	159	0	0	0	89	0	0	0	0	248
Principal forgiven	0	227	6	2	7	438	23	182	39	67	991
Interest forgiven	0	204	2	0	0	723	923	2	10	25	1,889
Total forgiveness	0	431	8	3	15	2,273	4,011	403	49	128	7,319
Total debt relief	30	2,019	94	95	22	2,551	5,185	1,177	175	240	11,586

Source: World Bank, *Global Development Finance CD-ROM*, 2001.

Figure 2─1. Public debt by creditor, 1990-1999, (USD million)



Source: World Bank, Global Development Finance CD-ROM, 2001.

2.2.1 Multilateral debt

In principle, the change in administration in 1990 opened the way for new aid from the US and from the multilateral institutions – all of which had been blocked by the US during the 1980s (Leogrande, 1996). As it had become clear that the country would no longer receive new loans from the multilateral institutions, Nicaragua had stopped paying debt service to its multilateral creditors (World Bank and the Inter-American Development Bank, IDB) in 1984. This led to large arrears, and these arrears formed an obstacle to new loans from these institutions and to an arrangement with the IMF. In turn, an agreement with the IMF was a condition for OECD countries to consider debt rescheduling in the Paris Club.

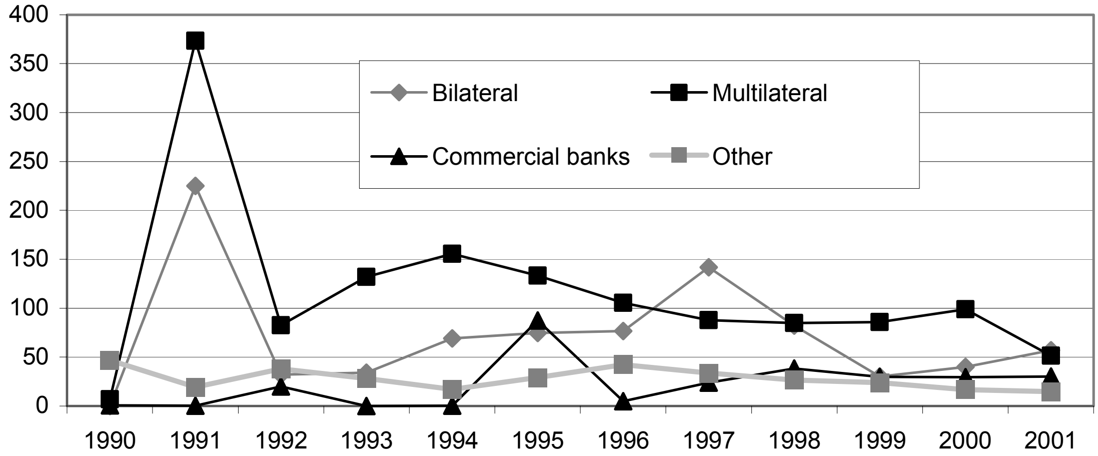
The new government perceived normalisation of relations with World Bank, IMF and IDB as the only way to get access to concessional finance and to begin renegotiating its foreign debt. Arrears to the World Bank and the IDB turned out to be USD 327 million. Several international donor conferences were held with the Nicaraguan government during 1990 and 1991 in which this problem was discussed. The final solution involved Nicaragua receiving USD 103 million in grants from seven bilateral donors (US, Canada, Denmark, France, The Netherlands, Norway, and Switzerland), and a USD 193 million bridging loan from Mexico (69m), Spain (69m), Venezuela (46m) and Colombia (9m). In addition, three bilateral donors (Germany, Korea and a Venezuelan Investment Fund contributed USD 24 million as balance of payments support. The money from the bridging loans was repaid with the new loan disbursements received from the IMF, the IDB and the World Bank in September 1991, together with cofinancing contributions from Japan and Switzerland (Gobierno de Nicaragua, 1996). As a result, new loans from the multilaterals did not mean fresh money. The whole operation led to large flows of aid in 1991, at least in the statistics, but these flows were just sufficient to clear the full nominal arrears to multilateral institutions. From then on, Nicaragua paid debt service to the IMF, the World Bank and the IDB as due.

No agreement had yet been achieved with another main multilateral creditor, the Central American Bank for Economic Integration (CABEI). Nicaragua's debt to CABEI originated from the bank's task as administrator of the clearing house (Cámara de Compensación), the mechanism by which Central American intraregional trade could continue without immediate payments between the countries. CABEI is formally a multilateral financial institution, but it is not really a development institution. Arrears to CABEI could continue without hampering an arrangement with the IMF, and arrears continued to increase in the 1990s. In 1997, following intervention by the IMF and the IDB, Nicaragua finally reached an agreement with CABEI on the debt, which by then amounted to USD 565 million. The largest part of it (305 million) would be rescheduled, 165m would be taken over by the private sector in Nicaragua, 94 million would be assumed by the Nicaraguan Central Bank and the remaining USD 104 million (which was forgiveness on accumulated arrears (Castro-Monge, 2001)), would be provided by CABEI itself and would be the CABEI contribution to HIPC, in anticipation of Nicaragua qualifying for it.[5] The Dutch document that refers to this agreement, adds that large amounts of donor money were necessary for the rescheduling, and that the IDB had promised to raise these funds. The IDB, that had just provided the CABEI with a USD 1 billion loan (Dijkstra, 1999: 76), had apparently expected that donors would be as generous as in the 1991 arrears cancelation, and that they collectively would provide USD 25 million for 1998 and 1999, about USD 45 million in 2000 and about USD 27 million in 2001. However, this money was not forthcoming. In the Consultative Group meeting in 1998 it turned out that most donors did not support this

[5] Memorandum DMO/MS, 5 March 1998, containing report of visits of delegations of IDB and of Central Bank of Nicaragua to The Hague.

rescheduling. The grounds for this were that a) CABEI is not considered a fully-fledged multilateral development institution; b) the proposed rescheduling was not at concessional terms but at market terms; and c) providing money for this rescheduling would be at the expense of development projects.[6] This created a problem for the ESAF programme that had just been signed, since if the money had to be raised from Nicaraguan sources, the country would go off-track.

Figure 2‒2. Debt service paid by type of creditor, 1990-2001 (USD million)



Source: Central Bank of Nicaragua.

In spite of its relatively low share in the total debt stock, multilateral debt service constituted the largest share of total debt service paid in most years (Figure 2‒2). There is a clear peak in this debt service in 1991, corresponding to the clearance of arrears. Given that multilteral debt service implied a heavy burden on the Nicaraguan economy, bilateral donors began to finance part of this debt service with debt relief grants in the 1990s.

Table 2‒2 gives an overview of debt forgiveness received by Nicaragua by type of creditor, on the basis of Central Bank data. The penultimate line of this table gives these grants used for debt service. However, figures do not seem to be complete since, for example, the 1991 contributions for the arrears clearing operation are not included. It also appears that some Dutch contributions are missing. Table 2‒2 further shows that Nicaragua received some debt relief grants from the multilateral institutions themselves during the 1990s. The largest part of this was a USD 40 million grant from the World Bank for the buyback of private debt in 1995, which is dealt with below. In December 2000, Nicaragua qualified for the HIPC Decision Point. From 2001 onwards, the country began to receive interim debt service relief from the IDA, the IDB and the CABEI for a total amount of USD 49 million. The IMF did not grant interim relief to Nicaragua in 2001 (see section 1.3), since the country was off-track in that year.

[6] Memorandum DMO/MS, 7 April 1998, containing report of the macroeconomic and debt aspects of the Consultative Group meeting for Nicaragua held on 1-2 April 1998.

In principle, countries qualifying for the Decision Point of the enhanced HIPC Inititiative start receiving interim relief from the multilateral institutions. This relief constitutes a fixed percentage of debt service due on outstanding debt as established in the Decision Point document, and this will be continued over a period of 10-20 years. The World Bank (IDA) will provide relief of 90% of debt service due for a total of about USD 379 million. Once the country is on track, the IMF will provide relief over a period of nine years, for a total of USD 81.5 million in NPV terms.[7] Since in the case of the IDA and IDB the relief is a fixed percentage of debt service due, it cannot be taken for granted that total debt service to some of these multilaterals diminishes after HIPC. For example, HIPC relief from IDA is expected to increase from USD 3.4 million to in 2001 about USD 18 million at the end of the 20-year period, reflecting the fact that total debt service due to IDA increases in the course of the first decades of the 21st century. The 10 per cent that Nicaragua must still pay constitutes an increasing absolute amount of debt service paid. This most likely also holds for the IDB, since IDA and IDB loans were resumed in 1991 and carry a 10 year grace period.

2.2.2 Bilateral debt

Paris Club creditors

The Paris Club creditors were *not* the largest group of bilateral creditors in 1990 (Figure 2–3). Nicaragua owed much more to former socialist countries, and also to Latin American countries. However, Paris Club members were important since Nicaragua expected new loans, and, in particular, new grants from this group of countries. Paris Club creditors were also very important in financing the grants and part of the bridging loan to clear the arrears with the IDB and the World Bank in 1991. For this reason, Nicaragua began to pay some debt service to Paris Club creditors in May 1991 (Figure 2–2), even before an agreement with the Club was reached.

As soon as Nicaragua had a Stand-by agreement with the IMF, a first Paris Club meeting could be held. This took place in December 1991. Nicaragua attempted to get much better conditions than the Toronto terms that were then in effect, and partly succeeded. All creditors except the US accepted ‘enhanced Toronto’ or London terms, that is, 50% forgiveness on accumulated arrears until December 1991 and on debt service due (excluding late interest) between January 1992 and 31 March 1993. Nicaragua requested a cutoff date of 31 August 1991, but it was fixed at 1 November 1988. Nicaragua also requested that debt with an original maturity of less than one year be included. This had never been done before, but in Nicaragua’s case it was conceded, as these types of debt constituted a large share of the outstanding debt service due and of arrears. Private debt was included in the agreement if and when the private debtor had made the corresponding payment in local currency to the Central Bank before 31 December 1991 (IMF, 1992). But private sector debts had to be repaid between 1992 and 1996. Half of the moratorium interest on earlier arrears that was due in the consolidation period had to be paid on schedule, and the other half had to be paid between 1992 and 1996. Accumulated arears and debt service due that was not forgiven was rescheduled over 23 years with a 6 year grace period. ODA loans were rescheduled over 30 years with a 12 year grace period. However, individual countries could grant more forgiveness on ODA loans. The agreement contained a clause that if Nicaragua complied fully with the agreement, maintained satisfactory relations with all creditors and continued to have an arrangement with the IMF, creditors would consider a stock treatment after 3 years.

---

[7] IMF Press Release No. 00/78, December 21, 2000 (www.imf.org).

The total amount covered by the agreements was USD 722 million (www.clubdeparis.org). However, immediate flow forgiveness in 1992 was only USD 79 million (Table 2–2). This is due to several reasons. First, Nicaragua concluded subsequent bilateral agreements with the 17 participating Paris Club creditors only between 1992 and 1994, so this led to some delay in the application of the agreement (Gobierno de Nicaragua, 1996). Second, the agreement allowed creditors to chose between several options, and not all chose option “a” that led to immediate forgiveness. Five creditors chose option “c” (rescheduling at concessional interest rates but with no grace period) for the non-ODA debt, and two others chose option “b” (rescheduling at market interest rates but with 14 year grace period) (IMF, 1992). Third, most debt service on ODA debts was rescheduled and not forgiven.

Table 2–2 Debt forgiveness by stock and flow forgiveness and by type of creditor (USD million)

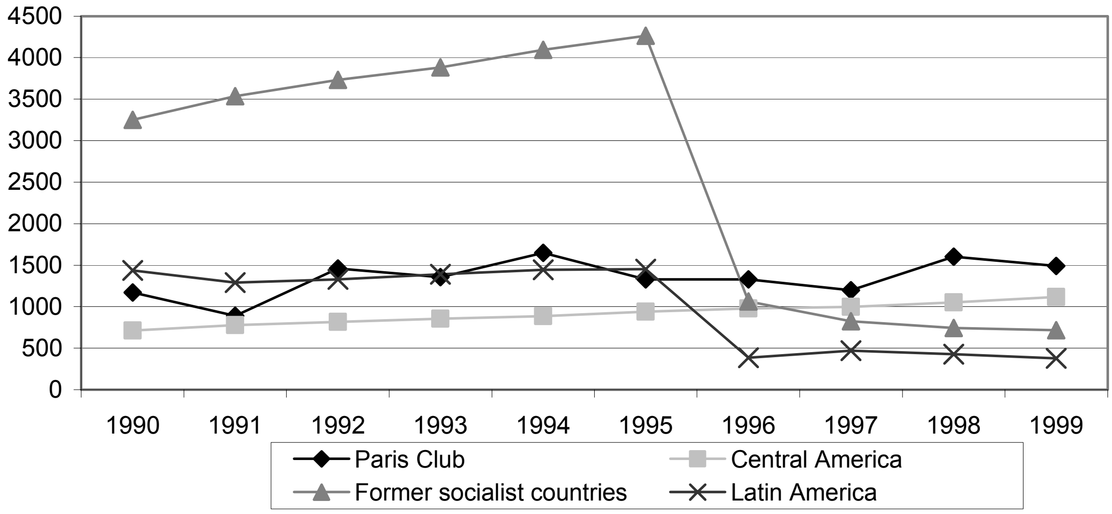
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total
Stock													
Bilateral PC		260[1]	4	2	0	23	24		49			435	796
Bilateral non-PC	279			114	17	0	4183	18	50				4661
Multilateral								104				12	116
Private						1011							1011
Total	279	260	4	116	17	1034	4208	121	99	0	0	447	6584
Flow forgiveness													
Bilateral PC			79	58	123	445	6	5	40	94	9	5	864
Bilateral non-PC							6	15	9	9	18	21	77
Multilateral												49	49
Private				1	4								4
Total	0	0	79	59	127	445	12	20	49	103	26	74	994
Total forgiveness													
Bilateral PC	0	260	84	60	123	468	30	5	89	94	9	440	1660
Bilateral non-PC	279	0	0	114	17	0	4190	32	59	9	18	21	4738
Multilateral	0	0	0	0	0	0	0	104	0	0	0	61	164
Private	0	0	0	1	4	1011	0	0	0	0	0	0	1016
Total	279	260	84	175	144	1480	4219	141	147	103	26	521	7578
Grants used for debt service													
Bilateral		0		11	12	14	20	14	50[2]	8	0		165
Multilateral					0	44	5	4	5	5	4	4	69

Source: Central Bank of Nicaragua.
[1] The whole amount is a debt cancelation by the US.
[2] USD 45 million corresponds to contributions to the Central American Emergency Trust Fund (CAETF) created after hurricane Mitch for paying debt service of Honduras and Nicaragua.

In 1992 the Stand-by agreement ended and it was only in 1994 that an ESAF was concluded. In March 1995 a second round of negotiations with the Paris Club began. Nicaragua requested 80% forgiveness on eligible debt service, but this demand was not met. Instead, Nicaragua became the first country to benefit from Naples terms, i.e. 67% forgiveness on arrears and on debt service due in 1995 and 1996 on eligible (pre-cutoff date) debt. The other one-third insofar as interest payments were concerned, had to be paid between 1997 and 2000. Payment of principal on non-ODA debt was rescheduled over 23 years with six years of grace. The major share (90%) of the amount covered in the agreement was due to Germany. Germany granted forgiveness on 80% of debt service due (including arrears), and this accounts for the major share of the USD 445 million Paris Club debt flow forgiveness shown in Table 2–2. Paris Club creditors again promised to consider stock reductions if the country signed a new ESAF with the IMF in 1997 (Gobierno de Nicaragua, 1996: 83).

However, the next ESAF was only concluded in early 1998. In April 1998 the third Paris Club agreement was signed. It was again a flow arrangement with 67% forgiveness, covering arrears until 1 March 1998 and debt service due on eligible debt from March 1998 to March 2001. While the 1995 agreement still covered USD 848 million, this agreement only covered USD 213 million (www.clubdeparis.org), due to the reduction that had been achieved in 1995 in the debt to Germany.
After hurricane Mitch that struck the country in October 1998, Paris Club creditors held a special meeting in December 1998. In this meeting they decided to defer all debt service payments on pre-cutoff date debts from December 1998 up until March 2001. According to this agreement, interest would be capitalised on these deferred payments on non-ODA debt and all of this would have to be paid from March 2002 onwards. Nicaragua had requested a deferral until the end of 2001, but the creditors preferred a date of 1 March 2001 because it coincided with the end of the 3-year ESAF.[8] The idea was that Nicaragua by then would have entered a new IMF arrangement, so that the Paris Club could then reconsider Nicaragua's debt. However, the second annual ESAF tranch was disbursed with a long delay, and the third tranch was never disbursed: in April 2001, the ESAF/PRGF[9] programme was officially declared off-track.

Figure 2–3 Bilateral debt by group of creditors 1990-1999[1] (USD million)



Source: Banco Central de Nicaragua, 2001.
[1] The category "other countries" is omitted from this graph. Its amount gradually diminishes from about USD 650 to about USD 400 million.

Since this created an acute payments problem for Nicaragua, the Central Bank of Nicaragua requested the Paris Club on 26 February 2001 to allow a continuation of the

[8] A confidential Dutch report of the December 1998 Paris Club meeting reveals that, although the deferral was for only two years and two months and was communicated as such to Honduras and Nicaragua, creditors agreed that the press release would speak about three years-deferral.
[9] Since the beginning of the enhanced HIPC Initiative in 1999, ESAF has been called 'Poverty Reduction and Growth Facility' (PRGF).

deferral of debt service payments (except post-cutoff debts), arguing that negotiations on the third annual PRGF were underway.[10] The IMF representative supported the Central Bank of Nicaragua in declaring to the Paris Club that the non-payment on pre-cutoff date debt – which was against Paris Club conditions – would be "technical arrears" that would not prevent Nicaragua from achieving the completion point.[11]
Table 2─2 shows that forgiveness from the Paris Club had peaks in 1991, 1995 and 2001. The 1991 figure corresponds entirely to a cancelation of a debt to the USA, while the 1995 amount is largely due to forgiveness on the debt to former East Germany. In 2001, two Paris Club creditors canceled debts to Nicaragua: Spain (399 million) and the Netherlands (36 million), the latter because Nicaragua had reached the HIPC Decision Point. In the case of Spain, this forgiveness refers to a triangular operation with Guatemala, in which the Nicaraguan debt to Guatemala was canceled (see below). Other than these peaks, debt forgiveness was not particularly high, but it was higher in 1992-1994 than in later years, probably due to the high arrears in 1990, part of which had to be forgiven.

Table 2─3 gives an overview of debt flow reschedulings by type of creditor. Between 1993 and 1996, large amounts of debt service due to the Paris Club were rescheduled. As in the case of forgiveness, the amounts rescheduled were at lower levels in subsequent years. The reschedulings are one of the reasons why the debt stock to Paris Club creditors did not decline during the 1990s (Figure 2─3). The other cause of the increase in the total debt is new disbursements from, amongst others, Japan, Germany and Spain.[12] By 31 December 2001, total post-cutoff date debt to Paris Club creditors amounted to USD 262 million (data from Central Bank of Nicaragua). Almost all of this was concessional.

Paris Club creditors have committed themselves to grant 90 per cent reduction of the pre-cutoff date debt stocks of Nicaragua once the country reaches the Completion Point of the enhanced HIPC Initiative. A large amount of this debt stock to be forgiven consists of capitalised interest. Although it is (or will be) a substantial reduction of those stocks, stocks have first increased due to late recognition that Nicaragua was unable to pay those debts. Had this been recognised earlier, then debt relief could have been given at a much smaller nominal cost (and at much lower transaction costs, see (O'Connell & Soludo, 2001)). In practice, reaching the Completion Point will not reduce the actual debt service flow, as Nicaragua has not been paying pre-cutoff date debts to the Paris Club since Mitch.

2.2.3 Non-Paris Club creditors

Paris Club agreements always stipulate that the debtor country seeks comparable treatment from non-Paris club creditors. Nicaragua had to deal with a wide variety of creditors: Latin American countries, former socialist countries and neighbouring countries in Central America. In June 1990, Nicaragua reached a first agreement with Venezuela by which a USD 248 million debt was restructured on very generous terms. Payment of interest would be due after 1997, but only if Nicaraguan exports reached at least USD 1400 million (Gobierno de Nicaragua, 1996: 59) – which has not happened so far. In 1991, agreements were concluded with Mexico and Colombia. Half of the USD 1,059 million debt to Mexico was restructured on similar terms as had been agreed with Venezuela. On the other half, a very low interest rate had to be paid from the 8th until the 14th year. The USD 47 million debt to Colombia was reduced to USD 3 million and then restructured over 40 years. In 1993, most of the debt to Argentina was canceled but a

[10] Letter from President of Central Bank of Nicaragua to the Chairman of the Paris Club Secretariat.
[11] Interviews with Central Bank staff.
[12] This can be deduced from Central Bank data on the stock of post-cutoff date debt by end 2001.

small amount (USD 9.7 million) remained on which a commercial interest rate had to be paid. In 1997 Nicaragua decided to buy back the remainder at USD 10.7 million. In 1996, a new agreement was concluded with Mexico. It was “highly beneficial”, but also “confidential” (Gobierno de Nicaragua, 1996: 84). Nicaragua still has debts to Brasil and Peru, but no payments have been made on these debts (data from Central Bank of Nicaragua).

Table 2–3 Flow reschedulings 1992-2001, by type of creditor (USD million)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total
Flow rescheduling											
Bilateral PC	49	129	139	140	163	94	46	83	84	29	954
Bilateral non-PC							9	7			16
Multilateral					60	59	54	45	81		298
Total	49	129	139	140	163	154	105	145	136	110	1269
Negative flows											
Bilateral PC			1	1	1	17	16				35
Bilateral non-PC		1	3	3	13	29	13	12	14	15	102
Total		1	3	3	14	46	29	12	15		137
Overall flow rescheduling effect											
Bilateral PC	49	129	138	140	162	77	30	83	84	29	920
Bilateral non-PC	0	-1	-3	-3	-13	-29	-13	-4	-7	-15	-87
Multilateral	0	0	0	0	0	60	59	54	45	81	298
Total	49	128	135	137	149	108	76	133	122	95	1131

Source: Central Bank of Nicaragua.

The largest debt in the category of former socialist countries was that to the former Soviet Union. In 1996, when Russia was not yet a member of the Paris Club, Nicaragua concluded an agreement with the country on its USD 3.4 billion debt. Ninety percent was canceled, and the remainder had to be paid over 15 years. Other agreements were concluded with the Czech Republic and with Slovakia. With the other Eastern European creditors, Poland, Bulgaria, Hungria and Yugoslavia no agreements were concluded and debt service was not paid.

No payments were made on debts with Central American countries Costa Rica, Guatemala and Honduras. In 2001, a Nicaraguan debt of about USD 500 million was canceled by Guatemala, as a result of the triangular operation, referred to above, in which Spain canceled a claim of about the same size on Guatemala.[13] Spain and Costa Rica are studying the possibility of a similar triangular solution to the Nicaraguan debt with Costa Rica, which is also of about USD 500 million.

---

[13] As Central Bank data show a debt stock to Guatemala by end 2001 of zero, and no debt forgiveness from Guatemala in that year, this forgiveness must have been recorded under Paris Club stock (Spanish) forgiveness in Table 2–2.

Central Bank data show that there is one other important non-Paris Club creditor, namely Taiwan. By December 2001, Nicaragua owed about USD 210 million to that country. All of that is post-cutoff date debt and is being serviced. The greater part of it is concessional.

Figure 2–3 shows that the debt to non-Paris Club creditors has declined during the 1990s. The largest reductions are visible in debts to former socialist countries and to Latin American countries. After the 2001 cancelation of the debt to Guatemala and the expected solution of the debt to Costa Rica, Central American debt will also have declined to negligible levels. This is in sharp contrast to the debt stocks of Paris Club creditors, which have increased over the decade. Non-Paris Club creditors have applied higher percentages of forgiveness; they have also applied stock forgiveness and not only flow forgiveness; and, to the extent that they rescheduled, it was on much more favourable terms.

On the other hand, Table 2–3 shows that the stock agreements with non-Paris Club creditors often led to debt service payments that were not made before, resulting in negative flows. More detailed Central Bank data (not shown here) indicate that this holds, in particular, for debts to Mexico, Argentina (until the buyback in 1997), and to the Czech Republic and Slovakia. Nicaragua also began to pay debt service to Russia but, since Russia became a Paris Club member in 1997, these amounts are recorded under negative flows to the Paris Club in 1997 and 1998. Russia then also participated in the debt service deferral as of 1999.

2.2.4 Private creditors

In 1990, most of the debt to private creditors was to commercial banks, on which hardly any debt service was paid in the early 1990s (Figure 2–2) In 1995, a debt buyback operation was completed in which 81% of the commercial bank debt was involved. It was bought at USD 0.08 cents per dollar, and the buyback was financed by donor money, including a USD 40 million concessional loan from the IDB, a USD 40 million grant from the World Bank's Debt Reduction Facility, and grant contributions from Switzerland, Sweden and the Netherlands (Gobierno de Nicaragua, 1996: 83). As Figure 2–2 shows, debt service to commercial banks was not zero from 1997 onwards. This means that remaining commercial creditors probably benefited from the buyback and now receive higher debt service than they would otherwise have obtained.

The "other" category of debt to private creditors consists of suppliers' credits. It is usually short-term credit and Nicaragua is meeting payments on it.

2.2.5 Conclusion

In sum, Nicaragua received large amounts of debt forgiveness and rescheduling, in particular from bilateral creditors and from commercial banks. However, debt forgiveness often led to debt service payments that were not made before (negative flows), whilst debt reschedulings, in particular form Paris Club creditors, led to a nominal increase in debt stocks. Until 2001, the multilateral institutions did not give any relief on their debts, and in most years debt service to these institutions constituted the largest share of total debt service paid.

2.3 Objectives and conditions of debt relief

In the World Bank documents on Nicaragua from the early 1990s, a distinction is made between Paris Club creditors, other bilateral creditors that are expected to be net providers to Nicaragua, and other official creditors (World Bank et al., 1990). The former socialist countries (except former East Germany), as well as most commercial banks are in the latter category. As Nicaragua was not servicing debt to those creditors, achieving a debt arrangement with Nicaragua would be the only way for them to get at least something repaid on their outstanding claims. This can be seen as the most important objective of providing debt relief for that group of creditors. For other creditors who were still providing net finance (loans or grants), giving debt relief probably aimed to maintain debt service at manageable levels for Nicaragua, while at the same time getting as much debt service from the country as possible. Below, a more extensive analysis is made of Dutch debt relief.

As shown above, debt relief from Paris Club creditors came with conditions. While non-Paris Club creditors had already begun debt negotiations in 1990 and 1991, Paris Club creditors required Nicaragua to have a formal arrangement with the IMF, first. The Stand-by agreement was concluded in September 1991, and the first Paris Club agreement was signed in December of that year. Later Paris Club agreements on forgiveness and restructuring (1995, 1998) were also contingent upon, and were concluded after, an arrangement of Nicaragua with the IMF.

The US was a special Paris Club creditor. The US had supported the former contrarevolutionaries against the Sandinista government and had also engaged in other hostile activities such as mining? the Corinto harbour. Nicaragua had therefore sued the US government in the International Court in the Hague, and had been awarded damages. The new Nicaraguan government requested the US administration to adhere to the judgment of the International Court (DGIS, 1990). However, the US made it clear that Nicaragua would only receive aid if the country would drop this claim. Nicaragua did so, and then received about USD 300 million aid from the US in the early 1990s, as well as USD 260 million in debt forgiveness on earlier aid loans.

At the time of the Standby agreement (September 1991), Nicaragua had already started a successful stabilisation program, and had begun important structural reforms such as a *de facto* liberalisation of the foreign exchange market and the privatisation of most state enterprises. Conditions in the IMF agreement included targets for government expenditure, government domestic borrowing and international reserves. Conditions for the accompanying IDA and IDB loans included privatisations, the permission of private banking, and trade liberalisation. The IMF targets were met during the first year. However, in the course of 1992, just after the release of the second tranche, they ceased to be met. Reversals on other structural reforms, such as trade liberalisation, also occurred. One reason why the IMF could not be complied with was the fact that the US did not disburse aid that had already been committed. This occurred for political reasons that had nothing to do with macroeconomic policies.[14]

Paris Club creditors and donors were pushing for a new agreement with the IMF in 1993 However, negotiations were difficult and it took until early 1994 before a new agreement was concluded. This first ESAF again involved tight fiscal and monetary policies. In addition, the government comitted itself to the payment of indemnity to all former owners of properties nationalised during the 1980s, and to the privatisation of the state telecommunication company Telcor. But it managed to avoid the privatisation of the largest state bank, Banades.
In the second ESAF year (1995), the Nicaraguan government could no longer comply with the macroeconomic targets. Losses of the state banks proved to be large, and there was an increase in government expenditure in the period before the 1996 elections. As a

[14] The US government was unhappy with the influence of the Sandinistas on the new government. For example, it demanded that Sandinista leaders Humberto Ortega and René Vivas were removed as chief of the army and police respectively (Dijkstra, 1999).

result, the IMF representative did not request disbursement of a second tranch from its Board. Nevertheless, somewhat unusually, the ESAF was not officially declared off-track, and the ESAF continued with several "bridging programmes" (Neira, 1996). The IMF representative requested bilateral donors and the World Bank to continue giving programme aid, which most of them did. Cross-conditionality (the system whereby other donors only disburse programme aid if there is a current IMF program) thus broke down on the instigation of the IMF itself (Dijkstra, 1999).

In 1997, bilateral donors were again pushing the government to conclude a new agreement with the IMF. Apart from strict monetary and fiscal policies, the IMF now also required "prior actions" in the area of structural reforms. A new tax law had to be approved by the National Assembly, Telcor had to be privatised (again – the first attempt had been blocked in the Assembly), and Banades now had to be closed. After difficult negotiations and difficult discussions in the Assembly, all the measures were approved.

Although bilateral donors requested an IMF agreement to be in place before they would consider debt relief in the context of the Paris Club, they were not always happy with the contents of those agreements. This was particularly the case in 1997, when a group of six bilateral donors, including the Netherlands, wrote a "non-paper" to the IMF and the government, expressing their dissatisfaction with several aspects of the draft ESAF. This concerned, in particular, the lack of attention to social spending and other poverty reduction expenditure, the lack of attention to governance issues, and the preferential treatment of "US citizens"[15] in the award of indemnity for nationalised properties. The latter had been included in the draft ESAF on the instigation of the US government. On this issue the group of six managed to change the draft text of ESAF (Dijkstra, 1999). In addition, the ESAF came to include a statement that social spending could increase *if* fully financed by foreign aid. To this end, the government established a *Fondo Social Suplementario* (Supplementary Social Fund, FSS). Donors could contribute to this fund either for specific projects in the social sectors, or with general contributions. The latter would be used for increases in social spending that would otherwise not have occurred. In practice, however, the FSS started out as a list of six social sector projects that were already financed by three donors: the IDB, the World Bank, and USAID.[16] There were only a few liquid bilateral contributions to the FSS (Sweden in 1999, the Netherlands in 2000), which the government used to finance the counterpart funds of these projects.

After hurricane Mitch in 1998, the country immediately received large amounts of aid and debt relief. At the same time, many donors were already unhappy with many actions of the Alemán government and wanted to pressure it to be more serious about poverty reduction and good governance. However, the large aid flow itself enhanced doubts on the appropriate use of the funds by the government. This led to a reduction in aid, especially liquid aid. The government did not adjust spending levels to these lower aid levels, and at the end of 1999 it could no longer meet the ESAF/PRGF targets. The IMF did not disburse the second tranch of that programme. Yet, as in 1995, the IMF representative again requested the other donors to continue giving programme aid.[17] In October 1999, however, the ruling liberal party made an agreement with the second largest party in the Assembly, the Sandinistas (known as the *Pacto*), in which they divided all seats on the Supreme Court, the Electoral Council, and several other public bodies. This was virtually

---

[15] These were Nicaraguans who had seen their properties nationalized during the 1980s, sometimes after having left the country, and who had acquired US citizenship in the meantime.
[16] In the case of the US, the FSS contribution consisted of the countervalue money from food aid, so implied double tying; in addition, the US demanded that e.g. medicines for FSS projects be purchased in the US.
[17] Interview with IMF representative in Managua.

the end of all parliamentary opposition and also of an independent judiciary. This stopped most bilateral donors from further giving programme aid.

In August 1999, Nicaragua was assessed “eligible” for the enhanced HIPC Initiative on the basis of its high debt/GNP and debt/exports ratios (IDA & IMF, 2000). Formally, the conditions for reaching the Decision Point include two three year periods of compliance with IMF and World Bank structural adjustment programmes, as well as the elaboration of a Poverty Reduction Strategy Paper (PRSP) in a participatory way. Since Nicaragua could not show six years of compliance with ESAF (both the first and the second ESAF had been interrupted), the donors set specific conditions for the Decision Point, apart from the general requirement of the elaboration of a participatory PRSP. The country had to return to an “on track” position with the IMF, and had to implement an extensive reform programme, covering public sector reforms and governance. Contrary to the idea of HIPC that there would be an *ex post* assessment of general performance in terms of reforms, combined with an *ex ante* outlining of the plans for poverty reduction, this implied that Nicaragua was subject to *ex ante* conditionality with respect to both macroeconomic targets and structural reforms.

In fact, bilateral donors were particularly upset by many government actions that went against the principles of good governance. Rumours of corruption increased, the Comptroller General who had been denouncing this corruption was jailed and the Pacto had ruled out all opposition. In a May 2000 Consultative Group meeting, donors were demanding more efforts from the government in fighting corruption, and more commitment to poverty reduction. They made it clear that they would not provide more resources to Nicaragua unless these conditions were satisfied (Castro-Monge, 2001, 424-5).

In August of that year the Nicaraguan government presented its “Strengthened Poverty Reduction Strategy”. This document was endorsed by the Boards of the IMF and the World Bank as a sufficiently elaborated Interim-PRSP. In December 2000 the two Boards approved Nicaragua's reaching the HIPC Decision Point. The Decision Point Document reports that Nicaragua has implemented important reform legislation as required, such as a bill to strengthen the financial sector, the public sector procurement law and the social security law. In addition, the country had made “satisfactory progress” with improving governance, “in particular in the areas of transparency and accountability in the use of public funds, resolution of outstanding property claims, and improving the efficacy of the Comptroller’s General Office.” (IMF & IDA, 2000: 3). The IMF approved disbursement of the second tranch after giving a waiver because of Mitch. But already in January 2001, the staff discovered a new domestic debt of USD 50 million.[18] In practice, Nicaragua passed the threshold for interim relief not so much because the country had complied with all conditions, but because the international donor community was under strong pressure to admit eligible countries to the HIPC Initiative before the end of the year 2000 (Castro-Monge, 2001).

The following conditions for the floating Completion Point were established (IMF & IDA, 2000, 17):

- The completion of a fully participatory PRSP and satisfactory implementation of at least one year of the full PRSP, as evidenced by the staff assessment of the country’s annual progress report;
- The use of budgetary savings resulting from the interim relief under HIPC would be in accordance with proposals set out in Annex 3 of the HIPC Decision Point document and would be reported “in the PRSP process”;

[18] Interview with IMF representative in Managua.

- Maintenance of a stable macroeconomic framework and satisfactory performance under the PRGF;
- Implementation of reforms to promote human capital development and social protection, including the adoption of an action plan to introduce an effective social protection programme, based on the results of a pilot programme started in 2000,[19] the approval of a school autonomy law and adoption of a health law, among other measures;
- Implementation of – specifically mentioned – governance strengthening measures, for example in the area of civil service reform and public procurement;
- Implementation of remaining actions needed to introduce a satisfactory pension system of funded, private sector-managed, and individual accounts;
- Divestment of ENITEL (the former TELCOR) and of all electricity generating units of ENEL (electricity company).

This means that conditions for reaching the HIPC Completion Point are more extensive than ever, and also far more extensive than they are for many other HIPC countries. Usually, there is the requirement of the elaboration of a full PRSP in a participatory way, and the implementation of some structural reforms, for example in the area of privatisation and liberalisation. In Nicaragua, the donors (in fact the IMF, the World Bank and the IDB) require specific reform measures and approval of laws also in the social area. This not only expands the set of *ex ante* HIPC conditions, but could theoretically also contradict the text of a PRSP based on participation and ownership.

The conditions also include requirements for the *use* of the “HIPC savings” originating from the Interim Relief provided by the multilateral institutions. So, while earlier programme aid from the multilateral institutions consisted of freely spendable resources, this debt relief must be spent for specific projects and actions, and is subject to detailed reporting and monitoring. A first problem with this requirement is that it assumes that the interim relief provides additional resources. Although actually paid debt service to multilateral creditors decreased in 2001 as compared to 2000 (Figure 2–2), this need not be so in subsequent years, as explained above. The setting of conditions for the use of HIPC debt relief may therefore lead to requirements for the use of regular government income. Nevertheless, the World Bank representative told the evaluators that the government needs to define more projects for all HIPC savings that are supposed to come.[20]
Provided there *are* HIPC savings, there is another problem with the requirement that the relief be spent on specific projects and programs and that this additional spending will be monitored. The Decision Point Document includes an Annex outlining the specific programmes for which HIPC relief will be used. This is a list of projects, such as a school back-pack programme, a programme to provide education materials in rural areas, and a programme to provide basic medical services and supplies. These programmes form part of the Supplementary Social Fund (FSS), and spending will also be monitored in the context of the FSS. However, if anything has been learnt from earlier evaluations of programme aid, it is that it is not effective nor efficient to require programme aid to be spent on specific purposes with their own specific reporting requirements (White & Dijkstra, 2003 (forthcoming)). It is not effective because money is fungible, and it is not efficient because it redirects government attention and resources from improving the budgeting process as a whole to the monitoring of specific issues for the donors. More

---

[19] This is the controversial “social safety net” promoted by the IDB, in which poor families receive cash if a 0-5 year old child attends a health care center or if an older child attends primary school.
[20] Interview with World Bank representative.

important systemic effects can be obtained from programme aid if donors focus on the improvement of the *overall* budgeting and reporting systems.

The fiscal situation continued to worry the IMF, and the ESAF/PRGF went again off track in April 2001. The IMF did not disburse the third tranch and did not make a start with the provision of the promised interim debt relief. Nevertheless, the IMF requested Paris Club creditors to accept a continuation of the debt service deferral after March 2001, and they seem to have done so in practice. The other multilateral institutions, World Bank and IDB, did provide interim relief. Again, the assigned "monitor" and "gatekeeper" for conditional finance is not providing that finance itself but does pressure other donors to continue providing it.

In July 2001, the IMF decided to have a staff-monitored programme with Nicaragua until December. Such a programme is not accompanied by new resources from the IMF, but it intends to keep the government to its promises with respect to monetary and fiscal policies. And this guarantee of IMF monitoring usually brings in new programme aid from other donors – it did bring the second tranch of an IDB financial sector adjustment loan, for example.[21] In this case, it was highly unlikely that promises with respect to expenditure would be kept since the programme covered the last months of the Alemán government, and included the November elections for a new President. However, the shadow programme served several interests of the donor community – at least partially.[22] First, it would provide more legitimacy and more resources to the current liberal government, which was expected to influence the result of the presidential elections in November in favour of the liberal candidate and at the cost of FSLN candidate Daniel Ortega.[23] An (anticipated) victory of Ortega was also expected to lead to an increase in capital flight, so the IMF programme was expected to diminish capital fligh both before and after the elections. Second, the existence of an IMF shadow programme would allow the Boards of the IMF and the World Bank to endorse the full PRSP, which had been presented in the Summer of 2001. This would be a first step towards reaching the HIPC Completion Point. The full PRSP was indeed accepted by the Boards in August, although the usual conditions that a country should be on track with its IMF programme, was not met. Then, in October of that year the shadow programme was also deemed off-track. Government expenditure was much higher than agreed while tax income fell as a result of lower economic growth. International reserves had dwindled by USD 170 million, so that the required covering of 3 months of imports was reduced to 2.3 months. This was mainly due to the government take-over of losses of bankrupt private banks. To date (September 2002), the third tranch of the PRGF has not been disbursed and this is one of the obstacles to Nicaragua's reaching the HIPC Completion Point.

Over the whole period, conditionality for debt relief has increased. Paris Club debt relief was conditional upon the conclusion of an agreement with the IMF. However, once such a rescheduling agreement existed, Paris Club creditors adhered to it even if Nicaragua did not comply with the conditions of the IMF programme. The IMF itself has sharpened its conditionality in the course of time by requiring prior actions for the 1998 ESAF. In order for Nicaragua to have access to the HIPC Initiative, conditionality has further expanded. Since Nicaragua did not have a good track record, many *ex ante* conditions were set for the Decision Point, on top of the elaboration of a participatory PRSP. For the Completion

---

[21] Interview with IDB representative in Managua.
[22] This could be concluded on the basis of interviews with representatives of the government (SETEC) and of several donors such as USAID, DfID, and IDB.
[23] The US government, in particular, was working hard to prevent Ortega from winning the elections. For example, the US had effectively discouraged a third candidate from running, because a third candidate was expected to divide the non-Ortega votes and would thus lead to a FSLN victory.

Point, many detailed and specific conditions have been added, also in the area of social sector reform and social expenditure (with little respect, it seems, for the accompanying requirement that the government outlines its plans in a PRSP based on participation and ownership), and including specific conditions for the use and monitoring of the “HIPC savings”, i.e. the multilateral interim debt relief to be received in period between Decision and Completion Points.

2.4 The additionality of debt relief

This paragraph examines the question of whether debt relief was additional to other aid flows, or substituted for them. We look at additionality from the viewpoint of the recipient country. While it is impossible to know the amounts of aid that donors would have given in the absence of debt relief, we can investigate whether aid flows diminish when debt relief increases. Although this does not produce a counterfactual, it is the relevant fact for the recipient country.

Since we have detailed data by type of creditor for both aid and debt relief, we can examine additionality in a more specific way. What matters is the trends in aid flows from those donors that have also given debt relief. Nicaragua has received large amounts of aid during the 1990s from both bilateral and multilateral donors. But multilateral donors hardly provided debt relief during the 1990s (the one exception is the World Bank contribution to the commercial debt buyback in 1995), while almost all bilateral aid came from OECD countries.[24] This means that we can examine the relationship between debt relief received from the Paris Club members, and bilateral aid. If the two flows move in opposite directions, debt relief has substituted for aid. If they move together, there has been additionality.

Furthermore, it seems likely that if debt relief substitutes for aid, this will mainly affect non-project aid. The Nicaraguan Central Bank distinguishes between liquid and “tied” aid. Liquid aid is aid (loans and grants) that is not tied to projects or imports. It can therefore be considered freely spendable programme aid.[25]
Figure 2–4 shows the trends in debt relief from Paris Club creditors, including both forgiveness and flow rescheduling, and in bilateral aid. The aid flow was very high in 1991, but as we will see below (chapter 3), most of this and especially most liquid aid, was used to pay debt service to both multilateral institutions and Paris Club creditors. After the 1991 peak aid levels came down. They were a bit higher in 1994, after the signing of the first ESAF, and in 1999, as a result of hurricane Mitch. The second ESAF (1998) only led to a very small increase in bilateral aid and, surprisingly, to a further decline in liquid aid. Liquid aid then resumed after Mitch with the establishment of the Central American Emergency Trust Fund (CAETF). Bilateral aid declines strongly in 2000 and 2001. Liquid aid follows the trend in total aid, including the fall in 2000 and 2001. In the latter year there was no bilateral liquid aid at all.

Changes in the amount of Paris Club debt relief moved in the same direction as changes in aid seven out of eleven years (1991-92, 1994, 1997-2000), but in the opposite direction

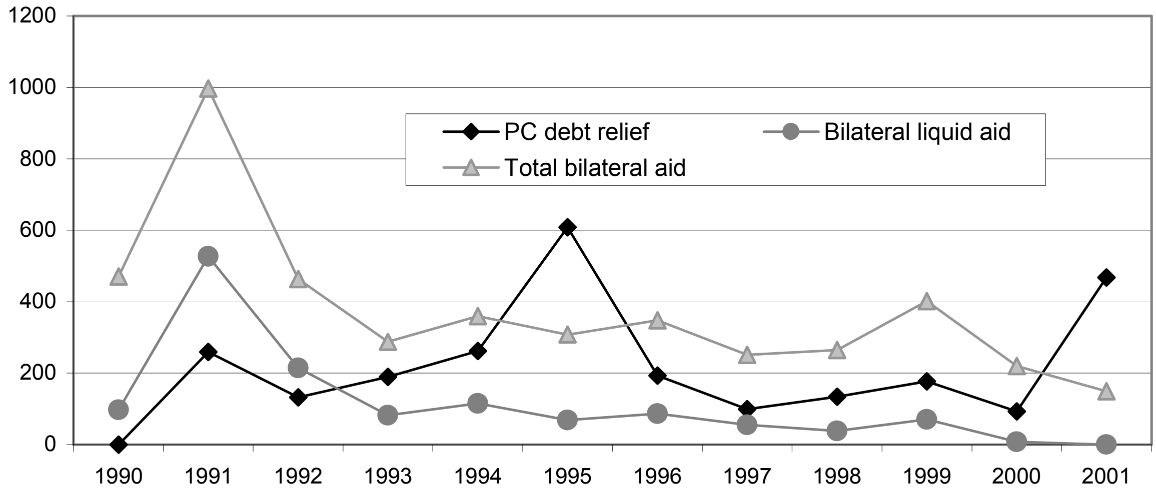
---

[24] Not all data are broken down by donor, so we do not know the exact figures. In sofar as aid data are broken down by donor (liquid grants), we can confirm that most aid is originating from OECD donors; there is only a USD 0.3 million grant from Korea. Judging from the post-cutoff date debt stock by end 2001, however, there must also have been tied concessional loans from Taiwan.
[25] Programme aid by definition includes (tied) import support, but that is excluded from the Central Bank definition of “liquid aid”.

in the remaining four years (1993, 1995-96, and 2001).[26] As explained above, the large increases in debt relief for 1995 and 2001 are due to exceptionally high forgiveness from just a few countries: Germany in 1995, and Spain and, to a lesser extent, the Netherlands, in 2001. Representatives of Germany and Spain in Nicaragua informed us that the money for these particular reductions and cancelations came from separate budgets, and did not reduce regular aid budgets to Nicaragua.[27] For the Netherlands case' (see below) we also know that the 2001 debt relief was truly additional. For other donors we could not establish the extent of additionality of debt relief as compared to aid, but given that the coefficient is positive if we exclude the two exceptional years, we conclude that Paris Club debt relief was largely additional to aid.

In general, we saw above that Paris Club debt relief was conditional upon the existence of an agreement with the IMF but was then implemented as agreed. Bilateral aid flows seem to have been much more sensitive to the *implementation* of the agreement and to other donor opinions on government policies. This also suggests that there was little relationship between debt relief from the Paris Club (on bilateral debt) and aid flows from the same creditors/donors.

Figure 2–4 Additionality: Paris Club debt relief and bilateral aid (USD million)



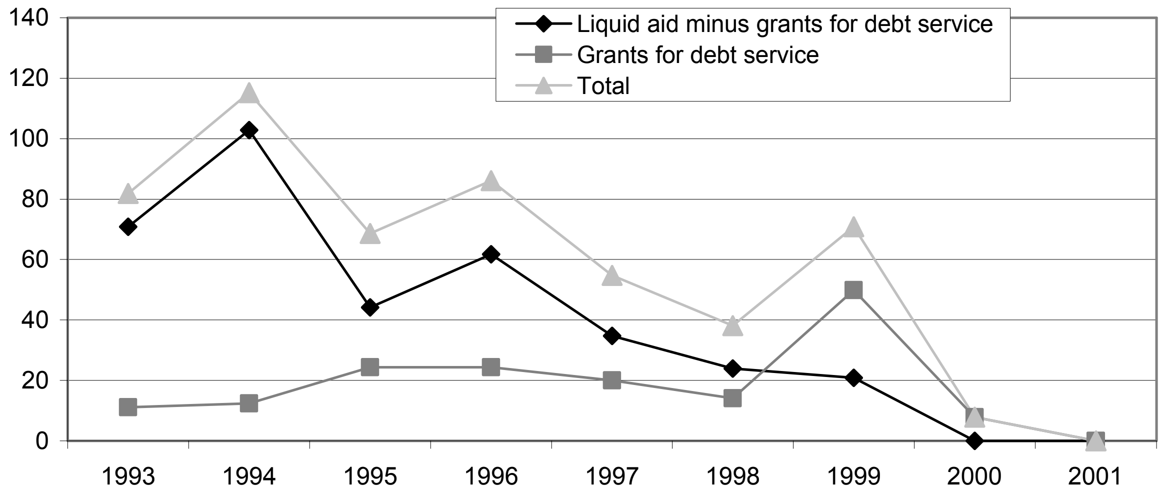
Source: Central Bank of Nicaragua.

In Figure 2–4, "bilateral liquid aid" includes bilateral grants for the take-over of debt service to the multilateral institutions. This is also a form of debt relief. This particular modality of liquid aid may substitute for other liquid aid (freely spendable balance of payments support, for instance), thus reducing the additionality of – at least this modeality of – debt relief. Central Bank figures allow us to examine this issue. However, the data do not seem to be reliable. According to the data, grants used for debt service are zero in 1990 and only amount to USD 0.3 million in 1991, while there were large amounts of

[26] The correlation coefficient is –0.10. For liquid aid, the correlation coefficient is also negative, but smaller: -0,01. The negative figures can be explained from the fact that the deviations are large in years when the trends move in opposite directions, and especially in 1995 and in 2001. Excluding those two years, the coefficients become +0.39 and +0.48, respectively.
[27] Interviews with staff of German and Spanish Embassies in Managua.

bilateral grants for the cancelation of arrears to IDB and World Bank in that year. Central Bank data also omit some Dutch contributions in later years. Most likely, therefore, the data on “grants used for debt service” underestimate the actually received amounts, probably due to the fact that these grants were often directly disbursed to the multilateral institutions. For what it’s worth, Figure 2–5 shows the data from 1993 onwards (recorded data are also zero in 1992). Since bilateral liquid aid (as presented in Figure 2–4) includes grants for debt service, they have now been subtracted from this aid.[28] Figure 2–5 shows that there may have been some substitution, in particular, in 1995 and in 1999. In other years, however, the two flows moved together or there was no relationship. On the basis of available data, we tend to conclude that there was no relationship between grants used for debt service and other liquid aid.

Figure 2–5 Additionality of bilateral grants for debt service to multilateral institutions as compared to other liquid bilateral grants (USD million)



Source: Central Bank of Nicaragua.

2.5 Dutch debt relief to Nicaragua

2.5.1 Amounts and modalities of debt relief

Nicaragua is the country that received most Dutch debt relief during the 1990s, and this involved debts to all types of creditors. The Netherlands actively participated in the cancelation of arrears to the IDB and the World Bank in 1991, and contributed an amount of NLG 10 million in December 1990 for that purpose (see Table 2–4 for an overview of all amounts). This first NLG 10 million was financed from a 1990 budget surplus that had to be spent quickly. It therefore arrived before the full arrangement for the clearance of arrears had been worked out. The contribution was used to pay immediate debt service due to both the IDB and the World Bank, thus reducing the amount of arrears that had to be cleared later. It was also expected that the Netherlands’ contribution would have a catalytic effect, inducing other contributions.[29] In 1991 another contribution of NLG 7 million was disbursed. In 1994, 1995, 1996, 1998 and 1999 the Netherlands took over current debt service to multilateral institutions (World Bank and IDB) (see also Figure

[28] The correlation coefficient between the two series is +0.04, so almost zero.
[29] Memorandum from DMP/MZ (department then dealing with macroeconomic support and debt relief) within Ministry of Foreign Affairs, 7 December 1990.

2–6). In so doing, the Netherlands was one of the most helpful donors over the years, providing aid that could be used for priority debt service. The 1999 debt relief was given after Mitch, and disbursed to the CAETF.

Nicaragua's bilateral debt to the Netherlands consisted of ODA loans and a small amount of non-ODA loans (guaranteed export credits). The ODA loans were contracted between 1980 and 1985, with one more in 1987. All of them were thus contracted before the cutoff date of November 1988. According to Central Bank of Nicaragua figures, the debt stock to the Netherlands by the end of 1990 consisted of USD 104.9 million ODA and USD 3.7 million non-ODA. No new loans were contracted during the 1990s, but in 1990 and 1991 there were some small disbursements (USD 0.3 and USD 0.6 million, respectively) on earlier ODA loans contracted.
The Netherlands participated in the 1991 Paris Club meeting and chose option "a" (50% forgiveness on eligible arrears and debt service due) for the export credit debt. The amount consolidated was NLG 18 million, consisting of NLG 8.7 million medium and NLG 9.3 million short-term debt (Meijer, 1991). Figures from the Dutch Ministry of Finance show that NLG 7.9 million in debt service was forgiven in 1992. This amount is not in Table 2–4 (nor in Figure 2–6) since it was paid by the Ministry of Finance and was not recorded in the files of Ministry of Foreign Affairs.[30] However, since the remainder of the arrears and debt service due was restructured at market terms, Dutch non-ODA claims increased from USD 3.7 million in 1990 to 7.4 million in 1992 and further to USD 8.3 million in 1995. After 1995, the non-ODA debt stock began to fall (Central Bank of Nicaragua data). No further debt forgiveness on non-ODA debts has been granted to Nicaragua since 1992.

Dutch non-ODA debt has not been part of the 1995 Paris Club agreement since the Dutch claims falling due qualified for the "minimis", the amount below which all debt service due had to be paid.[31] Nicaraguan data show that debt service on non-ODA debts was indeed paid between 1993 and 1998. The amount was USD 1.3 million in 1993, and then it gradually declined from USD 0.8 million in 1994 to USD 0.5 million in 1998. It was paid because debt service to Paris Club creditors was priority debt service that had to be paid. This means that indirectly, Dutch debt relief grants for multilateral debt service also helped to pay the Dutch Ministry of Finance.

In the April 1998 Paris Club meeting the Netherlands preferred to stay outside of the agreement for the non-ODA debt. At the request of the Netherlands, the "minimis" was raised to SDR 750,000 and this implied that the Netherlands indeed qualified, so that Nicaragua had to pay all debt service on the non-ODA debt.[32] As a result of the special Paris Club meeting in December 1998, after Mitch, debt service on all debts was deferred until after March 2001. This also held for the debt service on export credit debt (non-ODA debt) to the Netherlands, so this is the reason that no debt service was paid after 1998. However, a request from the Nicaraguan government to apply a concessional interest rate on these deferred payments, due in March 2002, was turned down by the Netherlands after a negative recommendation from the Ministry of Finance.[33] As Nicaragua is now in

---

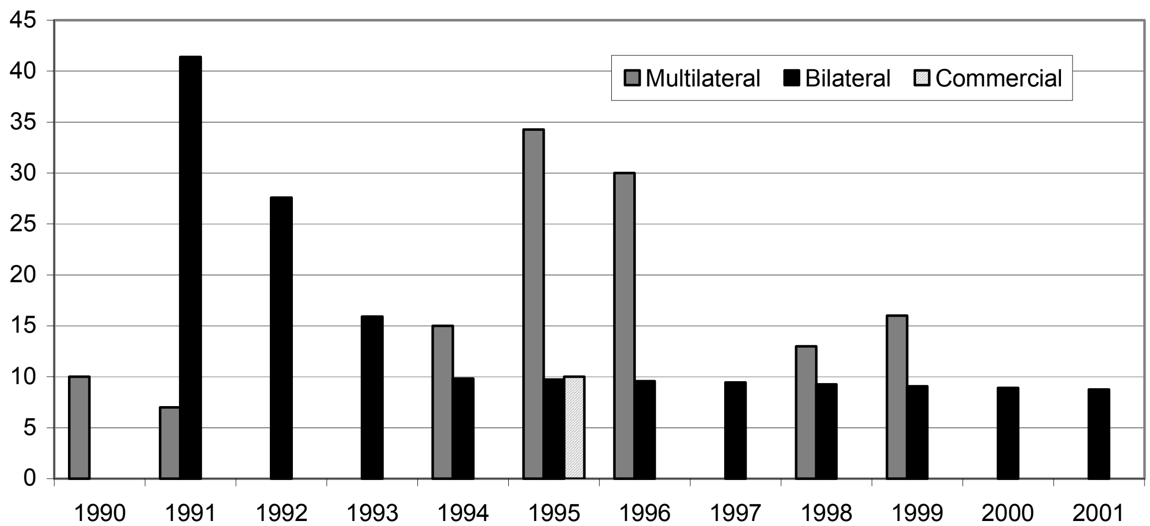
[30] A NIO document of June 15, 1992 asserts that negotiations between Ministry of Foreign Affairs and the Ministry of Finance are needed on the payment of the NLG 8 million for the forgiveness on non-ODA debt. However, judging from Table 2–4 and Ministry of Finance data, it has been charged to the latter.
[31] From the Dutch Draft Instruction for the Paris Club meeting in April, 1998.
[32] Memorandum from DMO/MS of Ministry of Foreign Affairs to the minister for development cooperation, 6 May 1998, containing a report of the Paris Club meeting.
[33] Fax from DMO/AS to Nicaraguan Embassy, dated 3 February 1999. The Ministry of Finance argues that the same request has been directed to the Paris Club in general, with a negative reply, and that the Netherlands cannot deviate form that.

"technical arrears", neither is debt service paid nor are the deferred payments made to the Netherlands. The nominal debt stock must have increased since 1999 by about 8% annually. Apparently, the Netherlands so far has not applied its general policy for the programme countries that reach the HIPC Decision Point, namely to provide interim relief in the form of forgiveness of 100% of the consolidated debts, to be followed by 100% forgiveness on the total commercial debt stock[34] (and the Netherlands participated in the 1991 Paris Club agreement, so debts have been consolidated).

Very different were the developments with respect to the (much larger) ODA debt, including some mixed credits. All debt service (including interest and principal repayment) on these ODA loans was forgiven. This began with accumulated arrears on debt service due until December 1991, and then continued with the annual debt service due. The Netherlands thus made use of the possibility, allowed in Paris Club minutes, to grant larger forgiveness than the long-term concessional rescheduling agreed for the ODA debt. However, decisions were always taken on an annual basis and by the Minister for Development Cooperation him- or herself. No commitments were made on forgiveness for future years.[35] There was one exception, namely in 1999. After the general Paris Club debt service deferral the Dutch Minister for Development Cooperation decided to forgive all debt service due on ODA loans for 1999 until 2001.

In addition to the annual forgiveness on debt service due, the Netherlands also sometimes canceled the full principal of aid loans. This occurred, for example, in December 1992 with two aid loans contracted in 1980 for a total amount of NLG 16.5 million, and in December 1993 with two loans of 1982 and 1983. Figure 2–6 shows that bilateral forgiveness was high at the beginning of the decade due to forgiveness of arrears and on some principals of aid loans. As of 1994, the Netherlands just canceled the annual debt service due, including interest and some amortisation.

Figure 2–6 Dutch debt relief 1990-2001, by type of debt, excluding the contributions paid from budget of Ministry of Finance in 1992 and 2001, (NLG million)



***Source*:** Files Ministry of Foreign Affairs.

---

[34] Letter from Ministers of Finance and Development Cooperation, Second Chamber, 1999-2000, 26234, No. 14, 23 May 2000.
[35] For example, Internal Memorandum DMP/MZ 054-92 of 30 January 1992 reports that promises on debt forgiveness for 1992 to the Nicaraguan authorities cannot be made.

Nicaraguan data confirm that no debt service at all was paid on ODA debts to the Netherlands during the 1990s, or in 2000 or 2001. As a result of this forgiveness, the stock of ODA debt gradually decreased from USD 109.3 in 1992 to USD 41.0 million in 1999 (Central Bank of Nicaragua). After Nicaragua reached the HIPC Decision Point, in December 2000, the Dutch government canceled the full ODA debt of NLG 85 million. This occurred in August 2001 (not in Figure 2–6). As a result, the stock of ODA debt registered zero in the Central Bank data.

The Netherlands also participated in the commercial debt buyback in 1995 with a contribution of NLG 10 million (Figure 2–6 and Table 2–4).

2.5.2 Objectives and rationales for Dutch debt relief

The objective for the take-over of arrears to the IDB and the World Bank in 1990 and 1991 obviously was to restore the relationships with the International Financial Institutions so that Nicaragua could conclude an IMF arrangement. The objective most often mentioned for forgiveness, at least until 1996, was to improve the macroeconomic situation of Nicaragua (Table 2– 4). However, many debt forgiveness activities on bilateral aid loans and also the contribution to the commercial debt buybacks did not have explicit objectives. From 1996 onwards, the objective most often mentioned was to support macroeconomic policy.

In general, far more elaborate rationales were offered for the debt relief on multilateral debt than for that on bilateral aid loans. There was little documentation for the appraisal of these activities. From 1994 onwards, "policy continuity" became an important rationale for the forgiveness of debt service on bilateral aid loans. The memorandum on the 1997 debt service forgiveness explicitly assesses the macroeconomic situation and government policies of Nicaragua according to the "macro-exercise".[36] It is argued that the quality of Nicaraguan adjustment policy was not very good at that moment, but that it was improving: according to IMF information the signing of an ESAF was at hand in early 1998.

The first take-over of debt service to multilateral institutions in 1994 was supported with a lengthy justification. The Appraisal Memorandum includes a detailed analysis of Nicaragua's macroeconomic and debt situation.[37] In spite of having carried out good macroeconomic policies, a growth take-off is not yet visible. The debt burden is heavy. The country's "hard" debt payment obligations (to Paris Club creditors and the IMF) exceed its freely spendable aid receipts. Additional aid that can be used for debt payments is therefore very welcome, and had already been requested from the Netherlands by the Nicaraguan authorities. So far, all Dutch aid had been project aid, with the exception of retroactive financing of oil imports in 1992. In addition, according to the ESAF agreement that had just been signed, the country would allocate any additional liquid aid to the necessary increase in foreign reserves and thus this aid would not be used for additional government spending.

In 1995 the amount for this relief was more than doubled (Figure 2–6). It is again justified at length, although the country name "Bolivia" appears a few times instead of Nicaragua. This time, the IDB also received this type of debt relief. The 1994 and 1995 Appraisal

---

[36] This involves the investigation of a range of variables of a recipient country: quality of policies, good governance issues, degree of poverty and degree of indebtedness.
[37] Appraisal Memorandum November 1994 and draft Memorandum October 1994.

Memoranda refer to the "Programme aid manual" that had developed criteria for assessing all macroeconomic support.

The 1996 multilateral debt relief was approved earlier in the year. The Appraisal states that Nicaragua had been "off-track" with its ESAF programme since early 1995, but that monetary and fiscal discipline had been reestablished in September 1995 and that the IMF would soon disburse the second tranch.[38] The 1996 memorandum does not refer to the Programme aid manual. But it does include a plea for continued multilateral debt relief in the next year. However, in 1997 no multilateral debt relief was disbursed. This is probably related to the absence of a new IMF arrangement in that year. Nevertheless, Nicaragua did qualify for bilateral debt relief in 1997 after an appraisal according to the "macro-exercise" (see above). One may assume that if the same appraisal had been applied to the relief of multilateral debt, Nicaragua would also have qualified, or would not have qualified for either of the two. Continuity of Dutch policy with respect to the forgiveness on bilateral debt service was probably the more important justification for giving bilateral debt relief.

After the signing of ESAF 2 in 1998, multilateral debt relief could be resumed. A first NLG 10 million was granted in October, after an appraisal according to the "macro-exercise". Surprisingly, one of the rationales was "policy continuity", in spite of the policy break in 1997. An additional NLG 3 million was allocated in December of that year to the then just established CAETF, motivated by the need for extra debt relief after the hurricane. Nevertheless, these amounts were much lower than the amounts given in 1995 and 1996 (Figure 2–6). It is not clear why this was so, and the lower amount is the more surprising as Nicaragua had just been selected as one of the seventeen "programme countries" on which bilateral aid would become concentrated.[39] In September 1999 a further and larger contribution was made to the CAETF, after an appraisal according to the "macro-exercise". However, this contribution arrived at a moment when many bilateral donors had postponed the contracting of new aid activities due to dissatisfaction with government policies. The Dutch ambassador in Nicaragua sent a letter to the Hague complaining about the timing of this contribution to the CAETF, since it went against the common opinion of like-minded donors and the government used it as propaganda at the time that many other donors were withholding funds. Attached to the ambassador's complaint was a page-wide government advertisement in a Nicaraguan newspaper in which the Dutch debt relief figured prominently.[40]

The decision to cancel the full ODA debt in 2001 was a result of a general Dutch policy for programme countries that reached the HIPC Decision Point. But this decision was not coordinated with the Dutch Embassy in Managua. In August 2001, the Embassy received a message from the NIO (the institution that administers Dutch aid loans) asking them to inform the Nicaraguan government about the forgiveness of the full ODA debt. According to the ambassador, the timing of that decision was wrong. It was a few months before the general elections, and the donors disagreed with many policies and actions of the Alemán administration, especially in the governance area. President Alemán used the Dutch debt forgiveness in his election campaign – to the discomfort of the ambassador and his staff. In the ambassador's view, this debt relief "could have been more effective". It seems that not much had been learnt from the plea for more coordination with the field and with other donors by the former ambassador in Nicaragua. In addition, we can wonder why this

[38] Assessment Memorandum May 1996. However, the IMF then had a bridge programme in Nicaragua and the second and third tranch on ESAF 1 were never disbursed (Dijkstra, 1999).
[39] This policy of the new Dutch minister for Development Cooperation meant increased selectivity. The selection criteria were poverty (low GNP per capita), good policy and good governance.
[40] El Nuevo Diario, 30 November, 1999.

cancelation in the context of HIPC was limited, so it seems from Nicaraguan data, to the ODA debt. General Dutch policy would be to also cancel the non-ODA debt.

The contribution to the commercial debt buyback did not have specific objectives or rationales. This operation had been prepared by the World Bank for a long time, and was finally carried out in August 1995. Acording to a Memorandum to the minister of 31 May, the Dutch contribution had already been approved by the minister, but was then withheld for some time because of the Constitutional crisis in Nicaragua.[41] Sweden also withheld its promised contribution, while for the Swiss the crisis was no reason not to go ahead. Apparently, that crisis was solved in time for the Dutch contribution to be disbursed.

2.5.3 Additionality of Dutch debt relief

Most Dutch debt relief (and all debt relief included in Figure 2—6) is financed from the aid budget, so there has been no additionality at the aggregate (worldwide) level. Only if debt relief is financed by the Ministry of Finance, is there full additionality. In the Nicaraguan case, this holds for the small amount of debt relief on non-ODA debt in 1992 as a result of a Paris Club agreement (NLG 7.9 million), and for the cancelation of the NLG 85 million ODA debt stock in 2001 (IOB, 2002). Both of these are not in Table 2—4, but they can be considered fully additional, both from the aggregate viewpoint and from the viewpoint of Nicaragua. All amounts listed in Table 2—4 have been financed from the aid budget, so are not additional at the aggregate level.

It is difficult to determine whether Dutch debt relief has been additional to other Dutch aid to Nicaragua, since there was no fixed, pre-determined aid allocation for the country. A large part of aid comes from regional, thematic or world-wide budgets. If debt relief is financed from these budgets it may be the case that it replaces aid that would have gone to Nicaragua anyway, or it may have been a “new” allocation to Nicaragua that replaces aid that would have gone to other countries. The documentation on the earliest debt relief activities in 1990 and 1991 does not specify at all from which specific budget number the activity is financed. All debt relief to Nicaragua between 1992 and 1996 is financed from budgetnumber 728.2, and all later activities are financed from number 777. Both are worldwide budgets meant for macroeconomic support. This means that no debt relief to Nicaragua at all was financed from the regional budget for Central America, from which regular aid for Nicaragua used to come.[42]

However, it can be assumed that Nicaragua would have received some macroecoomic support anyway, and that there has been substitution between other modes of macro-economic support and debt relief, in particular the debt relief on multilateral debt (Relief on bilateral debt has been given in all years). No systematic figures on other modalities of macroeconomic support to Nicaragua are available, but we know from the Memorandum accompanying the 1994 multilateral debt relief (see above) that balance of payment support was given in 1992 (retroactive financing of oil imports). In practice, this freely spendable aid was used for paying priority debt service (Dijkstra, 1999: 19). In December 2000, the Netherlands gave a grant of USD 6 million (about NLG 15 million) as budget support to the Fondo Social Suplementario (FSS, Supplementary Social Fund). This can be assumed to have substituted for multilateral debt relief. In 2001, no budget support or multilateral debt relief were given because Nicaragua was off-track with the IMF programme.[43] On the whole therefore, it seems that the Netherlands has given macro-

[41] There was a conflict between the Assembly and the Executive on reforms to the Constitution. Since the disagreement was on the composition of the Assembly itself, the legislative system was paralyzed for about six months (Dijkstra, 1999).
[42] Before 1999, the country did not have a specific budget but received most aid from the regional budget.
[43] Interview with Dutch embassy staff.

economic support (including multilateral debt relief) to Nicaragua from 1992 onwards, except for 1993, 1997 and 2001 when the IMF programme was off-track or when there was no programme with the IMF at all (1993, 1997). In most years, this has been in the form of multilateral debt relief but in two years, other modalities were used.

2.6 Conclusion

Nicaragua has received large amounts of debt relief from many different creditors during the 1990s. The new government in 1990 gave high priority to finding solutions to the huge arrears and to negotiating reductions of stocks outstanding and payment arrangements for debt service flows. Arrears to the multilateral development banks were paid with help of contributions from bilateral donors and, indirectly, with new loans from those institutions. From then on, all debt service to the IMF, the World Bank and the IDB was paid. Most of the outstanding commercial bank debt (81%) was reduced in 1995 through a donor-financed buyback at 8 cents to a dollar.

Paris Club creditors granted some forgiveness on debt serice flows, including arrears outstanding until 1991, and rescheduled another part of the flows on eligible (pre-cutoff date) debt. Nevertheless, the remaining debt service to Paris Club creditors was among the priority debt service and was the second largest category of debt service paid, after multilateral debt service. In addition, the Paris Club flow reschedulings led to an *increase in the nominal debt stock* to these creditors. Nicaragua also concluded debt stock arrangements with many non-Paris Club bilateral creditors. These agreements, including the one with Russia (that later became a Paris Club member), accounted for the largest reductions in the debt stock. However, these arrangements often led to *increases in debt service flows.*

The Paris Club applied one strict condition: debt negotiations could only be held if Nicaragua had concluded a programme with the IMF. The term for the rescheduling agreement then coincided with the IMF programme, and the rescheduling agreement was adhered to even if the country was no longer on-track with IMF conditions. Other bilateral official creditors or private creditors did not impose policy conditions for their debt relief. Since these creditors usually did not disburse new money to Nicaragua, Nicaragua did not pay any debt service to them. Entering into debt negotiations with Nicaragua was in their interest, even if it was at a loss, since it was the only way to get at least some of the earlier loans repaid.

It seems that, in general, debt relief as given by Paris Club creditors has been additional to other aid flows to Nicaragua. Debt relief from non-Paris Club official creditors and from private creditors was also independent from aid flows, since these creditors did not provide new concessional money. In 1991, however, a large aid flow was used to clear arrears to the multilateral institutions.
Dutch debt relief to Nicaragua has been extensive. The Netherlands has forgiven outstanding arrears and all debt service obligations on the ODA debt, which amounted to USD 109 million (including arrears) at the end of 1991. Although this debt service forgiveness was the result of annual decisions and did not include multi-year commitments, “policy continuity” seems to have been an important rationale. In 2001, after Nicaragua reached the HIPC decision point, the ODA debt stock was canceled fully. These policies were very different from Dutch policies with respect to the non-ODA debt. The non-ODA debt was included in the 1991 Paris Club agreement and this led to a partial (50%) forgiveness on debt service arrears and debt service due in 1992. In the 1995 and 1998 Paris Club agreements, the Netherlands’ non-ODA debt qualified for the “minimis”, the amount below which all debt service must be paid. As a result, all debt service due was paid between 1993 and 1998 – until the Paris Club granted a deferral to

Nicaragua after hurricane Mitch. However, interest on this deferred debt service is capitalised at market rates. The non-ODA debt was also excluded from the cancelation in 2001. In this light, Dutch policies appear to have been inconsistent.

While a rationale and objectives were sometimes missing and in other cases were rather sketchy for the bilateral debt relief on ODA debt, the decisions on multilateral debt relief were always appraised against explicit criteria (the “Programme aid manual” and later the “macro-excercise”).[44] This relief was not given in 1997 or 2001 when there was no programme with the IMF or when the programme was off-track, or in 2000, when “The Hague” made a choice for budget support (apparently replacing debt relief). Amounts for this macroeconomic support were much higher in 1995-1996 than in other years, which may reflect a higher confidence in the government of Chamorro than in that of its successor Alemán. The Netherlands also contributed to the commercial debt buyback in 1995 but no objectives or rationales were specified for this contribution.

Most Dutch debt relief was financed from the budget for development cooperation, so was not additional at the aggregate (worldwide) level. The only exceptions are the forgiveness on flows of non-ODA debt in 1992, and the ODA stock cancelation in 2001. What is remarkable, however, is that all other debt relief to Nicaragua was financed from the (worldwide) budget for macroeconomic support. No debt relief at all came from the usual – regional – budget, not even the annual forgiveness on ODA debts – which was granted on the basis of policy continuity and was not appraised as thoroughly as other macroeconomic support. In this sense, from the Nicaraguan viewpoint, most Dutch debt relief has probably been additional to other aid.

[44] Except for the contributions to the cancelation of multilateral arrears in 1990 and 1991, and for the 1996 relief

Table 2–4 Dutch debt relief to Nicaragua (NLG million)

Month/Year	Amount	Type of debt	Type of relief	Objectives	Rationales	ODA[1]
Dec. 1990	10.000	Multilateral	Payment of arrears to IBRD, IDA and IDB	Restoration relations with IFIs	Improvements macroeconomic policy; external vulnerability	yes
Sept. 1991	7.000	Multilateral	Payment of arrears to IBRD, IDA and IDB	Restoration relations with IFIs		yes
Dec. 1991	31.600	Bilateral aid loans	Forgiveness of arrears (PC)		Macroeconomic policy	yes
Dec. 1991	0.200	Mixed credits	Forgiveness debt service (PC)		Macroeconomic policy	yes
Dec. 1991	9.600	Bilateral aid loans	Forgiveness debt service (PC)		Macroeconomic policy	yes
May 1992	10.465	Bilateral aid loans	Forgiveness debt service (PC)	Economic recovery by improvement debt situation	Macroeconomic policy	yes
May 1992	0.574	Mixed credits	Forgiveness debt service (PC)	Economic recovery by improvement debt situation	Macroeconomic policy	yes
Dec. 1992	16.530	Bilateral aid loans	Forgiveness principal		Macroeconomic policy, difficult situation, SILIC status	no
Sept. 1993	9.970	Bilateral aid loans	Forgiveness debt service	Improvement macroeconomic situation	Macroeconomic policy with some results	yes
Sept. 1993	0.541	Mixed credits	Forgiveness debt service	Improvement macroeconomic situation	Macroeconomic policy with some results	yes
Dec. 1993	5.406	Bilateral aid loans	Forgiveness principal	Improvement debt situation	SILIC	no
May 1994	9.817	Bilateral aid loans	Forgiveness debt service		Macroeconomic policy, SILIC status, policy continuity	yes
Nov. 1994	15.000	Multilateral	Take-over debt service to IBRD	Improvement macroeconomic situation and debt situation	Macroeconomic policy, IMF agreement, high debt burden, lack of liquid aid	yes
June 1995	9.733	Bilateral aid loans	Forgiveness debt service		Macroeconomic policy, debt burden	yes
Aug. 1995	10.000	Commercial	IDA/DRF (6^{th} dimension) Buyback of arrears			yes
Nov. 1995	17.800	Multilateral	Take-over debt service to IBRD	Improvement macroeconomic situation and debt situation	Macroeconomic and social policy, high multilateral debt burden	yes
Nov. 1995	16.468	Multilateral	Take-over debt service to IDB	Improvement macroeconomic situation and debt situation	Macroeconomic and social policy, high multilateral debt burden	yes

Month/Year	Amount	Type of debt	Type of relief	Objectives	Rationales	ODA[1]
May 1996	9.576	Bilateral aid loans	Forgiveness debt service	Support macroeconomic policy	Macroeconomic policy and high debt burden	yes
June 1996	20.000	Multilateral	Take-over debt service to IDB	Support macroeconomic policy	Macroeconomic and social policy, high multilateral debt burden, return to "on-track" with IMF	yes
June 1996	10.000	Multilateral	Take-over debt service to IBRD/IDA	Support macroeconomic policy	Macroeconomic and social policy, high multilateral debt burden, return to "on-track" with IMF	yes
Dec 1997	9.431	Bilateral aid loans	Forgiveness debt service	Support macroeconomic policy, reduction bilateral debt burden	Macroeconomic and social policy, poverty, indebtedness (Macroexercise), expectation of ESAF agreement, policy continuity	yes
April 1998	9.235	Bilateral aid loans	Forgiveness debt service	Support macroeconomic policy, reduction bilateral debt burden	Macroeconomic and social policy, poverty, indebtedness (Macroexercise), ESAF agreement, policy continuity	yes
Oct. 1998	10.000	Multilateral	Take-over debt service to IBRD/IDA	Support macroeconomic policy	Macroeconomic and social policy, poverty, indebtedness (Macroexercise), ESAF agreement, policy continuity	yes
Dec. 1998	1.500	Multilateral	Contribution Central American Emergency Trustfund, IDB	Support macroeconomic policy	Need after Mitch, debt situation, policy continuity	yes
Dec. 1998	1.500	Multilateral	Contribution Central American Emergency Trustfund, IBRB	Support macroeconomic policy	Need after Mitch, debt situation, policy continuity	yes
March 1999	9.069	Bilateral aid loans	Forgiveness debt service (PC)	Relief debt burden	Need after Mitch	yes
Sept. 1999	16.000	Multilateral	Contribution Central American Emergency Trustfund, IBRD and IDB	Relief multilateral debt burden and support macroeconomic policy	Macroeconomic and social policy, poverty, indebtedness (Macroexercitie), Need after Mitch, policy continuity	yes

[1] According to the OECD/DAC definition of Official Development Assistance (ODA), forgiveness on principal and interest due increases net ODA. (The DAC records forgiveness oninterest as net ODA; forgiveness on principals is ODA neutral since an offsetting entry of the same amount is required. However, since repayments of principals are subtracted from ODA, this means that recorded net ODA is higher with forgiveness than with repayment.

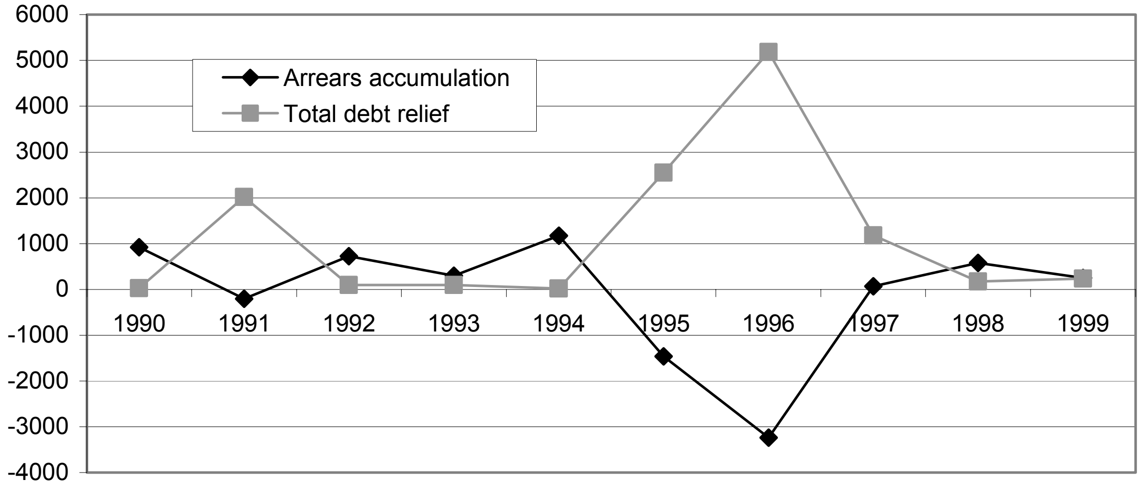
3 EFFICIENCY ANALYSIS

In this chapter we examine whether and to what extent the amounts of debt relief received have led to flow and stock reductions. In addition, we analyze to what extent the conditions set for debt relief have been implemented. Finally, we also examine the intermediate effects of the reduced debt service flow on thebalance of payments.

3.1 The reduction of the debt service flow

Debt relief leads to a reduction of the actual debt service flow a) if the debt service would have been paid in the absence of debt relief; b) if debt relief does not lead to increases in debt service to the same or to other creditors (bailing out); c) if debt relief is additional to other aid flows; and d) if debt relief does not lead to new loan inflows that increase the debt service flow. In chapter 2 we concluded that most debt relief had been additional although there may have been some substitution of other liquid aid. We will now begin by investigating the first two of these issues. The last paragraph of this section investigates the effects of new disbursements on the debt service flow during the 1990s.

Figure 3–1 Arrears accumulation and total debt relief (USD million)



Source: GDF.

If debts are not paid, the debt service due is added to the stock of arrears. Therefore, we expect that relief on debts that would not be serviced in the absence of debt relief, substitutes for arrears accumulation. In addition, relief that only reduces a debt stock will be accompanied by arrears *decumulation.* This means that if a large share of debt relief falls in either of these two categories, and therefore does not lead to a reduction of the debt service flow, we expect debt relief and arrears accumulation to substitute for each other: in years with high arrears accumulation there is little debt relief, and vice versa. In Figure 3–1, arrears accumulation is computed from the sum of principal arrears and interest arrears, and debt relief includes forgiveness, rescheduling, flow and stock relief as in Table 2–1. There is a fairly close inverse relationship between debt relief and arrears accumulation.[45]

[45] The correlation coefficient between the two series is –0.97. If we take the debt relief and arrears figures from Central Bank data, a similar picture arises (not shown here). In the latter case, the correlation coefficient is –0.91

This relationship is not surprising. We saw in chapter 2 that the largest amounts of debt relief received over the 1990s were stock reductions on debts that had not been paid until then (the reduction in debts to Latin American and former socialist countries, and the 1995 commercial debt buyback). In most of these cases, the debt stock reduction led to an increase in the debt service flow after the event, so there were *negative* flow effects from these agreements (Table 2–3).

We can expect that the flow effect will be larger for debt relief (forgiveness or rescheduling) on flows, as opposed to debt relief on stocks. However, it depends on the type of debt and the type of creditor whether flow relief reduces the actual debt service burden (i.e. debt service that would, otherwise, have been paid). Grants received for the payment of multilateral debt service did contribute to a reduction of the debt service burden, since these debts were always paid. The same holds for flow forgiveness given by multilaterals themselves in 2001. However, debt service to the CABEI was not paid for some time before agreement was reached with that institution. The amounts of flow rescheduling on multilateral debt in Table 2–3 therefore did not reduce actual debt payments. This also holds for debt service reschedulings from non-Paris Club bilateral creditors, since these debts were not paid before the agreement was concluded and most likely would never have been paid. The flow forgiveness provided by non-Paris Club creditors as of 1996 (after stock agreements were made) can be assumed to have provided net resources, since from then on (after the stock agreements), Nicaragua was servicing debts to these countries.

For the rescheduling and forgiveness on debt service flows to the Paris Club creditors the conclusion is more difficult. Nicaragua started paying part of its debt service due to the Paris Club in 1991, even before an agreement was concluded. This implies that debt service would have been paid. However, in the early 1990s Paris Club creditors also experienced accumulation of arrears due to non-payment. This concerned debt service to creditors with whom no bilateral agreement had yet been achieved, and debt service due after 31 March 1993 (the end of the term for the first agreement) and before March 1995 (the beginning of the second agreement). From Figure 2–2 it can be deduced that in 1997, after the end of the second agreement, debt service continued to be paid as due. This would imply that from the second Paris Club agreement onwards, Nicaragua has been paying Paris Club creditors as due. However, most of the debt forgiveness from the Paris Club in 1995 came from Germany and concerned forgiveness on accumulated debt service arrears on debts to former East Germany (USD 416 million). For this reason, we assume that Nicaragua would have met debt serevice payments to Paris Club creditors from 1995 onwards, so that debt relief from that year on had a flow effect. But we exclude the USD 416 million provided by Germany.

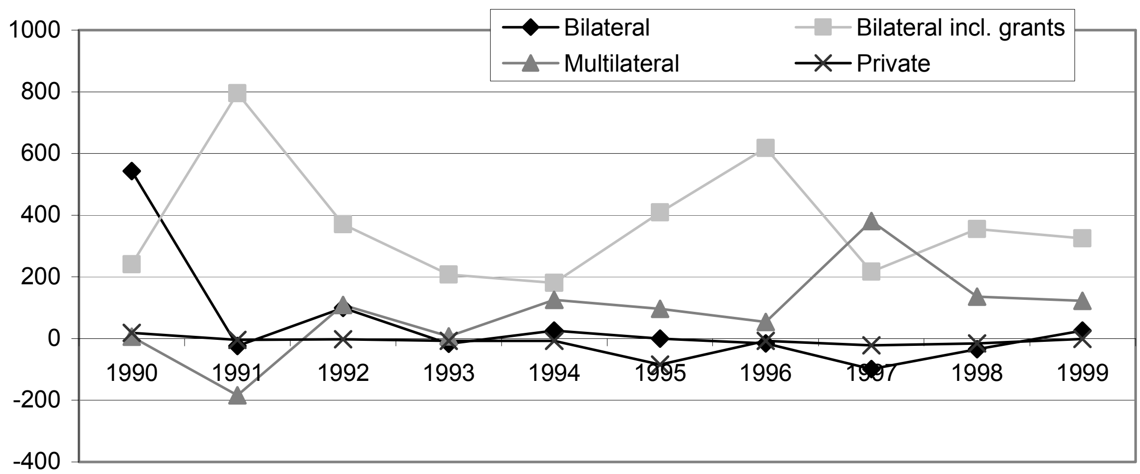
Apart from the debt stock reductions referred to above that induced debt service payments that were not being made before (negative flow effects), there were other cases in which debt relief led to increases in debt service paid. First, the Paris Club reschedulings led to increases in debt service later in the decade. The 1991 Paris Club agreement rescheduled a large amount of debt service, but the grace period was only six years for the non-ODA debts and even shorter for moratorium interest payments and private sector debts that had been taken over by the Nicaraguan government (see chapter 2). So, this agreement led to immediate payments from 1992 onwards and larger amounts from 1997 onwards. In addition the 1995 Paris Club agreement led to interest payments between 1997 and 2000, and payments of principal from 2001 onwards.

Second, within the Paris Club there was some bailing out between those creditors who received debt service payments on their new (post-cutoff date) loans, and those who only provided relief on past (pre-cutoff date) loans. The post-cutoff date debts were always serviced. To some extent, debt relief provided by some Paris Club creditors allowed the post-cutoff date debt service being paid to other Paris Club creditors.

Thirdly, debt relief and aid from bilateral creditors to some extent allowed Nicaragua to pay the multilateral creditors the full amounts due (except for CABEI). In 1991, arrears to the World Bank and the IDB were cleared by grants and bridging loans from bilateral donors. This was a textbook case of bailing out. It cleared the way for new loans from the multilateral institutions, but the full amount of the fresh resources provided in 1991 had to be used to pay the providers of the bridging loans – implying that there was no flow effect at all. Also after 1991, debt service to the IMF, the World Bank and the IDB was always paid, while for all other types of creditors debt service paid was smaller than debt service due.

The extent of bailing out between creditors can also be examined by looking at net transfers on debt (disbursements minus total debt service) by group of creditors: multilateral, bilateral and private. However, bilateral creditors not only provide loans but also grants, and they are (with some small exceptions) the only group to do so. For this reason we also examine the trend in net bilateral transfers plus grants (excluding technical co-operation). Private net transfers have been close to zero but were negative in all years except 1990 (Figure 2–3). Bilateral net transfers are also small in most years, and often negative. But bilateral transfers including grants are always positive and large, although highly fluctuating. In 1997, the figure was very low. In that year, net transfers on bilateral debt were negative, probably due to the negative flows as a result of stock reductions in 1996 and the increased debt service as a result of the Paris Club rescheduling of 1991. But grants were also low in that year, probably because there was no IMF agreement. Multilateral net transfers are negative in 1991 reflecting the large payments of arrears in that year. In most years except 1997, multilateral net transfers are smaller than bilateral net transfers including grants. Given the large multilateral inflows it is difficult to maintain that the multilaterals have been bailed out. However, all debt service to the IMF, the World Bank and the IDB has always been paid (until 2001) and this was not the case with other creditors. In addition, a small part of the debt service to multilateral institutions could be financed from bilateral grants (but these are not included in the GDF debt relief figures).

Figure 3–2 Net transfers on debt by group of creditors, (USD million)



Source: World Bank, Global Development Finance CD-ROM.

Finally debt service may increase as a result of debt relief is when debt relief leads to new loan inflows that must be serviced. Nicaragua indeed received new loans from some Paris Club members, and from the IMF, the World Bank and the IDB. It is clear that new disbursements from these three multilateral institutions were made possible by debt relief in 1991 that cleared the arrears. However, only the relatively small inflows from Paris Club members and from the IMF gave rise to debt service during the1990s. The large World Bank (IDA) and IDB loans received in the 1990s have a 10 year grace period, so debt service on these loans will only begin from 2001 onwards.[46]

It is difficult to quantify the extent of the flow effect from debt relief. The best approximation probably is to sum the bilateral flow forgiveness and rescheduling from the Paris Club from 1995 onwards (excluding the German amount), the grants provided for debt service payments (except for the 1991 amounts that just cleared arrears) and the multilateral debt service relief in 2001, and to subtract the negative flows. This means we exclude multilateral flow rescheduling, all stock forgiveness, all non-Paris Club flow rescheduling and forgiveness, and Paris Club flow relief until 1995 and the 1995 German amount. This is probably still an overestimate of the flow effect, since the amount of additional debt service flows during the later 1990s as a result of the Paris Club reschedulings is not included as it is not known.

Table 3—1 Estimate of debt relief leading to actual flow reductions (+) or flow increases (-), 1993-2001[1] (USD million)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	1990-1999	1990-2001
Flow forgiveness:											
Bilateral PC*			30	6	5	40	94	9	5	175	188
Multilateral									49		49
Private	1	4								4	4
Flow rescheduling:											
Bilateral PC			140	163	94	46	83	84	29	525	638
Grants used for debt service:											
Bilateral	11	12	14	20	14	50	8			129	129
Multilateral		0	44	5	4	5	5	4	4	63	71
Total positive	12	16	228	193	117	141	190	97	86	896	1079
Negative flows:											
Bilateral PC		-1	-1	-1	-17	-16				-35	-35
Bilateral non-PC	-1	-3	-3	-13	-29	-13	-12	-14	-15	-74	-102
Net flow effect	11	13	225	180	71	112	178	83	71	788	942

Source: See text, and computed on the basis of Table 2—2 and Table 2—3 (data from Central Bank of Nicaragua).
[1]Actual flow reductions were zero from 1990-1992.

Table 3—1 gives the flow effects from 1993 onwards. The years 1990-1992 have been omitted since flow effects are zero in those years. The overall net flow effect of USD 942 million proves to be much lower than the total debt relief according to the tables in chapter 2. Total forgiveness amounted to USD 7,812 million (Table 2—2), and total rescheduling

[46] During the 1990s, Nicaragua was still paying debt service to these institutions on the (mostly non-concessional) loans provided in the 1970s and early 1980s.

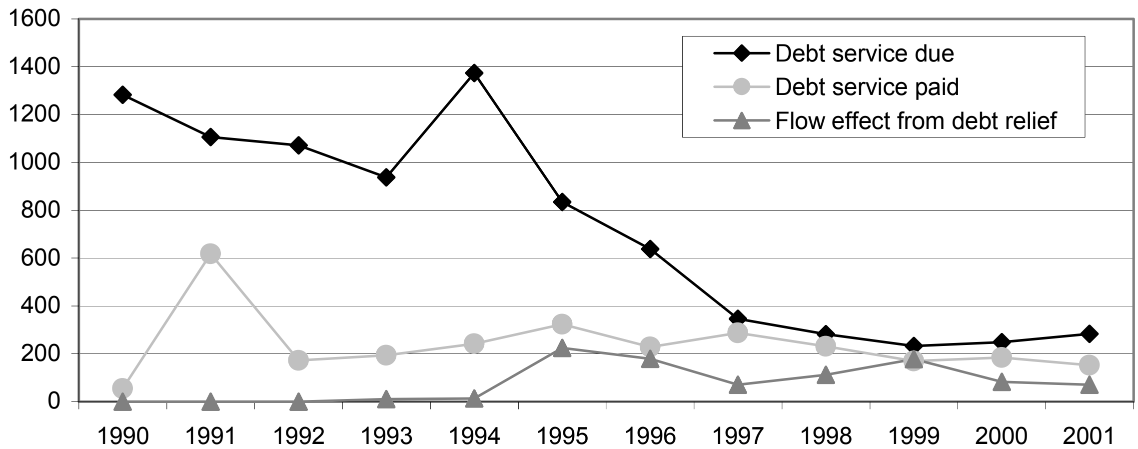
USD 1,131 million (Table 2—3), giving a total of USD 8,443 million. This means that actual debt service relief amounted to only 10.9% of total debt relief. For the evaluation period (1990-99), the flow effect is USD 788 million, compared to total debt relief of USD 8,294 million, implying that the flow effect was equal to only 9.5% of total debt relief.

In relation to debt service due, the flow effect from debt relief was small until 1996, and became important from 1997 onwards (Figure 3—3). This shows that most debt service due until 1996 was not paid and accumulated as arrears. However, relative to actual debt service paid, the flow relief from debt relief has been extensive, especially for the years 1992-1996 and in 1999. In 1997 the flow effect from debt relief experienced a deep fall, and this is accompanied by a peak in actual debt service paid. From Figure 2—2 we know that this peak is due to bilateral debt service.

Chapter 2 concluded that most debt relief was additional to other aid. This means that although most debt relief did not have a flow effect, it was at least not a substitute for aid.

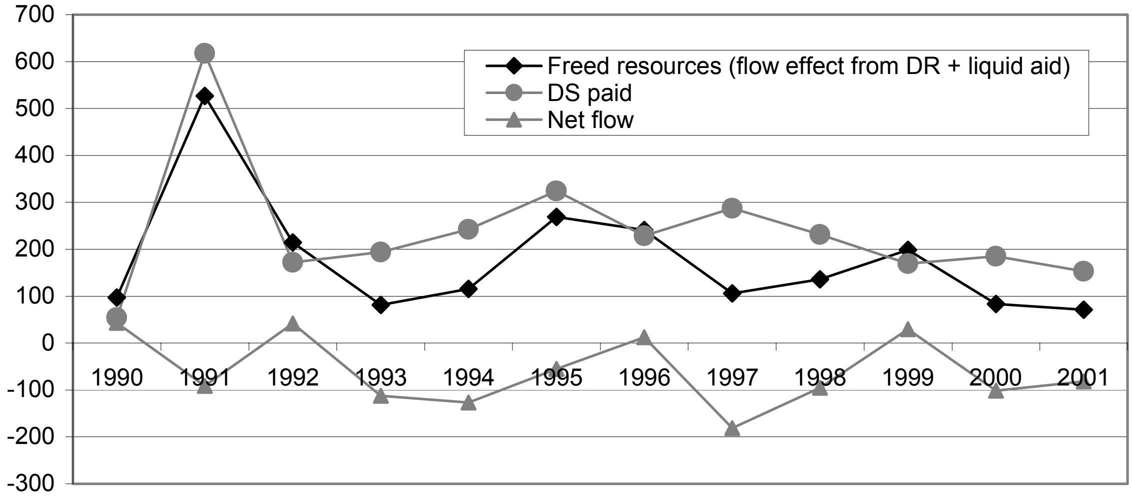
The Nicaraguan strategy with respect to debt service was to pay those creditors from whom new loans and grants could be expected, so that the net balance (including new inflows) would be positive. This net balance (the flow effect of debt relief, plus aid, minus debt service) is indeed the relevant number for Nicaragua: to the extent that debt relief leads to a reduction in actual debt service paid and thus frees resources, there is no difference between debt relief and (other) aid. However, most aid is project aid and the government cannot use it to pay debt service. For this reason, the total flow effect should only include liquid aid (and we exclude grants provided for payment of debt service since they are already included in the flow effect, see Table 3—1). Figure 3—4 shows that the net flow was positive only in 1990, 1992, 1996 and 1999, but negative in all other years. This means that in these other years the Nicaraguan Central Bank paid more in debt service than it received in liquid aid or in debt relief that actually freed resources. In fact, the net flow was probably also negative in 1996 and 1999, so was continuously negative from 1995 onwards, bearing in mind that the flow effect from debt relief is overestimated in the later 1990s: in that period, the country had to pay an unknown amount of additional debt service as a consequence of the earlier Paris Club reschedulings. Perhaps the year 1999 was the only positive exception, as result of the additional debt relief inflows after hurricane Mitch.

Figure 3—3 Debt service due, debt service paid, and flow effect from debt relief (USD million)



Source: Table 3—1, and Central Bank data for debt service due and paid.

Figure 3–4 The net resource flow: Freed resources minus debt service paid (USD million)



Source: Table 3–1and Central Bank data.

3.1.1. The flow effect on the balance of payments

An alternative way to compute the flow effect from debt relief is to analyze balance of payments figures. This is possible, because the balance of payments includes figures for payment of arrears and for accumulation of arrears. During the 1990s, Nicaragua has continuously had a large negative trade balance, and also a large current account deficit, although a growing flow of remittances had reduced the latter somewhat (Table 3– 2). Foreign aid, both loans and grants, have financed a large part of the deficit. In addition, part of the flow under "net private capital" also consists of aid, namely aid to the private sector (NGOs).

More insights in the trends on the balance of payments can be obtained by reordering it in a table of sources and uses of foreign exchange (forex) (Table 3–3). The flow effect from debt relief can be defined as the sum of debt forgiveness (DF) and debt rescheduling (DR), minus the payment of arrears (PA) (see last lines of Table 3–3. This gives lower figures than above (Table 3– 1. The total flow effect proves to be USD 584 million (7% of total debt relief), and only USD 429 million (5% of total debt relief), if we only take the years 1990-99 into account. It shows that a large share of debt relief was used for the payment of arrears, and did not lead to a net inflow of resources. Since annual data on accumulation of arrears are also provided, it is possible to compute actual debt service paid.[47] The net flow effect from all transactions on debt proves to be a high negative number. However, if the total aid flow (grants and loans)[48] is added, a positive flow results – although a very low one in 1997.

---

[47] Balance of payments data, by convention, give interest and amortisation payments *due*.
[48] Not just liquid aid, as above in Figure 3-4.

Table 3—2 Balance of payments, 1990-2001 (USD million)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Exports	331	272	223	270	335	466	466	577	573	545	645	592
Imports	-572	-669	-798	-679	-781	-881	-1043	-1371	-1397	-1699	-1648	-1628
TRADE BALANCE	-241	-397	-575	-409	-446	-415	-577	-794	-824	-1154	-1003	-1036
Net non-factor services	-67	-96	-70	-68	-43	-73	-75	-19	-11	-42	-32	-37
Interest payments	-216	-375	-495	-431	-472	-372	-324	-265	-185	-196	-202	-245
Remittances	15	15	10	25	50	75	95	150	200	300	320	336
CURRENT ACCOUNT	-509	-852	-1130	-883	-912	-786	-882	-927	-820	-1092	-917	-983
Grants	193	565	312	242	242	228	262	194	194	307	309	232
Loans	288	579	336	144	338	288	275	204	291	301	216	212
Debt forgiveness	279	260	83	175	144	1480	4219	124	147	103	26	476
Debt rescheduling and interest capitalisation	0	1059	184	115	382	305	797	427	117	46	71	23
Amortisations	-423	-1307	-753	-660	-1019	-656	-473	-229	-235	-147	-187	-139
Payment of arrears	-281	-1041	-247	-181	-527	-1795	-5058	-604	-179	-103	-41	-399
Net official capital	56	115	-85	-165	-440	-151	23	115	336	507	393	404
Net private capital	-179	-45	129	173	197	240	374	870	344	538	379	412
CAPITAL ACCOUNT	-123	69	44	9	-242	89	397	985	679	1045	773	817
OVERALL SURPLUS	-632	-783	-1086	-875	-1154	-697	-485	58	-141	-47	-144	-166
Financing:												
Arrears accumulation	600	784	1081	774	1223	687	563	153	91	98	106	58
Change in reserves	33	-2	5	100	-69	9	-79	-212	50	-51	38	108

Source: Central Bank of Nicaragua (www.bcn.gob.ni).

Table 3–3 Sources and uses of foreign exchange (USD million)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Sources:												
Exports	331	272	223	270	335	466	466	577	573	545	645	592
Remittances	15	15	10	25	50	75	95	150	200	300	320	336
Aid	481	1144	648	387	580	516	537	398	485	609	525	444
Net private capital	-179	-45	129	173	197	240	374	870	344	538	379	412
Debt forgiveness (DF)	279	260	83	175	144	1480	4219	124	147	103	26	476
Debt rescheduling and interest capitalisation (DR)	0	1059	184	115	382	305	797	427	117	46	71	23
Arrears accumulation (AA)	600	784	1081	774	1223	687	563	153	91	98	106	58
Change in reserves	33	-2	5	100	-69	9	-79	-212	50	-51	38	108
Total	1560	3486	2363	2019	2843	3777	6973	2486	2007	2187	2110	2449
Uses:												
Imports	572	669	798	679	781	881	1043	1371	1397	1699	1648	1628
Net non-factor services	67	96	70	68	43	73	75	19	11	42	32	37
Debt service (due, DD)	639	1682	1248	1091	1491	1028	797	494	420	343	389	384
Payment of arrears (PA)	281	1041	247	181	527	1795	5058	604	179	103	41	399
Total	1559	3488	2363	2019	2842	3777	6973	2488	2007	2187	2110	2448
Memo items:												
Net flow effect from debt relief (DF+DR-PA)	-2	278	20	109	-1	-10	-42	-54	86	46	55	100
Debt service paid (DP) = DD-AA	39	898	167	317	268	341	234	341	329	245	283	326
Net debt flow = net flow effect – DP	-41	-620	-147	-208	-269	-351	-276	-395	-243	-199	-228	-226
Net debt flow plus aid	440	524	501	178	311	164	262	3	242	409	297	217

Source: Elaboration of Table 3–2.

When Nicaragua reaches the HIPC Completion Point, the Paris Club will forgive 90% of the pre-cutoff date stock of debt. But this will not lead to additional flow relief, since Nicaragua has not paid debt service on this pre-cutoff date debt since 1999. According to some donor representatives, this relief has already been incorporated in regular government spending over the years 1999-2001, and in fact spending has gone far beyond the additional resources, especially in 2000 and 2001. The HIPC Initiative also stipulates that non-Paris Club creditors grant the same relief terms. If this occurs, Nicaragua must begin paying debt service on the remaining 10% of those debts, while this debt was not serviced before. This implies an increase in actual debt service. On the other hand, multilateral relief that began after the reaching of the Decision Point in December 2000 is new and additional. However, scheduled multilateral debt service may increase over the next two decades, so that additional free resources will be limited and actual debt service to these multilateral institutions may even increase. Nicaraguan government officials are also concerned about the lack of additionality of this multilateral debt relief: it may substitute for new concessional flows. Furthermore, this multilateral relief comes with conditions for its use, and these are all related to social expenditure. Overall, it implies that the net flow of *free* resources due to the HIPC Initiative may even be negative, and that additional fiscal cuts may have to be made in order to free resources for the required additional spending on poverty reduction.

This conclusion for Nicaragua on the possible results of HIPC is even more pessimistic than the more general findings of Berthelemy (2001) for countries with a relatively poor “track record” in reform. These countries – the poor track record is assumed to be evident from a late qualification for the enhanced HIPC Initiative – , do not experience a relief of the actual debt burden, since what they save in debt service payments must be spent on additional social outlays. Early qualifiers for HIPC had higher social expenditure already, and debt relief indeed alleviates their burden since it frees resources (Berthelemy, 2001).

3.2 The stock reduction

The next issue we examine is to what extent debt relief reduced the stock of Nicaragua’s debt. Table 3—4 presents the debt stocks according to GDF data, and forgiveness data from the same source (see also Table 2—1). Debt forgiveness has been considerable, especially in the years 1995 and 1996. From chapter 2 we know that this constituted forgiveness on debt stocks to the former Soviet Union, to former East Germany, to Mexico and to private creditors (the commercial debt buyback). This means that only a relatively small amount of the debt stock reduction originates from Paris Club creditors.

If we compare the amount of forgiveness with debt stocks of the preceding year forgiveness equalled 23.6 and 47 per cent in 1995 and 1996 respectively (Table 3—4). Over the whole period, forgiveness equals 124 per cent of the debt stock of 1999, which is higher than the percentages for the other seven country cases in our evaluation.[49] These figures are presented for the total long-term debt (LDOD). However, for most years total debt is equal to public (PPG) debt. Only in 1998 and 1999 public debt proves to be slightly lower than total debt (last line of Table 3—4), and this will hardly change the percentages.

[49] These other seven countries are Bolivia, Jamaica, Peru, Mozambique, Tanzania, Uganda and Zambia.

Table 3–4 Debt forgiveness in relation to debt stocks

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Total
Debt stock (LDOD)	8,281	9,153	9,312	9,303	9,624	8,541	5,125	5,336	5,636	5,905	
Forgiveness	0	431	8	3	15	2,273	4,011	403	49	128	7,319
As % of stock (t-1)	5.2	0.1	0.0	0.2	23.6	47.0	7.9	0.9	2.3	124[1]	
Memo item:											
Public debt	8,281	9,153	9,312	9,303	9,624	8,541	5,125	5,336	5,609	5,799	

Source: GDF.
[1] This is total forgiveness as percent of the 1999 debt stock.

The relative stock reduction is also affected by new disbursements over the evaluation period. According to GDF data, the public sector obtained USD 3,266 million over the years 1990-99 (Table 3–5). As described above, the vast majority of new inflows concerned concessional loans from IDA and IDB, carrying a 10 year grace period. This means no debt service was due on these loans during the 1990s , and we do not go far wrong if we just subtract the nominal disbursement amounts in order to get the hypothetical nominal debt stocks if these new inflows had not occurred. Table 3–5 shows that this would have made a big difference for the Nicaraguan debt stock. The remaining debt stock would only have been USD 2,639 million, and forgiveness over the 1990s would have constituted almost three times that amount.

Table 3–5 Debt forgiveness in relation to debt stocks minus new disbursements

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Total
PPG Disbursements	576	311	283	102	339	277	226	610	260	283	3,266
Debt stock minus disbursements	7,704	8,266	8,141	8,031	8,013	6,653	3,011	2,612	2,653	2,639	
Forgiveness	0	431	8	3	15	2,273	4,011	403	49	128	7,319
As % of debt stock	0.0	5.2	0.1	0.0	0.2	34.2	133.2	15.4	1.8	4.8	277.4
As % of stock (t-1)		5.6	0.1	0.0	0.2	28.4	60.3	13.4	1.9	4.8	

Source: GDF.

3.3 The implementation of conditions

3.3.1 Causes of the poor track record

As outlined in Chapter 2, Nicaragua has a relatively poor track record when it comes to the implementation of the conditions stipulated in the IMF agreements. Macroeconomic targets of the Standby Arrangement and of the first and the second ESAF were only complied with during the first year of these arrangements. And this was usually not so difficult, since in those first years generous amounts of foreign aid including freely spendable aid were flowing in. In the area of structural reforms, there were some policy reversals, for example in the area of trade liberalisation since 1993, and some cases of non-implementation after the first and second ESAF (the privatisation of the telecommunications company Telcor in both cases, altough this has now finally been implemented). However, other reforms were implemented in line with conditionality during the 1990s, such as allowing the creation of private banks in 1991 and, although later than the multilaterals had preferred, the closure of all state banks. Some very important reforms had already been carried out before an agreement with the multilateral institutions was concluded: the liberalisation of the foreign exchange market, and the beginning of the privatisation of most of the state-owned enterprises. In 1997, some prescribed reforms were carried out (tax reform, abolition of trade permits) because the International Financial Institutions (IFIs) required them as prior actions for the second ESAF.

There are several reasons for the difficulties with the implementation of stabilisation measures and reforms (Dijkstra, 2002). First, the consecutive Nicaraguan governments were under strong pressure to reach an agreement with the IFIs. The high debt and the dependence on aid made it impossible to survive without such an agreement. The government may have agreed to reforms, when it was uncertain whether these measures could be implemented. In particular during the Chamorro government (1990-96), there was a strong opposition both inside and outside parliament that complicated the implementation. For the second ESAF (1998), the chief negotiator for the Alemán administration was a former high-level IMF staff member. It can be doubted whether technocrats have a good insight in the feasibility of implementing reforms.

Secondly, the objectives of the IFIs and the Nicaraguan governments did not always coincide. They agreed on the need for stabilisation and on the other reforms that had already been carried out before the first agreement with the IFIs. But the two parties did not agree on privatisation of the state banks and of public utilities, on the speed of trade liberalisation, on the content of tax reforms and on higher fees for public utilities. On these issues there was also strong opposition in parliament.

Thirdly, and related to this, the support for and opposition to reforms was largely determined by whether powerful groups were winners or losers of reforms. Although stabilisation is in the collective interest, specific stabilisation measures hurt particular interests, at least in the short term, and are therefore difficult to implement. It was politically easiest to finance the budget deficit with aid. On the other hand, the reforms also produced powerful winners. The liberalisation of the foreign exchange market and the allowing of private banks allowed rich families to return to the country and to earn large profits. During the Chamorro administration, the privatisation process of state enterprises and the continued control over state banks allowed the government to favour its constituency, including the leaders of the Sandinista opposition whose support was needed for approval of other measures in the Assembly. The state banks proved to have a large bad loans portfolio, and many of the largest bad borrowers proved to be persons related to the government. The lowering of tariffs harmed most manufacturing sectors, but specific exceptions to these lower tariffs, and the newly introduced trade permits, allowed some firms in production and trade to make large profits.

Fourthly, the availability of large amounts of aid not only facilitated stabilisation but may also have induced some moral hazard. Once the IMF agreement was concluded and the aid money began to flow, it was tempting to relax attempts to meet the strict monetary and fiscal targets. Aid money could also be used to keep or gain support from politically powerful groups. For example, large amounts of IDB and IDA adjustment loans have been used to “restructure” the ailing state banks. This implied bailing out of earlier borrowers. In 1998, when the largest state bank, Banades, was finally divested, private banks willing to buy a branch office received USD 35,000 from IDA or IDB. The IDA and the IDB also financed the residual loss from the closure of Banades (Dijkstra, 1999).

In sum, as in other countries, domestic political factors were the main determinants of whether reforms were implemented or not. Some reforms were in the interest of the wealthier sectors, but others were not and were only carried out with a delay or not at all.

The debate on reforms and the policies actually carried out were the result of a struggle between what one recent study refers to as elites (Everingham, 1998).

The influence of the donors on the course of events was limited – if we exclude those measures in which the objectives of donors and government coincided. Reforms that were forcefully opposed in the beginning were sometimes carried out with a long delay, such as the privatisation of Telcor, or with a high cost in terms of donor money, such as the privatisation of Banades. In response to donor demands for indemnification of former owners of nationalised enterprises, the government issued state bonds (Bonos de Propiedad Indemnizada, BPI) with a 15 year maturity and a 10 year grace period. This was the beginning of the building up of a domestic debt.

The donor position was weaker than could be expected on the basis of the high aid dependency, for two reasons. First, the donors had different objectives and there was little coordination between them. For example, in 1992 the US did not disburse aid that had already been promised – for political reasons –, which reduced Nicaragua's chances of complying with the macroeconomic targets. Second, sanctions on non-compliance were not very effective. In 1995, the IMF did not disburse the second tranch on ESAF 2 but urged other donors to continue giving programme aid – which they did. In the same year, the World Bank temporarily stopped disbursing because of the delay with the privatisation of Telcor. And some bilateral donors (Sweden, the Netherlands) held up their programme aid in early 1996 in order to put pressure on the government to solve a constitutional crisis. All in all, the multiple objectives and the lack of coordination between donors weakened donor influence on Nicaraguan policies. The introduction of prior actions to be carried out before ESAF 2 in 1998, guaranteed that at least some donor-demanded reforms were implemented. But hurricane Mitch in October 1998 brought new differences of opinion between the donors to the fore. Large amounts of donor money helped the government to comply with IMF targets, but also gave rise to more corruption and misuse of funds. The resulting disappointment among the donor community then again complicated the meeting of IMF targets.

The question is now whether the HIPC Initiative with its new conditionality has changed the nature of the policy dialogue between donors and recipient. The enhanced HIPC Initiative is supposed to increase participation and ownership, by asking the government to elaborate its Poverty Reduction Strategy Paper in a participatory way. We first analyze whether the enhanced HIPC Initiative has increased participation and ownership, then we assess the results of the broader policy dialogue in the past few years, and finally we examine the prospects for Nicaragua to reach the HIPC Completion Point.

3.3.2 The PRSP process: Participation, ownership and donor influence

The Alemán government (January 1997 – January 2002) delegated the elaboration of the Poverty Reduction Strategy Paper to the Secretaría Técnica de la Presidencia (President's Technical Secretary, SETEC). SETEC receives institutional support from the IDB, and its staff is a group of well educated technocrats. It is also in charge of the negotiations with the IFIs. Between 1997 and 2001 it was headed by Luis Durán, a former IMF staff member. After the change in government in January 2002, Mario Arana, who was already responsible for the PRSP, was promoted head of SETEC. An important task of SETEC has been to reconcile the wishes of the donors.

In 1997 the government had already presented a development strategy to the donor community, in particular, for the CG meeting in Geneva in that year. In order to qualify as PRSP, this strategy had to be deepened and broaded, it had to become more focused on poverty reduction and the population had to be involved. From the beginning, SETEC has followed directions of the IFIs on content and process of the PRSP. In the words of Arana, a poverty reduction strategy was elaborated because the donors wanted it. “We cannot make any strategy without the consent of the donors”, since almost all capital expenditure is financed by them.[50] Of particular importance was the change in emphasis in the IFIs, where poverty reduction became a condition for HIPC Initiative relief. SETEC was convinced of the importance of getting access to HIPC debt relief and new finance from the multilaterals.[51]

In 1999 and 2000, participation in the elaboration of the “Strengthened Poverty Reduction Strategy”, mainly consisted of consultations with representatives of the headquarters of civil society organisations in Managua and with the Consejo Nacional de Planificación Económica y Social (National Council for Economic and Social Planning, CONPES). CONPES is an advisory body to the government, and consists of representatives of NGOs, universities, unions, private sector, and political parties. Although its existence was foreseen in the 1995 reforms to the Constitution, it was only established in 1999. Donor pressure executed in and around the post-Mitch donor conference for the reconstruction of Central America in Stockholm in May 1999, was the decisive factor in the establishment of CONPES. The Council first met in August 1999, and has played an important role in the consultation process for the PRSP. In addition to these consultations with representatives of civil society, there were many meetings with representatives of bilateral donors and multilateral organisations (Government of Nicaragua, 2000: 51). In July 2000, this new strategy was presented to the Boards of the IFIs, where it was endorsed as Interim-PRSP in August.

The important NGO network that had been established in the aftermath of hurricane Mitch, the Coordinadora Civil (Civil Coordination, CC) and that was a member of CONPES, commented critically on a first draft of this Interim PRSP. This held, in particular, for a list of projects that was proposed and that contained many old projects under a new name. For example, it included a health sector reform, which was a World Bank project and already underway since 1993, although it had never been evalued. Another criticism concerned the heavy emphasis on construction of new schools and health centers, while more resources were needed if these centers were to function. But the CC did not notice any changes in the strategy.[52]

Many NGOs and several donors felt that the consultative process had to be improved and expanded for the next version of the PRSP. In particular, the poor people themselves had to be involved and had to be given a chance to comment on the document. UNDP and DfID offered assistance to SETEC and to CONPES to expand the consultation process in preparation of the full PRSP, and to include experiences of the poor people in the regions. In July 2000 a first workshop was held with SETEC and CONPES, in which objectives, methods and criteria for the selection of regions were defined. However, the government did not take a next step after that. Apparently, the government was afraid that consultation would generate heavy demands for services which it would not be able to deliver. It was only in December that the donors reached an agreement with SETEC, although the results of the consultations were supposed to be sent to the World Bank in March 2001.[53] In February, SETEC appointed a coordinator, and the actual consultation process was carried out between February and August 2001. It covered eight departments. Although

[50] Interview with head of SETEC.
[51] Although the IFIs provide loans, not grants, the amounts are larger than those that can be obtained from bilateral donors, and there are fewer conditions for the use of the money. Interview with head of SETEC.
[52] Interview with CC representatives.
[53] Interviews with representatives of UNDP and CC. The CC adds that an agreement was only reached after they (the NGOs) had sent a letter to the World Bank, whereupon the World Bank told SETEC that it was unacceptable to block the process.

most observers are of the opinion that it was a useful process in itself, the results of the consultations held after May 2001 could not be incorporated in the full PRSP since the government wanted to present the new strategy to the IFI Boards in August.

The CC interpreted the delay as a lack of political interest of the government in popular participation, and thefore it no longer participated in the government-led consultation process. It began to set up its own consultations in rural areas. In addition, Denmark supported another consultation process in the region of León, together with the mayors of four municipalities in that region. UNDP then attempted to coordinate the outcomes of the three processes by organizing a meeting in which these results were discussed.

The IFIs and some of the bilateral donors have a positive opinion on the extent of participation for the PRSP. They point to the large number of meetings that have been held, and the number of persons involved, and note that it has been much more extensive than in other countries.[54] Nevertheless, the “Joint Staff Assessment” of the PRSP (by the World Bank and the IMF) also points out that the sense of ownership for the PRSP is still limited, in their views due to “the politically polarized society and the uncertainty over the upcoming elections” (IDA and IMF, 2001: 11).

However, most other donors, as well as representatives of civil society, are of the opinion that actual participation has been limited. This is also because the comments made have not been incorporated in the actual strategy. The main criticisms from civil society and from some of the donors concern the list of priority projects to be executed. Although the strategy has four pillars, namely broad-based economic growth, investment in human capital, protection of vulnerable groups, and institutional strengthening and good governance, almost all financial resources are directed to the second and third of these. In addition, the 10 priority projects are mostly projects that already exist, and are projects of the donors (the World Bank and the IDB, in particular) to which the government is now asked to contribute (more).[55]

Donors and civil society organisations also criticise the lack of coherence of the strategy. While the poverty analysis in the PRSP is said to be good,[56] there seems to be little relationship between this analysis and the ten priority projects. Furthermore, the lack of attention to growth and employment creation is criticised. The strategy is too much welfare oriented, and although the importance of economic growth is recognised in the paper, it is weak in outlining the concrete sources for growth. This is pointed out in the Joint Staff Assessment (of World Bank and IMF) (IDA and IMF, 2001), but is argued more strongly in a document by USAID, which states: “The first pillar of the strategy (i.e., broad-based growth) is the biggest disappointment of the plan”.[57] Many donors are of the opinion that the growth assumptions for the strategy are too optimistic. The DfID representative felt that the strategy was too complicated. There are too many goals and targets, and it will be difficult to implement. She also criticised the lack of government commitment to the strategy. In her view, the approval of the strategy by the Boards of the IFIs meant a “seal of approval for a corrupt government.”[58] Both US AID and DfID felt at the time that the full PRSP should not have been endorsed by the Boards. However, they were convinced by US high-level foreign policy officials and by IMF and World Bank staff that not endorsing

---

[54] Interview with World Bank and Swiss representatives.
[55] Interview with representatives of civil society, UNDP, and Sweden, among other donors.
[56] It is based on extensive data: the World Bank-supported Living Standard Measurement Surveys of 1993, 1998 and a smaller one post-Mitch in 1999, a Qualitative Poverty and Exclusion Study, and the 1998 Demographic and Health Survey.
[57] See “Assessment of Nicaragua’s Strengthened Poverty Reduction Strategy (SPRS)”, n.d., p. 4.
[58] Interview with DfID representative.

the PRSP in the months before the elections would have destabilised Nicaragua, and would have made a Sandinista victory more likely. Apparently, it was felt that, together with the IMF Interim Programme, the approval of the PRSP would help to keep the Liberal party in power – which was a key concern for the US. The DfID representative argued that in the event of a Sandinista victory, all the work on the PRSP would have been in vain. ("It would have been a waste of time for all of us").[59]

3.3.3 The broader policy dialogue

Whilst SETEC worked hard to elaborate the PRSP in accordance with the wishes of the donors, President Alemán and other important government officials did the opposite of pleasing the donors. Alemán was mayor of Managua before becoming President, and rumours were already abundant about him using city funds for building up his wing of the Liberal Party. These rumours on corruption became worse later on, and especially after hurricane Mitch. The donors disbursed money for a fund for road reconstruction but soon there were many doubts about whether the funds had been used for the devastated roads. In October 1999, Alemán concluded his "Pacto" with the opposition (see section 0). Late 1999, the government jailed the Comptroller General, who had been denouncing corruption by the government. Although he was released after a few weeks, the Comptroller General Office was then expanded and, in line with the Pact, the seats were neatly divided between Liberals and Sandinistas, thus weakening that institution.

Just how much corruption there had been during the Alemán government gradually came to the surface after the change in power. On 7 August 2002, Alemán, together with the former head of the Directorate General for Taxes was officially indicted for misappropriating USD 97 million during his Presidency – more than the annual budget for either health or education. Among other things, he was accused of using state credit cards to pay for jewels, clothes and travel expenses worth USD 1.7 million. In Panama, accounts were detected in which Alemán and other former Nicaraguan government officials kept USD 31 million (Ventana Emailbijlage, August 2002).

On the donor side, there are also two groups of principal players. On the one hand, several bilateral donors were very much concerned about these developments and have tried to influence the government. The Group of 5 (G5, later expanded to G6) was supposed to monitor the government commitments made during the donor conference for the reconstruction of Central America in Stockholm in May 1999.[60] Regular meetings were held with the government, but "things only deteriorated", and "the government was not interested in the Stockholm agreements".[61] As noted above, donor influence was decisive in the establishment of CONPES, and also led to much more consultation and participaiton for the PRSP than there would have been otherwise. However, despite donor pressure and the existence of this formal donor group to monitor government commitment (the G5), the government made the *Pacto*, and corruption and fraud continued. As analyzed above (see also chapter 2), all these criticisms did not prevent the approval of the I-PRSP in August 2000, the reaching of the Decision Point in December 2000, or the endorsement of the full PRSP in August 2001.

---

[59] Interview with DfID representative for Central America in Managua.

[60] The five members were Sweden, host country of the Conference, the US, Germany, Canada, and Spain. The sixth member is Japan. They were considered the most important donors.

[61] Interviews with some members of the G6. However, judging from the interviews, not all members of this group are equally worried about the lack of good governance. Japan and Spain, for example, are merely interested in the clean implementation of their projects, and do not want to interfere in more general governance issues.

A group of bilateral donors that is very much concerned about the lack of good governance is now (again) trying to influence the course of events. This group of like-minded donors (composed of Sweden, Norway, Denmark, Swiss, the UK, the Netherlands, and sometimes also Canada and Germany – membership is not fixed) has met regularly in the last months of 2001 and in 2002. Its main goal is to define suitable governance criteria, of which it is hoped that they will be taken on board by the IFIs as conditions for the HIPC Completion Point.

However, improving governance does not seem to be a top priority for the IFIs – the other key group of players on the donor side. Of course the IFIs were aware of the widespread corruption and of the Alemán government's lack of real commitment to poverty reduction. In response, the IFIs have defined more *a priori* criteria in the context of HIPC (see also seciton 2.3) than they usually do. The IMF takes up the issue of corruption only when it is related to the failures of private banks. The World Bank and the IDB, in particular, have used their power and leverage to influence the PRSP strategy. Although the IFIs formally agree that participation (and, for that matter, ownership) are important, in practice they have defined the most important paragraphs of the PRSP: the list of projects to be carried out. In addition, they are very concerned to develop a strict monitoring framework for the use of the HIPC savings.

Most of the "new projects" are IFI projects that were already underway, and sometimes had experienced stagnation before. As noted above, it has surprised many observers that, while the poverty analysis in the PRSP is very good, there seems to be little relationship with the ten priority projects to which the HIPC savings will be channelled. The PRSP reports that the ten priority projects "have been developed based on prior experience and interaction with donors." (Government of Nicaragua, 2001: 43). These projects are almost the same as those defined in the Decision Point Document. They are all meant to improve (mainly) health and education services for specific poor groups and poor regions. What is worrisome, is that these programmes and projects are meant ot be additional to the "regular" provision of health and education, while the quality and quantity of this "regular" provision have deteriorated much in the past 15 years. As many of the interviewed representatives of bilateral donors and of civil society have also argued, there is a heavy focus on infrastructure, while the problem over the past 15 years has been operation and maintenance of services due to continuous cuts in real recurrent expenditure. Rather than improving the delivery of education and health care in general, for example by increasing the salaries of teachers and nurses across the board[62] or providing money for maintenance (along with a severe cut in the staff of the central ministries in Managua) the IFIs have given priority to projects and programs that are easy to monitor and of which clear positive results can be expected in the short term.

The most obvious case in this respect is the social safety net program, for which the IDB has financed a pilot project of USD 10 million (with a loan) and which the government is now required to expand, using 14-15% of the expected "HIPC Initiative savings". This programme involves giving a rural worker's salary to families with young children, provided the child attends the health center or primary school. Of course, poverty will decrease spectacularly in regions where the programme is active. However, long-run sustainability is doubtful. People get money for things they should do anyway, they become very aid dependent and will reduce their efforts to earn money in a regular way. Once the programme stops, they will be faced with even greater poverty than before.

[62] The IDB representative explicitly replied negatively when we asked whether the shadow value of HIPC relief could be used for increasing teacher salaries across the board.

NGOs also report that the programme has increased violence against women, since the money is given to the mothers and the husbands want to have access to it.

3.3.4 Prospects for reaching the Completion Point

One of the conditions for the Completion Point is that Nicaragua uses the budgetary savings as a result of the HIPC Initiative in accordance with the PRSP, i.e. for the ten defined projects. The same PRSP states that the monitoring and evaluation of the ten projects will be carried out by a revised Social Fund, FSS. In February 2002, SETEC, in close cooperation with the donors involved in the FSS (the three IFIs, the US, Sweden and the Netherlands), developed a framework for this monitoring, which is now under discussion (Gobierno de la República de Nicaragua et al., 2002). It proposes to set up a Consejo Coordinador (Coordinating Council) of the FSS, in which the involved sectoral ministries, SETEC and the Social Investment Fund FISE are represented, as well as one representative of the donors and one of CONPES. This Council is responsible for the allocation and selection of concrete projects to be implemented, and for improving coordination of the execution. At the same time it is to take on the monitoring of this spending, both at project and programme level, and at the level of of spending of the PRSP in general. Such a combination of executive and monitoring functions in one council is somewhat unusual and could lead to conflicts of interest. A more effective monitoring system might be to develop a structure which is accountable to all the donors and the full CONPES, along with, of course, the National Assembly. However, such a view does not appear to be shared by the IFIs. In the view of the World Bank representative, one representative of the donors and one from civil society (CONPES) in this Consejo would be sufficient, since there has been "participation in the elaboration of the PRSP".[63]
The proposal also states that FSS projects should be *additional* to regular spending *and sustainable* (Gobierno de la Republica de Nicaragua et al., 2002: 7). However, if taken literally, it means that in the case of a fall in the amount of HIPC relief savings, the FSS projects would crowd out regular expenditure. Furthermore, the document proposes to channel additional resources to the FSS, such as liquid aid, but also resources from debt restructurings that reduce the NPV of an outstanding debt via lower interest rates or a longer maturity period, debt swaps, or debt stock reductions (Gobierno de la República de Nicaragua et al., 2002: 10-12). In all but the first two cases, the government would be forced to allocate money to the FSS projects that it does not receive (debt stock reductions, debt swaps and extensions of maturity periods usually do not have a flow effect), so this additional spending would lead to higher budget deficits, or, in the presence of IMF spending limits, it would crowd out other expenditure. It is also proposed to use proceeds from privatisations for the FSS, to which similar criticisms can be raised: privatisation provides a one-time income to the government, but reduces the income flow in subsequent years. Using its proceeds for additional and sustainable projects implies the risk of crowding out other expenditure in later years.

Interviews with the IFIs held in March 2002 reveal that the proposed monitoring system would be satisfactory. Nicaragua has also made good progress with many of the other conditions for the Completion Point. The laws on health and education reforms had been approved in the Assembly, the required privatisations were under way and the government (SETEC) was working on a progress report on the PRSP. These issues were not expected to delay the achievement of the Completion Point. The most important hurdle for Nicaragua to reach the HIPC Completion Point was seen in the PRGF programme being off-track.

---

[63] Interview with World Bank resident office.

In particular, the discontent of the IMF at the fiscal situation was a big problem. In 2001, the government spent much more than budgeted, which led to a deficit of about 14% of GDP (after grants). In addition, the expenditure figures in the 2002 budget presented in October 2001 exceeded those agreed in the PRGF. Another problem is the large domestic debt, which also had to be discussed with the government since payment on this debt could absorb all HIPC relief resources. According to the IMF representative, the government had to present and implement concrete plans to reduce expenditure and to increase taxes. The IMF will only go to the Board for approval of the third tranche on the PRGF if the government has established a track record of several months. At the earliest, this was expected to be the case in July or August of 2002.[64] Formally, the country must then be "on-track" for a full year, before the Completion Point can be achieved. But it might be possible to have this period shortened to perhaps six months. In the IMF's view, the "other five conditions" (laws on health and education reforms, and privatisations) for the Completion Point are not so significant, they are "technical things". Although the IMF has now taken on board a poverty focus, the most important thing for the IMF remains fiscal discipline.[65]
As mentioned above, the bilateral donors give much emphasis to good governance and want specific criteria to be considered before Nicaragua can reach the Completion Point. The like-minded group of donors is important for the government because they are the only ones willing to provide liquid resources. In addition, they have power through their Executive Directors in the IFI Boards. However, it remains to be seen how much influence these bilateral efforts have and whether their views make a difference. The developments in 2000 (the approval of the Decision Point) and 2001 (approval of the full PRSP) indicate that those bilateral donors seeking to make good governance a firm condition of further financing are unlikely to be successful. The momentum to provide debt relief approval seems to be stronger than the dissatisfaction of the donors concerned. When interviewed, the representatives of the IFIs did not refer to the possibility of additional, governance related, conditions for reaching the Completion Point.

On the other hand, current President Bolaños who took office in January 2002 seems to be serious in fighting corruption, and especially in denouncing and punishing the corruption and fraud of his predecessor. And the Bolaños administration is strongly supported in its anti-corruption struggle by the US – still a very powerful actor in Nicaragua. Possibly, therefore, the efforts of the like-minded group will have more results this time – but this is then due to the more favourable circumstances rather than to the efforts themselves.

3.3.5 Conclusions on policy dialogue in recent years

In sum, several parallel processes seem to have gone on at the same time. At the most visible level, the Secretary of the Presidency (SETEC) was elaborating a Poverty Reduction Strategy Paper (PRSP) in accordance with the wishes of the donors. It organised consultation processes in order to formally meet donor demands, and in the meantime listened closely to the IFIs, in particular, when designing the strategy and the concrete projects to be carried out. While all this went on, the President and other top level officials engaged in corruption and used money for their personal benefit. A group of bilateral donors was concerned about this and raised complaints at Consultative Group meetings and in other fora. However, this did not change the course of events. The concerns of these donors could not even prevent the IFIs nor their own Executive Directors in the IFI Boards from approving Nicaragua's reaching of the HIPC Decision Point in December 2000, and the endorsement of the full PRSP in August 2001. In the

---

[64] By September 2002, the IMF website does not show the third-year PRGF agreement yet.
[65] Interview with IMF representative in Managua.

first case, the lobby for debt relief was decisive, and in the second political concerns about preventing Ortega from achieving an election victory in the second. However, as a result of the donor criticisms of corruption, and the strong doubts about government commitment to poverty reduction, Nicaragua is subject to more extensive conditions for reaching the Completion Point than most other countries, as well as to far more extensive and specific monitoring requirements for the use of the debt relief savings. It can be doubted whether these additional conditions, i.e. the list of specific programmes and projects to be implemented, and the micromanagement of the use of resources are good from a development perspective.

3.4 Intermediate flow effects on the balance of payments

What would have happened if there had been no flow effect from aid or debt relief? This of course depends on what would have occurred to the other flows on the balance of payments. We assume that in the absence of aid and debt relief, the exchange rate would be slightly more competititive, leading to a 5% increase in exports. Furthermore, we assume that Nicaragua would not have paid any arrears in the absence of debt relief. With respect to the payment of other debt service, we analyze two scenarios: one in which the country pays debt service, as actually occurred, and another in which no debt service is paid at all (so arrears accumulate with the full amount of debt service due). All other flows are assumed not to change. This is a highy conservative estimate, since the lower imports resulting from lower aid would probably have reduced economic growth and thus also the inflows of private capital. The tables in the annex show the consequences for imports under the two scenarios.

Table 3–6 Consequences for imports under different scenarios

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Scenario 1: imports / actual imports, in %	14	-115	15	25	24	40	50	73	57	60	63	65
Scenario 2 : imports / actual imports, in %	20	19	36	72	58	79	73	98	81	74	80	85

Scenario 1: No aid, no debt relief, no payment of arrears; exports 5% lower, debt service as actual, and all other flows as actual.
Scenario 2: No aid, no debt relief, no payment of arrears; exports 5% lower, no payment of debt service, and all other flows as actual.

Table 3–6 shows imports as percentage of actual imports under the two different scenarios. If debt service were paid as actual (Scenario 1), imports would be between about 15 and 40 per cent of actual imports before 1996, with a negative figure for 1991. That is obviously impossible, and probably the country would not have paid debt service as occurred in that year. In the later years, imports would be between 50 and 73% of actual values. If Nicaragua had not serviced any debts, imports would of course have been higher, but would still have been very low in the early 1990s. This means that Nicaragua faced enormous pressure to cooperate with the OECD creditors, who were also the main donors, and to accept their conditions. Otherwise, imports would have been so low that the economy would have experienced further contraction.

In later years, we can probably also assume that economic growth would have been lower with lower imports. But the marginal impact of these additional imports has probably been smaller than in the early 1990s. First, even without aid and debt relief, imports would have exceeded exports from 1996 onwards, and would have been at levels that would not jeopardise domestic production and consumption. As can be seen from Table 3–2, from 1996 onwards the value of imports has been more than double the value of exports, and in 2001 imports were three times the value of exports. At least part of these imports have been financed by loans. This means that foreign aid has contributed to making the economy less sustainable in the long run.

Second, the contribution of all these additional imports depends on where these imports would have been used. An indication can be provided looking at the composition of imports (Table 3–7). The share of consumer goods first increased in 1991 and 1992, but then decreased again. This first increase was the result of the foreign exchange liberalisation. It was a recuperation, since consumer goods imports had been very low in the 1980s. However, the share of consumer goods rose again from 25% in 1995-96 to 33% in 2001, which reflects a huge absolute increase. The share of capital goods (which includes transport goods) first rose until 1999, but then declined. This means that the high level of imports in 2000-01 was at driven by capital goods. The higher import levels and higher current account deficits that were made possible by foreign aid, do not seem to have been used in the best way for promoting investment and growth.

Table 3–7 Composition of imports by destination category, in per cent

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Consumer goods	25	30	34	29	26	25	25	23	29	29	30	33
Petroleum and derivatives	19	15	14	14	14	15	15	13	10	10	16	15
Intermediate goods	25	30	27	31	35	36	34	37	31	29	30	29
Capital goods	31	25	25	25	25	24	25	27	30	32	25	23
Total	100	100	100	100	100	100	100	100	100	100	100	100

Source: Elaboration of data from Central Bank of Nicaragua (www.bcn.gob.ni).

3.5 The efficiency of Dutch debt relief

3.5.1 Flow and stock effects

Most Dutch debt relief was relief on bilateral aid loans. This relief was probably to a large extent additional to other aid, since it was provided from the budget for macroeconomic support, and not from the regional budget for Central America from which other aid to Nicaragua was financed. According to Central Bank staff in Nicaragua, Dutch bilateral debt would have been serviced, since it was part of the Paris Club's priority debt that would have been serviced anyway. In addition, the Netherlands was seen as a generous donor that sometimes continued providing liquid aid when other bilaterals did not.

In practice, Nicaragua did service the – much smaller – commercial bilateral debt to the Netherlands from 1993 onwards until the post-Mitch deferral of this debt service. However, it can be doubted whether bilateral debts would have been serviced in the early 1990s (until about 1993), since in those years Nicaragua was still accumulating arrears, also to Paris Club creditors. We conclude that debt relief on bilateral aid loans did have a flow effect (did free resources), at least from 1993 onwards. In 2001, the outstanding aid loans were forgiven altogether, while the commercial debt to the Netherlands was growing as of the 1999 debt service deferral. This debt stock has not yet been forgiven.

Debt relief on multilateral debt service in the years 1994-96 and 1998-99, as well as the 1992 retroactive financing of imports and the budget support to the FSS in 2000, also had a flow effect. However, the amounts provided to clear the arrears with the multilateral institutions in 1990 and 1991 did not free resources. Although they helped to clear the way for new multilateral loans, the immediate disbursements had to be used to pay back other bilateral donors who had provided bridging loans. The Dutch participation in the commercial debt buyback only reduced a stock and did not free resources. All in all, 67% of total Dutch debt relief freed resources for the Nicaraguan government, and 51% of total Dutch debt relief if we include that provided by the Ministry of Finance.

Since all Dutch debt relief provided from the development cooperation budget was forgiveness, and none of it was rescheduling, we can assume that it always had a stock effect.

3.5.2 Impact of conditions

During the Chamorro government (1990-96) the Netherlands has been a generous donor for Nicaragua, and one that gave relatively large amounts of liquid aid which was very much appreciated. The Netherlands was a member of Support Group for Nicaragua, along with Sweden, Mexico, Canada and Spain, that was active between 1994 and 1996 to ease political tensions in Nicaragua – and with some success (Dijkstra, 1999). This group met regularly with the Minister of the Presidency and other ministers, and we can say that the Netherlands had some influence on the government as a prominent member of this group.

From 1997 onwards the amount of liquid aid provided by the Netherlands has declined. That was mainly due to the dissatisfaction of the Dutch with the Alemán policies. Nevertheless, after hurricane Mitch the Netherlands again supported Nicaragua with large amounts of aid, including liquid resources for the Central American Emergency Trust Fund (CAETF). Even when other like-minded donors had stopped disbursing their contributions to that fund out of disappointment about the Pacto and corruption, the Netherlands still provided about USD 7.5 million to it in November 1999. This happened without consultation with the Dutch Embassy in Managua, and was the result of Dutch internal decision making processes that always lead to peaks in debt relief expenditure towards the end of the year. The disbursement was the more surprising since there was not even a current IMF programme at the time (but the IMF representative had requested other donors to continue programme aid, see above).

After Nicaragua reached the Decision Point, the Dutch government first gave budget support to the FSS in December 2000, being the only bilateral donor to provide liquid aid in that year, and then the Netherlands forgave the full stock of bilateral aid loans in 2001. Again, the Dutch Embassy in Managua was not consulted about this decision, and staff of the Embassy were disappointed about its timing – a few months before the Presidential elections which enabled the the President to use it in his campaign.

The Dutch Embassy's discomfort with Alemán's policies, along with that of many other bilateral donors, did not stop the multilateral decision to admit Nicaragua to the HIPC Initiative. In addition, it did not even influence the bilateral decisions in The Hague for generous aid and debt relief in 1999-2001. This lack of coordination weakens the influence of the Netherlands on Nicaraguan policies. Currently, the Netherlands is not a member of the most formal donor group, the G6, but it is an active member of the like-minded group that is trying to extend HIPC Initiative conditionality to include governance issues. In addition, and due to the Netherlands' support to the FSS, the country is participating in the talks about the monitoring of the PRSP. All in all, the Netherlands currently is a relatively active bilateral donor, but operating in an environment in which bilateral donors in general have little influence.

3.6 Conclusion

Debt relief received by Nicaragua over the years 1990-1999 had an important stock effect. The stock reductions amounted to 124% of the 1999 debt stock. Most stock reductions originated from non-Paris Club creditors. Since new inflows (mainly official, and mainly from multilateral institutions) during the 1990s constitute more than half of the 1999 debt stock, the debt reductions amount to almost triple the 1999 debt stock if we substract the new loan inflows from it.

Debt relief had only a very modest flow effect. Most debt relief, especially in the first half of the 1990s, was on debts that were not serviced, and some debt forgiveness and reschedulings actually increased the debt service paid. An estimate of the flow effect of debt relief by creditor and by modality leads to an amount of USD 788 million over the years 1990-1999, which is equal to 9.5% of total debt relief. An estimate on the basis of balance of payments data leads to a figure of USD 429 million, or 5% of total debt relief. In most years, debt service paid was higher than the flow effect from debt relief. If we add liquid aid to the flow effect from debt relief, negative flows still appear in 1991, 1993-95, 1997-98, and also in 2000 and 2001. Most new loan inflows are from the IDB and the World Bank. Given their ten-year grace period, they did not increase debt service payments yet, but will do so from 2001 onwards. This reduces the possible flow effect from the HIPC Initiative, since multilateral HIPC relief is a fixed proportional reduction of (an increasing flow of) debt service due.

There was some bailing out between creditors. The multilateral development banks were bailed out by bilateral donors in 1991, and they continued to receive 100% of debt service due (until the interim HIPC relief began in 2001), while all other creditors had to be satisfied with less than that percentage. However, there was also some redistribution beween bilateral creditors, and even between Paris Club creditors, since the post-cutoff date debt to Germany, Japan and Spain, in particular, was also fully serviced, while other bilateral debts (from the pre-cutoff date) were not.

Nicaragua had a poor track record with respect to the implementation of conditions before HIPC. Bilateral donors were very dissatisfied with the Alemán administration (1997-2002) in areas of governance: its lack of commitment to poverty reduction, the corruption, and the lack of independence of the judiciary, the Comptroller General's Office, and the Electoral Council. In spite of the high aid dependency, the government only conceded to the donors in elaborating the PRSP and in allowing some participation. These were the key conditions for being admitted to the HIPC Initiative. CONPES was established under donor pressure, and a broad consultation process was organised in the preparation of the PRSP. In other governance areas the donors had virtually no influence, and the IMF programme was almost permanently off-track between 1999 and 2002, due to the government's abundant spending policies.

Although there was a broad consultation process, it does not seem to have had much influence on the contents of the PRSP. The influence of the IFIs has been dominant on the actual spending priorities in the PRSP. This dominance of the IFIs has reduced both ownership and participation. The IFIs also required the detailed monitoring of the use of HIPC savings, to be spent to specific programmes and projects. This micromanagement of the use of resources has been shown earlier to be ineffective and inefficient.

So far, the government has done just enough to be admitted to the HIPC Decision Point (December 2000) and to have the PRSP endorsed by the Boards of the IFIs (August 2001). In both cases, it was clear that Nicaragua did not meet the IMF targets and that there were serious concerns about corruption and about bad governance in general. However, other donor objectives changed the balance in favour of Nicaragua. Pressure for debt relief has been decisive in the first case, and preventing an election victory of the opposition in the second. This continuous approval in the midst of donor dissatisfaction about Nicaragua's policies has led to the formulation of an extensive list of conditions for the Completion Point. It appears that the return to an on-track position with the IMF is the most difficult of these.

Although the flow effect from debt relief was limited during the years 1990-99, the flow effect from aid was considerable. A counterfactual simulation shows that without aid and debt relief, imports would have been much lower. In the early 1990s, there would have been virtually no imports, even if no debt service at all had been paid. This means that Nicaragua had no choice but to cooperate with the donors and to make arrangements with the IMF.

Most (67%) Dutch debt relief given from the budget of development cooperation had a flow effect, and all of it had a stock effect. The impact of conditions set for Dutch debt relief was limited. An IMF agreement was usually in place before Paris Club relief and relief on multilateral debts was provided. However, Nicaragua usually met with IMF targets during only one year out of the multi-year agreement. Although in 1998 the Netherlands selected Nicaragua as one of the 17 (later 19) programme countries – on the basis of the criteria of poverty, good policy and good governance – governance during the Alemán administration (1997-2002) was continuously considered to be bad by the Dutch embassy in Nicaragua. This judgement did not change the positive appraisals in the Hague and did not stop the flow of Dutch macroeconomic support or support for Nicaragua within the HIPC Initiative, thus weakening the influence of Embassy staff on the Nicaraguan government.

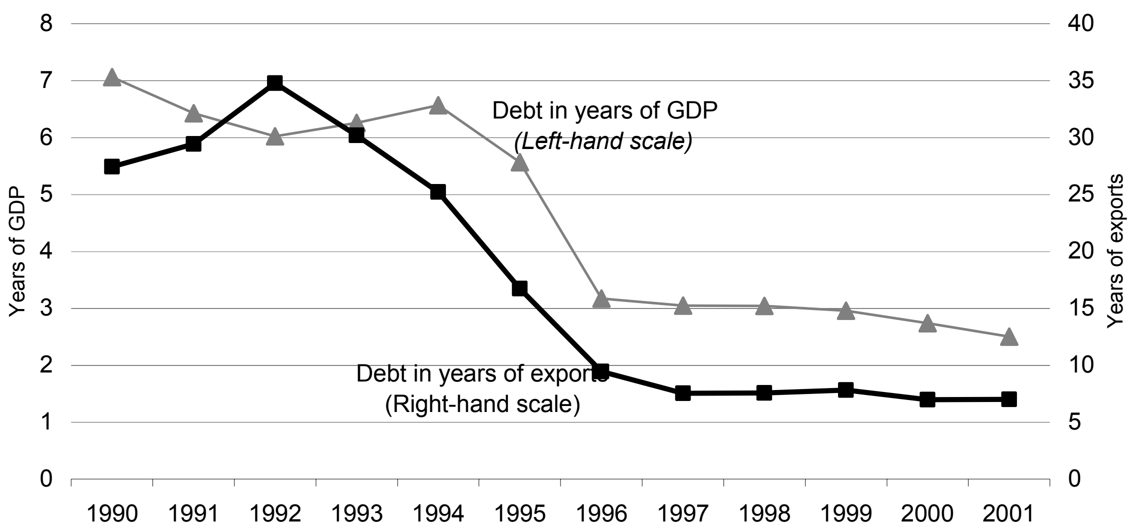
4 THE OUTCOME OF DEBT RELIEF

4.1 Debt sustainability

Nicaragua's debt sustainability indicators registered a considerable improvement during the 1990s. Nevertheless, because they started at such an extraordinarily high level, even after a substantial reduction, the absolute value of the indicators remained very high.

One important indicator of debt sustainability is the ratio of the external debt-to-GDP. This declined markedly in the 1990s, as can be seen in Figure 4—1. In 1990, the debt was equivalent to 7.1 years of GDP, but, following large debt stock reductions in 1995 and 1996 it dropped to 3.2 years at the end of 1996 and, after further smaller declines, had fallen to 2.5 years by 2001. Despite this marked reduction, however, Nicaragua still had one of the highest debt-to-GDP ratios in the world.[66]

Figure 4—1 Nicaragua: External debt in years of GDP and exports



Source: Banco Central de Nicaragua. Exports include goods and services.

A second indicator of sustainability is the ratio of the external debt to exports. This too declined notably in the 1990s, as can also be seen in Figure 4—1. At the peak in 1992, the debt was equivalent to 34.8 years of exports, but it fell to 9.5 years in 1996, and 7.0 years in 2001.[67] The ratio of debt to exports is the indicator that has been selected by the World Bank and IMF for determining eligibility for debt relief under the Highly Indebted Poor Countries (HIPC) initiative. However, the World Bank and IMF do not use the nominal value of the debt but rather the net present value (NPV), which is a way of taking account

---

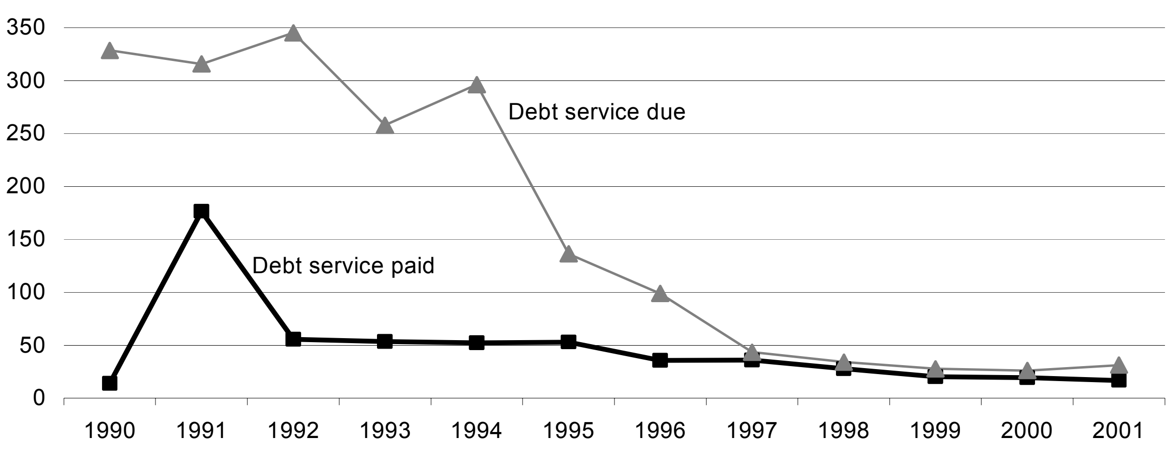
[66] See Sutcliffe, 2001, p. 83, for comparisons based on 1998. Nicaragua was only exceeded by the Democratic Republic of the Congo (7 years), Sao Tome e Principe (6.5 years) and Guinea-Bissau (4 years).
[67] This is based on figures from the BCN for the debt and for exports of goods and services. It differs slightly from the ratio calculated by the BCN itself, which is based on exports of only goods and not services. The figures for the export of services includes the net income from the export processing zone, which increased considerably in the course of the 1990s.

of the fact that part of the debt was agreed on concessional terms.[68] According to World Bank and IMF estimates, the net present value of Nicaragua's external debt in 1999 was USD 5.5 billion, compared with a nominal value of USD 6.5 billion.[69] On this basis the ratio of debt to exports for 1999 was 6.6, rather than 7.8 as is obtained using the nominal debt. By comparison, according to the terms of the HIPC Initiative, for sustainability, the NPV of the external debt should not be greater than 1.5 years of exports—a level which Nicaragua exceeded over four times!

The World Bank and the IMF approved Nicaragua's eligibility for debt relief under the HIPC Initiative in December 2000, (this was the date when the 'Decision Point Document' was approved). Just how unsustainable Nicaragua's debt position was considered to be at that time is indicated by the scale of the debt relief that was thought would be necessary. The proposed relief involved a reduction in the NPV of the debt by 72 per cent, which was higher than that proposed for any other country except Guinea-Bissau, with 85 per cent, and Sao Tome e Principe, with 83 per cent. The cost of relief for Nicaragua was estimated at USD 4.5 billion, more than for any other country.[70]

A third key indicator of debt sustainability is the ratio of debt service due-to-exports, which is shown in Figure 4–2. At the beginning of the 1990s, the debt service due was equivalent to 328 per cent of exports, representing an amount that was obviously completely unpayable. Following debt relief, the service due fell to 43 per cent of exports in 1997, and by 2000 it was down to 26 per cent. It should be noted, however, that the downward trend was then reversed, and the debt service due in 2001 increased slightly, to 31 per cent of exports. Figure 4–2 also shows the debt service actually paid as a percentage of exports, and it can be seen that, since 1997, the gap between service due and service paid has been substantially closed.

Figure 4–2 Nicaragua: Debt service as per cent of exports



Source: Calculated from data from Banco Central de Nicaragua. Exports include goods and services.

---

68 The IMF defines the net present value of debt as: 'The sum of all future debt service obligations (interest and principal) on existing debt, discounted at the market rate of interest. Whenever the interest rate on a loan is lower than the market interest rate, the resulting NPV of debt is smaller than its face value, with the difference reflecting the grant element.' (IMF, 1999)

69 IDA / IMF, 2000, p. 34.

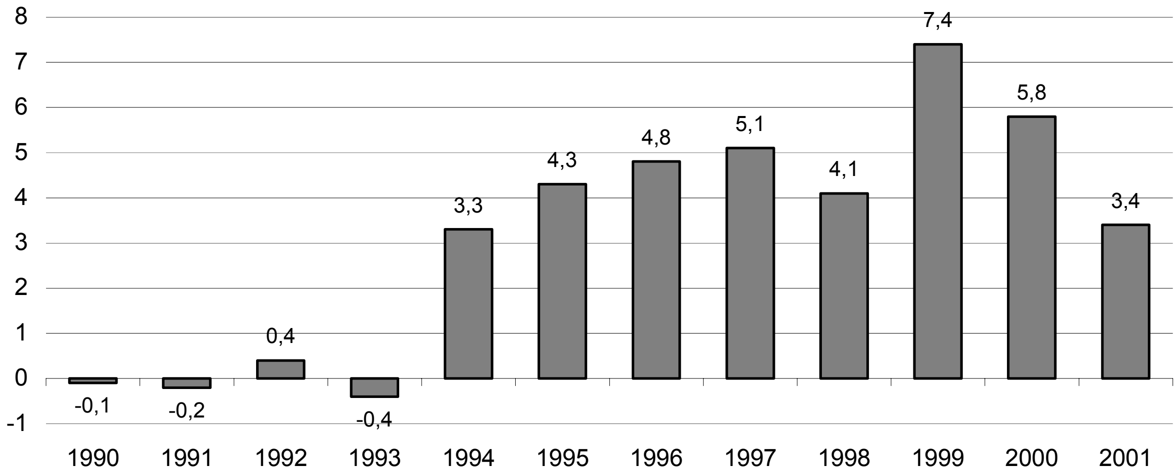
70 Abrego and Ross, 2001, p. 43. Nicaragua was followed by Mozambique (USD 4.3 billion), Zambia (USD 3.8 billion) and Tanzania (USD 3 billion).

4.2 Sources of changes in sustainability indicators

The improvement in Nicaragua's debt sustainability indicators in the 1990s was, in important respects, due to the fact that, following the election of the government of President Chamorro in 1990, the country cleared its arrears with the multilateral financial institutions, and subsequently benefited from substantial reductions in the debt stock. However, the improvement in the debt sustainability indicators also reflects a better performance of the Nicaraguan economy from 1994 onwards, with a strong growth in both GDP and exports.

The growth rate of real GDP hovered around zero between 1990 and 1993 as the government implemented stringent stabilisation policies under the tutelage of the IMF. However, from 1994 the country registered relatively sustained economic growth for the first time since the 1970s, and between 1994 and 2001 real GDP increased at an average annual rate of 4.8 per cent (see Figure 4–3). The main source of the growth was agricultural production. With the end of the armed conflict in rural areas, poor peasant producers increased the production of basic grains, notably on previously uncultivated land stretching across to the country's Atlantic coast. At the same time, there was strong expansion of commercial farmers' production of coffee and sugar. The construction industry also contributed significantly to the expansion, especially in 1999 and 2000, when Nicaragua received considerable external assistance to support reconstruction in the aftermath of the damage caused by hurricane Mitch in 1998. The result of this protracted period of growth was that the nominal value of Nicaragua's GDP increased from USD 1.5 billion in 1990 to USD 2.5 billion in 2001, an increase of almost 70 per cent. As a result, higher GDP accounts for some 40 per cent of the improvement in the ratio of debt to GDP over this period.[71]

Figure 4–3 Nicaragua: Economic growth, 1990-2001 (per cent)

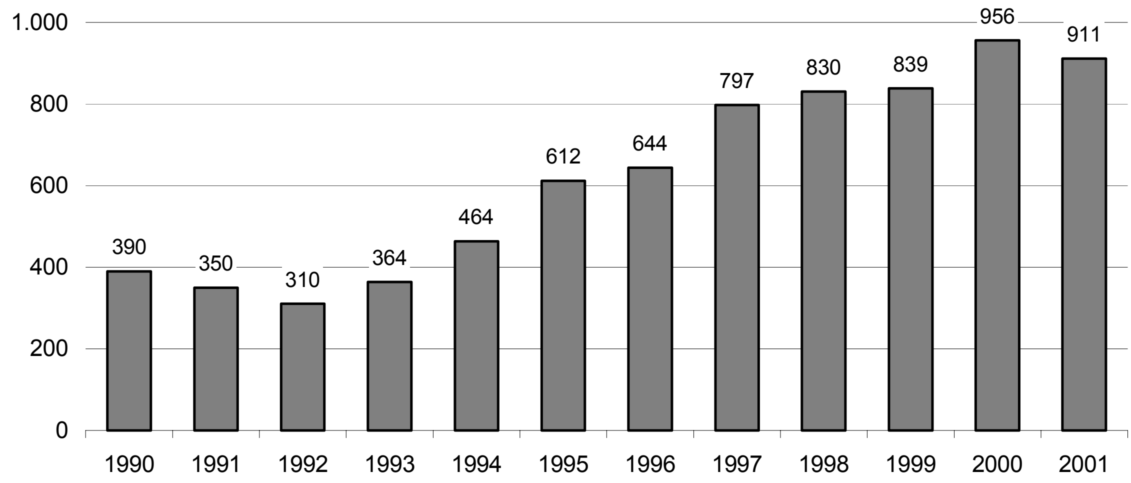


Source: Banco Central de Nicaragua.

[71] Nicaragua's GDP figures are generated using a methodology that was developed in the 1970s. Based on its surveys of consumer expenditure, the World Bank has concluded that this seriously underestimates Nicaraguan GDP, perhaps by as much as 60 per cent. In a study conducted for the IDB, an input-output matrix for the Nicaraguan economy was constructed using data for 1995, and this also concluded that GDP figures were underestimated. If this were true, the debt to GDP ratio would, of course, be correspondingly lower.

A similar development occurred in the case of Nicaragua's exports. Exports had previously registered a peak in 1977, and then fallen through the 1980s and the early 1990s. However, from 1993 onwards, exports finally began to rise again, as shown in Figure 4—4. The main increase was attributable to coffee, followed by beef, the export processing zone, and shell fish. Between 1990 and 2001, the value of exports rose by 130 per cent, and this increase accounts for almost 60 per cent of the improvement in the ratio of debt-to-exports, and of debt service-to-exports.

Figure 4—4 Nicaragua: Exports of goods and services, 1990-2001 (USD million)



Source: Banco Central de Nicaragua.

Despite the improved economic performance since 1994, Nicaragua's economy remains highly vulnerable to external factors. The impact of hurricane Mitch in 1998 contributed to lower economic growth that year, although the increased foreign aid that followed facilitated very high growth in 1999. In 2001, however, the economy experienced a reduction in both the rate of growth and in exports as a result of external shocks. One factor was a draught, which had a negative impact on the production of basic foods by small-scale peasant producers in the north of the country. In addition, exports were affected by a sharp decline in the world price of coffee, which has fallen from an average of around USD 1.50 per pound in the 1990s to around USD 0.50 in the last year. Exports from the export processing zone, which had increased steadily in the course of the 1990s, also fell in 2001, as the economic downturn in the US led to a decline in demand for imported textile products. This continual vulnerability to climatic and world market conditions means that simple extrapolations of growth and exports into the future must be treated with caution.[72]

4.3 Impact of debt relief on public spending and social indicators

The analysis presented in chapter 3 indicated that, despite the substantial reduction in the stock of debt in the 1990s, the impact of debt relief on the flow of debt service payments was at the best rather limited, and that the process of negotiating a reduction in the stock

[72] This is a weakness of the projections contained in the debt sustainability analysis conducted by the World Bank and IMF, as reported in the 'Decision Point Document'.

of debt involved having to start paying service on that part of the debt which was not cancelled. This analysis is confirmed by the figures for government expenditure, shown in Table 4–1.

The stabilisation programme that was agreed with the IMF in 1991 created the basis for regularising Nicaragua's debt position with the international financial institutions and for negotiating relief on bilateral debt with members of the Paris Club. However, a key feature of the stabilisation programme was a cut in public expenditure, which fell sharply in 1991. The amount of spending subsequently increased nearly every year up to 1998, although as a share of GDP it remained steady at just over 30 per cent. In 1999, however, in the aftermath of hurricane Mitch, Nicaragua received substantial additional external support, and government spending shifted sharply upwards, rising to 38 per cent of GDP in the years from 1999 to 2001.

From the beginning of the 1990s, when Nicaragua began to regularise its debt position, until 1997, the amount of debt service paid from the central government budget increased steadily from virtually nothing to just over 170 million dollars, or 25 per cent of government spending.[73] It was only after hurricane Mitch, when the Paris Club allowed Nicaragua to defer service payments, that payments declined. The decline was particularly marked in 2000, although by 2001 service payments were almost back to pre-Mitch values.

Government expenditure on social programmes, by contrast, remained strongly constrained up to 1998. In 1991, social spending declined as a result of cuts associated with the stabilisation programme, but subsequently increased slightly. From 1994 to 1998 social spending was largely unchanged, at just over 200 million dollars a year, although this meant that, as a percentage of total spending, and also in per capita terms, it fell slightly each year. In 1999, however, social spending increased very markedly. The amount increased by over half, to 320 million dollars, and as share of total spending it rose to 38 per cent. This was made possible partly by the large inflow of resources from abroad after hurricane Mitch; it is also the one period when the resources available for social programmes were increased as a result of lower debt service payments.

[73] Government spending on debt service is less than total debt service, notably in the first half of the decade, because part of the debt service, including the large bridging loans received in 1991, were managed by the Central Bank, and not the central government.

Table 4—1 Nicaragua: Public expenditure (USD million)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Social services	177.0	153.3	190.2	187.7	209.4	206.9	207.0	206.7	202.1	332.6	328.0	307.4
Education	79.4	72.1	86.3	76.4	87.8	81.5	85.4	97.6	97.5	141.0	146.4	145.8
Health	77.8	62.8	76.6	68.2	77.1	81.3	80.3	76.6	74.0	115.4	117.3	112.2
Housing	0.0	0.2	0.3	5.7	3.2	0.4	0.1	0.0	0.0	5.5	4.0	3.7
Other	19.8	18.2	27.1	37.4	41.3	43.7	41.2	32.5	30.6	70.6	60.3	45.6
Infrastructure and production	51.1	52.1	74.9	90.9	83.3	115.4	110.6	135.1	160.2	244.8	225.4	186.0
Defence and security	218.0	69.6	101.8	68.1	65.5	58.4	64.6	55.0	54.4	58.9	64.4	66.6
Public administration	99.0	108.6	95.3	62.5	74.1	68.8	111.0	82.9	95.5	116.1	148.9	175.1
Debt service	0.3	43.2	84.1	125.0	165.8	152.6	132.3	172.9	170.0	162.6	122.4	164.1
Interest	0.0	16.2	40.0	66.7	88.7	71.6	54.6	90.4	88.5	69.9	69.1	85.0
Amortisation	0.3	27.0	44.1	58.3	77.0	81.0	77.8	82.4	81.6	92.8	53.3	79.1
Total	545.4	426.8	546.4	534.2	598.1	602.2	625.4	652.6	682.2	915.0	889.0	899.2
Percentages												
Debt service as % of total	*0.1*	*10.1*	*15.4*	*23.4*	*27.7*	*25.3*	*21.2*	*26.5*	*24.9*	*17.8*	*13.8*	*18.2*
Social spending as % of total	*32.4*	*35.9*	*34.8*	*35.1*	*35.0*	*34.4*	*33.1*	*31.7*	*29.6*	*36.3*	*36.9*	*34.2*
Infrastructure as & of total	*9.4*	*12.2*	*13.7*	*17.0*	*13.9*	*19.2*	*17.7*	*20.7*	*23.5*	*26.8*	*25.4*	*20.7*
Total spending as % of GDP	*33.0*	*27.7*	*29.0*	*28.2*	*31.5*	*31.7*	*31.2*	*30.8*	*32.0*	*38.1*	*38.2*	*38.7*

Source: Ministerio de Hacienda y Presupuesto. Current córdobas converted at average annual exchange rate.

The social impact of the changes in government spending are difficult to assess since, as already noted in chapter 1, the data for Nicaragua are not very reliable.[74] Some of the official figures published by the World Bank are shown in Table 4–2. These indicate that life expectancy and infant mortality continued to improve throughout the 1990s, and that the coverage of immunisation programmes also continued to widen. The figures for primary school enrolment, on the other hand, improve until 1994, but then decline slightly. In addition, the data collected on child malnutrition show a deterioration of conditions between the observations in 1993 and 1997.

Table 4–2 Nicaragua: Social Indicators

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Life expectancy at birth, total (years)	64.5	..	66.0	..	..	67.3	..	68.1	..	68.6
Mortality rate, infant (per 1,000 live births)	51.0	..	48.0	..	..	39.5	..	37.0	..	34.3
Malnutrition prevalence, height for age (% of children under 5)	..	..	..	22.5	..	..	..	..	24.9	..
Malnutrition prevalence, weight for age (% of children under 5)	..	..	..	11.0	..	..	..	..	12.2	..
Immunisation, DPT (% of children under 12 months)	66.0	71.0	74.0	78.0	74.0	85.0	91.0	94.0	86.0	83.0
Immunisation, measles (% of children under 12 months)	82.0	54.0	73.0	83.0	73.0	81.0	90.0	94.0	100.0	97.0
School enrolment, primary (% gross)	93.5	97.3	99.5	102.3	104.4	102.6	100.9	101.6	..	..
School enrolment, primary (% net)	72.2	74.9	78.5	79.2	79.9	77.6	76.3	77.3	..	..
Unemployment (%)	7.6	14.4	14.4	17.8	17.1	16.9	16.0	14.3	13.2	10.7

Source: World Bank, *World Development Indicators,* CD-ROM.

The official figure for unemployment registered a sharp increase in 1991, when the stabilisation programme was introduced, and continued to rise in the following two years. From 1994, however, when economic output began to rise, unemployment fell steadily. Total employment increased from 1.1 million in 1994 to 1.5 million in 1999 and 1.7 million in 2001. These figures do not include underemployment, which by official accounts amounted to a further 10-12 per cent of the workforce, but they provide an indication of labour market conditions. The main sources of new employment were in agriculture, followed by construction and commerce. Unemployment fell slightly further in 2000, to 9.8 per cent, but, under the impact of the adverse factors referred to above, returned to 10.7 per cent in 2001.

Information about the extent of poverty in Nicaragua has improved since the 1990s as a result of sample surveys of households conducted with the support of the World Bank. The first of these was held in 1993, and subsequent surveys were carried out in 1998 and 2001.[75] A person is considered to be living below the poverty line if his/her level of consumption is not sufficient to meet a narrowly defined range of essential basic items; the extreme poverty line is defined as not being able to meet minimum caloric

[74] In the early 1990s, data for some indicators was produced by simply extrapolating previous trends. As a result, national figures for infant mortality figures improved, although studies conducted at a local level indicated a deterioration. (See Evans, 1995, pp. 236-37.)
[75] At the time of preparing this report, only preliminary results were available from the 2001 survey. For a brief summary of the methodology used in the surveys, see World Bank, 2001, p. 10-11.

requirements even if a persons entire consumption is devoted to food.[76] The results of the surveys, shown in Table 4—3, indicate that the proportion of Nicaragua's population living in poverty fell slightly between 1994 and 2001, from 50 to 46 per cent, while the percentage living in extreme poverty declined from 19 to 15 per cent. Most of the improvement was due to a decline in the figures for poverty in rural areas, although the incidence of rural poverty remained much higher than the national average. Between 1994 and 2001, the proportion of the rural population living below the poverty line fell from 76 to 64 per cent, while the proportion below the absolute poverty line fell from 36 to 25 per cent.

Despite the improvement in the figures for the proportion of people living in poverty, because the population has grown, the results imply that the absolute number of people living in poverty increased by some 344,000 between 1993 and 2001.The number living in absolute poverty remained virtually unchanged.

Table 4—3 Nicaragua: Poverty Evolution by Region, 1993-2001

	Poverty					**Extreme Poverty**				
	Incidence (per cent of population)			**Change (per cent)**		**Incidence (per cent of population)**			**Change (per cent)**	
	1993	1998	2001	93-98	98-01	1993	1998	2001	93-98	98-01
National	50.3	47.9	45.8	-2.4	-2.1	19.4	17.3	15.1	-2.1	-2.2
Urban	31.9	30.5	28.7	-1.4	-1.8	7.3	7.6	6.1	+0.3	-1.5
Rural	76.1	68.5	64.3	-7.6	-4.2	36.3	28.9	24.7	-7.4	-4.2
Managua	29.9	18.5	20.2	-11.4	+1.7	5.1	3.1	2.5	-2.0	-0.6
Pacific										
Urban	28.1	39.6	35.9	+11.5	-3.7	6.4	9.8	6.2	+3.5	-3.6
Rural	70.7	67.1	55.6	-3.6	-11.5	31.6	24.1	14.7	-7.5	-9.4
Central										
Urban	49.2	39.4	35.1	-9.8	-4.3	15.3	12.2	12.1	-3.1	-0.1
Rural	84.7	74.0	70.5	-10.7	-3.5	47.6	32.7	33.9	-14.8	+1.2
Atlantic										
Urban	35.5	44.4	42.8	+8.9	-1.6	7.9	17.0	12.9	+9.0	-4.1
Rural	83.6	79.3	76.5	-4.3	-2.8	30.3	41.4	26.9	+11.1	-14.5

Source: World Bank Poverty Surveys.

The results of the poverty surveys also show marked regional differences in the incidence of poverty. Managua, where over a quarter of the population lives, has the lowest poverty rate, and registered the largest decline in poverty between 1993 and 1998, as new jobs were created in industry, construction and the financial sector.[77] However, there was a slight increase in the share of the population living below the poverty line between 1998 and 2001 (although not of those in extreme poverty). In the Pacific region, which has suffered from the decline of traditional agricultural production and the closure of many industrial enterprises, urban areas registered an increase in the rate of both poverty and extreme poverty. The Central region, by contrast, which depends overwhelmingly on

[76] In 1998, the poverty line corresponded to USD 403 per person per year, and the extreme poverty line to USD 212 per person per year.
[77] See World Bank, *Nicaragua Poverty Assessment,* p. 13.

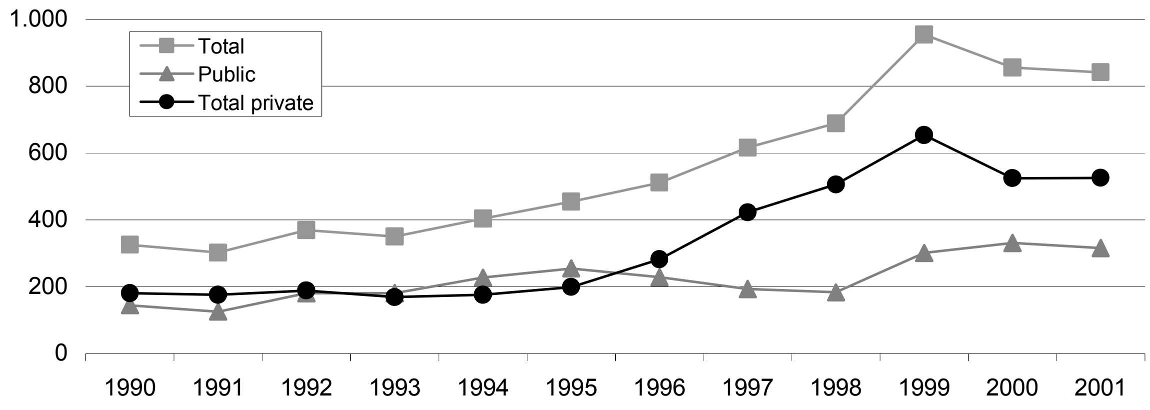
agriculture, registered declines in both poverty and extreme poverty rates, although both rates remain very high. Finally, in the sparsely populated Atlantic region, urban areas registered an increase in the poverty rate, while rural areas, many of which are very isolated, show an increase in both the poverty and extreme poverty rates.

In summary, while government expenditure on debt service increased through most of the 1990s, social spending suffered a reduction as a result of the 1991 stabilisation programme, and after recovering, remained virtually unchanged for much of the decade, despite a growing population. It was only after hurricane Mitch in 1998, when Nicaragua was allowed to postpone part of its debt service payments, and additional international resources were made available, that a significant increase in social spending occurred. Standard social indicators, such as infant mortality and life expectancy show an improvement, but the deterioration in the figures for malnutrition indicate that parts of the population faced great hardship. While poverty rates improved at a national level, there were parts of the country where conditions deteriorated. Furthermore, despite the improvement in poverty rates, the absolute number of people living below the poverty line actually increased.

4.4 'Crowding in' of private investment

When the monetarist counter-revolution was in the ascendancy in the 1970s, one of the key ideas that was used to argue against public investment was that, far from providing a boost to aggregate demand, and therefore economic growth, as Keynesians believed, it merely displaced or 'crowded out' private investment. The usual mechanism that was put forward to explain this crowding out was that the increased demand for credit by the state would put upward pressure on the interest rate, thereby discouraging the private sector from investing.[78] Subsequent experience, however, suggested that by leading to a deterioration in public infrastructure, sharp cuts in public expenditure could create conditions which were not very attractive for private firms to invest. This gave rise to the notion that public spending could, by creating more favourable general conditions for conducting business, serve to encourage or 'crowd in' private investment.

Figure 4–5 Nicaragua: Fixed investment (USD million)

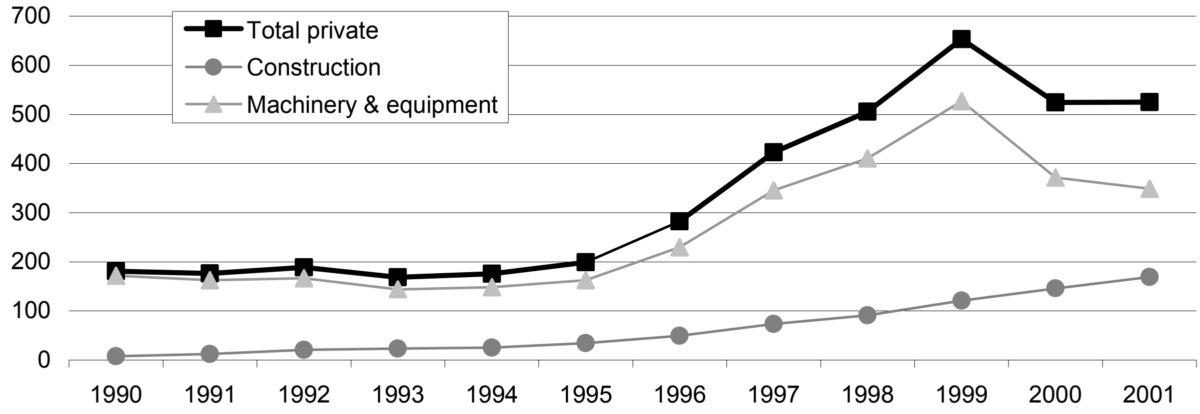


Source: Banco Central de Nicaragua. Cordoba values divided by the annual average US dollar exchange rate.

[78] Another mechanism that is sometimes advanced is the so-called Ricardian equivalence theorem. This argues that if the state increases its spending, 'rational' (according to an extreme form of neo-classic logic) agents will recognise that this will involve future tax increases to cover increased debt charges, and they will immediately reduce their own spending in anticipation of their higher tax bill, thereby off-setting the positive impulse of the public investment.

Private fixed investment, which is also shown in Figure 4–5, was virtually unchanged from 1990 to 1995, fluctuating slightly around an average of USD 185 million a year (10.9 per cent of GDP). From 1996, however, private investment began to rise quite markedly, and by 1999 it had reached USD 650 million (29.7 per cent of GDP). It then fell back slightly in the next two years to USD 525 million (21.1 per cent of GDP). The major part of the private fixed investment was in machinery and equipment, as can be observed in Figure 4–6. Private investment in construction increased steadily throughout the period, but was always well below that in machinery and equipment.

Figure 4–6 Nicaragua: Private investment by type (USD million)



Source: Banco Central de Nicaragua. Nominal values in cordobas divided by the annual average US dollar exchange rate.

The depressed level of private investment in the early part of the 1990s might be taken as evidence of the 'crowding in' hypothesis: insofar as depressed government spending, including public investment, contributed to weak domestic demand and the absence of economic growth, this did not create an environment that was conducive for private firms to increase their productive capacity. When private investment did increase, from 1996, however, this did not coincide with an increase in public investment—in fact there was a slight decline in public investment at this time.

One explanation for the upturn in private investment is that, after two years of economic expansion, confidence began to rise that the decade-long period of decline and stagnation had finally come to an end. It is, however, likely that political factors also played an important role. Many members of the country's business elite, who had looked askance at the close political relation between the government of Violetta de Chamorro and the Sandinistas in the first half of the 1990s, reacted very positively to the election of Alemán, and after his government assumed office in 1997, they finally began to repatriate their capital from Miami, where they had been holding it since the time of the Sandinista Revolution.[79] Political factors may also have contributed to the decline in private

[79] A marked shift also occurred in the The Euromoney credit-worthiness ratings for Nicaragua in 1996. Ratings carried out in September of each year had registered 17 (out of 100) in 1994 and 16 in 1995, but then jumped to 25 in 1996, where they remained until 2000. It is, however, not clear whether the shift in the ratings

investment in 2000 and 2001. This was a period when conflicts between the Alemán government and the international donors increased, mainly due to allegations of corruption, and when Alemán engaged in frequent changes of ministers. Uncertainty in business circles was also increased by strong indications that the Sandinstas might be returned to power in the presidential elections in October 2001.[80]

4.5 Impact of lower debt stock on private investment

In addition to the effect that lower debt *service* might have on public investment, and any consequent 'crowding in' of private investment, it is also sometimes argued that a reduction in the debt *stock* can also have a directly beneficial effect on private investment. One channel through which such an effect might act is said to be the expectation that a lower debt stock will require lower service payments in the future, and that this will lead to a lower rate of taxation, including the taxation of company profits. Another possible channel is that, with a lower external debt, less foreign currency will be required to meet service payments, and there is less chance of a major devaluation, or of exchange controls that would prevent investors from converting profits into hard currency. Yet another, more general, argument is that, with a lower external debt, there is less chance of a foreign exchange crisis that would have a negative effect on private business prospects.

The representatives of the private business sector with whom we spoke were, not surprisingly, all in favour of debt reduction. Nevertheless, none of them suggested there was a connection between the stock reduction in Nicaragua and the increase in private investment. Those that offered a view on how a reduction in the debt stock might affect the business climate tended to focus on the effect of debt service charges on taxes. The general manager of APENN, an organisation set up with the help of USAID to represent producers of non-traditional exports, suggested that if the debt remained high, this was likely to lead to an increase in taxes, which would be bad for producers. Similarly, the manager of Delmore, a former state-owned meat processing firm that was purchased by its workers in the early 1990s, expressed his concern that a failure to reduce the level of debt could lead to sales taxes being raised from 15 to 18 per cent. APENN's general manager also said that there was concern about the external debt because meeting debt service payments results in a lower level of social spending, and this could lead to a social explosion.

Despite the support for debt reduction, the views expressed by the representatives of the business sector indicated a greater ambivalence about the results of some of the economic policies that had been introduced in the 1990s, many of which had been linked to the process of regularising Nicaragua's position with the multilateral institutions, and so in obtaining debt relief.

One issue is access to finance. APENN identified this as the main problem facing private producers, and this view was echoed by the other private sector organisations that we spoke with. Interest rates are exceptionally high; long-term credit, necessary for purchasing machinery and equipment, is virtually unavailable; and the banking system only accepts real estate as security for loans, thereby excluding the large number of agricultural producers who rent their land. UNAG, the Union of Farmers and Ranchers,

---

reflected the expected political victory of Alemán, or whether it was responding to the increase in investment that had just begun.

[80] The degree of uncertainty is indicated by the fact that the Central Bank was unable to place its standard short-term bonds (CENIs) immediately prior to the election, despite offering a rate of interest of 17 per cent, and was therefore obliged to issue an exceptional instrument, entitled *Títulos Especiales de Liquidez,* which offered a return of 23 per cent.

and USAID drew our attention to the fact that the increase in agricultural output in the 1990s had been obtained by increasing the areas cultivated—something that faces a certain limit—and not by increasing the yield, which would require fixed investment. The issue of access to finance is, of course, particularly complicated in Nicaragua, because of the experience with hyper-inflation and a culture of non-repayment of loans, which developed in the 1980s. However, the situation today is also, in part, the result of policy conditions established by the multilateral institutions. A restrictive monetary policy; the rapid drive to create new private banks, which in the event have orientated themselves largely to highly profitable consumer credit; and the closure of the National Development Bank, have all contributed to the problems which many producers have in obtaining finance. The executive secretary of Cadin, the Chamber of Industry, was particularly critical of the way in which the new private banks are profiting from their focus on the financing of non-productive activities.

A second problem is the cost of public utility services. According to the head of the Export Processing Zone in Managua, the external debt was not a problem for the foreign firms which invest in the Zone, since their profits do not technically enter the country and can therefore be repatriated quite freely. However, he said, although there had been extensive investment in communications, electricity generation, and transport, and the quality of the services was now good, they are very expensive. In fact, the public utility companies have all been subject to privatisation in recent years as one of the conditions attached to multilateral loans, and there has been considerable criticism of the way in which the privatisation was conducted.[81] The manager of Delmor was very critical of the low price at which the state telecommunications and energy generation plants were sold to private companies, and of the sharp rise in the price of water and electricity that has occurred since 1997.

A third concern involves the government's Poverty Reduction Strategy. This was developed as part of the conditions that have to be met to qualify for HIPC relief, and the strategy document produced by the government is praised by the IMF and the World Bank.[82] However, UNAG, the Union of Farmers and Ranchers, together with a number of other organisations have criticised the strategy for being too welfare-oriented and for failing to devote resources to promoting the development of the country's productive capacity. This is a criticism that was also repeated by representatives of several bilateral donors. By committing the government to increase spending on an ambitious series of social programmes, less resources are likely to be available for promoting economic projects that could make a more sustained contribution to combating poverty. In the view of the Coordinador Civica, a network that links many development NGOs in Nicaragua, the resources that are envisaged for the strategy might be able to alleviate extreme poverty, but they are unlikely to contribute much to eliminating the fundamental causes of the poverty which affects a majority of the population. The critics also draw attention to the fact that many of the programmes are dependent on external finance. This means that

---

[81] The privatisation of the highly profitable telecommunications company proved to be the most controversial. It was first proposed for 1994, but after repeated delays, not completed until August 2001. The company was sold to a Swedish-led consortium for USD 83 million, with an initial payment of USD 33 and five subsequent annual instalments of USD 10 million. In the 1990s, the company undertook a major investment programme, installing state-of-the-art electronic switch boards and fibre-optic cables. Figures published by the Central Bank (2001, Table VII-12, p. 146), show that between 1992 and 1997, capital expenditures amounted to a total of USD 212 million, financed principally out of the company's operating surplus, which was equal to around USD 40 million a year. In 1998, the last year for which figures are published, there was virtually no capital expenditure, and the surplus was largely booked as profit. Assuming more recent figures are similar, this would imply that the profits generated by the company itself were sufficient to comfortably cover the payments for the purchase.

[82] Interviews with IMF and World Bank country representatives.

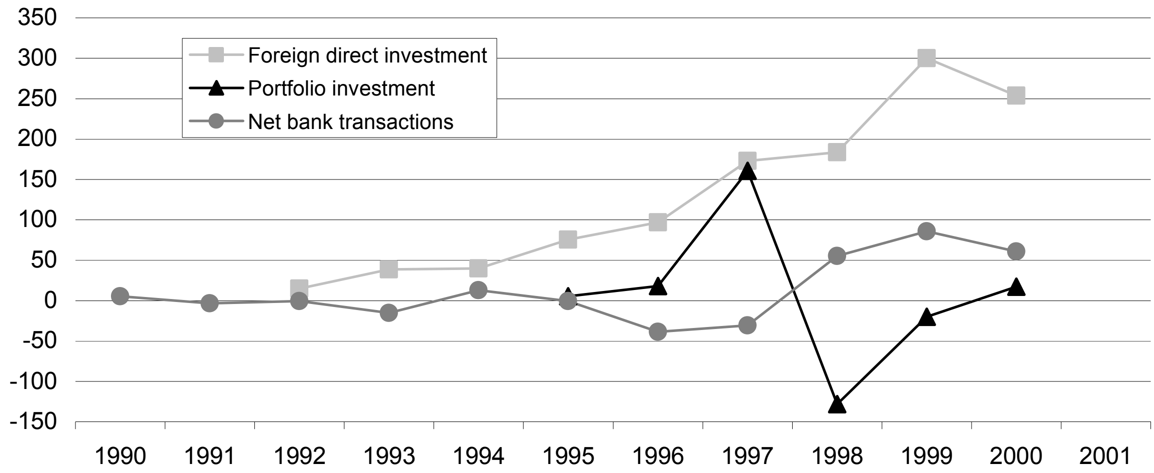
they are not sustainable; furthermore, insofar as they are financed by external loans, they represent a charge on the country in the future.

One other issue, raised by the industry association Cadin, is that the macroeconomic policies which the government has been obliged to follow in order to qualify for debt relief have depressed domestic demand and thereby had a negative effect on businesses in the industrial sector. According to Cadin's executive secretary: 'The IMF and the World Bank forced us to adopt austerity programmes. This has made us tighten our belts. All the sacrifice has been borne by the poor and the business sector.'[83]

4.6 Private capital inflows

The main form of private capital inflow to Nicaragua since the early 1990s has been foreign direct investment (FDI), as can be seen in Figure 4–7. Data for FDI is not available for 1990 and 1991, and in 1992 direct investment was accounted for almost entirely by reinvested earnings rather than additional capital from abroad. From 1993, however, FDI increased markedly, and the increase was almost entirely due to inflows of equity capital from abroad. As a result, FDI rose from USD 15 million dollars a year in 1992 to USD 300 million a year in 1999, although it then declined slightly to USD 254 million in 2000.

Figure 4–7 Nicaragua: Private capital inflows (USD million)



Source: International Monetary Fund, *Balance of Payments Statistics,* CD-ROM, June 2002

The timing of the increase in FDI does not indicate a close link to the reduction of the debt stock. FDI began to increase in 1993, whereas the major reductions in the debt stock occurred in 1995 (commercial bank debt) and 1996 (bilateral debt). However, it seems likely that the reestablishment of financial stability and capitalist order in the early 1990s created the preconditions for the resumption of foreign investment. The main turning point was the implementation of the comprehensive stabilisation and structural adjustment programme, and the regularisation of the country's position with the IMF and the other multilateral lenders, both of which occurred in 1991. The increase in FDI followed in 1993. It is likely that this was in part related to the privatisation programme which began to assume momentum around this time. It might also be noted that the pattern of FDI follows

[83] Interview with the Executive Secretary, Cámara de Industrias de Nicaragua.

that of private fixed investment quite closely. The main difference is that whereas FDI began to rise in 1993, the upturn in growth did not occur until 1994, and the strong upturn in fixed investment only began in 1996.

The second largest form of capital inflow involves portfolio capital, but this is much less important than FDI, and was only really significant in one year, 1997. This portfolio inflow is accounted for by foreign purchases of money market instruments issued by the Central Bank known as *Certificados Negociables de Inversion,* or *CENIs*. These were initially created in 1995 with the aim of providing the central bank with instruments for conducting open market operations. However, in 1997 after the Alemán government failed to reach an agreement on a new loan facility with the IMF, a large volume of CENIs was issued in order to replenish the country's foreign reserves. To this end, the Central Bank contracted the New York investment bank, Lehman Brothers, to sell USD 160 million worth of CENIs at very attractive rates of interest to foreign investors. However, as can be seen in Figure 4—7, these foreign holdings were substantially redeemed in 1998, and portfolio investment has been relatively insignificant in other years.

The figures for the inflow of capital through banks includes both loans and all other international transactions in which banks are involved, including deposits of foreign currency. As can be seen in Figure 4—7, these were very small, or even negative up to 1997, and although they increased from 1998, even then they did not rise much above USD 50 million a year.

The greater financial stability achieved in the 1990s has therefore been associated with a notable increase in the inflow of FDI into Nicaragua, but there has not been a significant rise in other forms of foreign capital inflow.

4.7 Long-term sustainability

Since the mid-1990s, the Nicaraguan economy has registered a significant improvement in a number of key indicators, including output, exports and employment. In addition, following a substantial reduction in its debt stock during the 1990s, there is a serious prospect that the debt will be further reduced as a result of the World Bank/IMF HIPC Initiative. Nevertheless, the Nicaraguan economy continues to exhibit a number of major imbalances, including a large trade deficit, and large gaps between domestic savings and investment, and between government income and spending. These imbalances have been financed by foreign loans and donations, and were reflected in the substantial new debt acquired by Nicaragua in the 1990s. The aim of this section is to consider indicators for the Nicaraguan economy which attempt to examine whether Nicaragua would be able to sustain some more moderate level of debt in the long run.

The first of the long-term sustainability indicators concerns the trade deficit. The idea behind this indicator is that a country's debt will be sustainable in the long run, and it might even be able to sustain a trade deficit and rising external indebtedness, provided the growth rate of exports is higher than the interest rate on the debt.[84] In the case of Nicaragua, since 1993 the growth rate of exports has exceeded the interest rate on the debt, as is shown in Table 4—4. This means that, were Nicaragua starting from a sustainable debt position, the growth of the exports would allow it to maintain a sustainable debt position (more specifically, the ratio of debt to exports would not rise) even with some trade deficit, and consequent increase in debt.

[84] For the derivation of this type of long-term sustainability indicator, see Gillis et al, 1996, pp. 414-15.

Table 4—4 Long-term debt sustainability: Trade gap

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Growth rate of export (g_X), %*	8.7	-2.4	-1.2	12.2	25.6	21.1	20.2	11.0	9.6	6.4
Average interest rate (i), %	5.6	4.2	4.0	4.1	4.6	4.6	4.6	4.6	4.4	4.2
$g_X - i$	3.1	-6.6	-5.2	8.1	21.0	16.5	15.6	6.4	5.2	2.2
$a = (M - X) / X$, % *	104.4	138.2	154.3	141.7	102.7	96.0	95.0	101.9	115.6	117.5
$b = (M - X -$ *Tied Aid – Remittances*$) / X$, % *	60.3	70.4	76.3	82.0	54.9	51.7	54.2	58.2	65.7	75.2
$a / (g_X - I)$	33.6	-20.9	-29.7	17.6	4.9	5.8	6.1	16.0	22.0	54.0
$b / (g_X - I)$	19.4	-10.7	-14.7	10.2	2.6	3.1	3.5	9.1	12.5	34.6

Source: Based on data provided by Banco Central de Nicaragua, and International Monetary Fund, *International Financial Statistics,* CD-ROM. *M* = Imports, *X* = Exports. * Three-year moving average.

At present, Nicaragua's debt position is obviously not sustainable, and therefore does not yet provide the necessary starting conditions for such a scenario. But, even if a sustainable debt level were established, the figures in Table 4—4 also indicate that the scale of Nicaragua's current trade deficit is far larger than is compatible with a sustainable debt. Exports have grown strongly, but so have imports. The coefficient *a* shows that the trade gap (imports *minus* exports) is equal to 100 per cent or more of exports. Even if various other sources of foreign exchange, such as donations and workers' remittances are taken into account (coefficient *b*), the trade gap is still equal to well over 50 per cent of exports.[85]

The figures in the final two lines of Table 4—4 show the ratio of debt-to-exports that is, according to this type of indicator, supposed to be sustainable in the long run. Since 1993, these have been positive, though, even using the smaller measure of the trade gap, they are well above 1.5 (the value considered to be sustainable under the terms of the HIPC Initiative) and usually by a huge margin. The size of the figures cast some doubt about the meaningfulness of this type of indicator for Nicaragua in the present circumstances. But, within its own terms, it suggests that, even if Nicaragua's debt were written down to a sustainable level, and the strong export growth of recent years continues, the trade gap is so large that the country's debt would again quickly rise to an unsustainable level.

The second long-term indicator concerns the gap between savings and investment. In this case, the debt is supposed to be sustainable in the long run, and the country should even be able to finance a savings-investment gap with new debt, provided that the growth of GDP exceeds the rate of interest on debt. The figures in Table 4—5 show that through most of the 1990s, the rate of growth of GDP did not exceed the rate of interest on the debt. In fact, it was only at the end of the period, when the figures are strongly influenced by the high growth of nominal GDP in the aftermath of hurricane Mitch, that GDP growth exceeds the interest rate. Nevertheless, if we consider the period from 1994, when GDP growth resumed, through to 2001, average GDP growth was equal to 4.8 per cent, which just exceeds the average interest rate over the same period, which was 4.4 per cent. This indicates that, if Nicaragua had started out with a sustainable ratio of debt to GDP, it could

[85] Only tied donations have been included, since much of the liquid donations was intended to assist in meeting debt service payments, and such assistance would not have been necessary or forthcoming if the debt were already sustainable. A part of the liquid donations should certainly be included here, but, even if it were, the trade gap would still remain extremely high in relation to exports.

have maintained this ratio, provided that only a very small amount of new debt was contracted.

Table 4–5 Long-term sustainability: Investment-saving gap

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Growth of GDP (g_Y), % *	1.8	5.8	5.2	3.7	0.9	3.0	3.4	4.0	4.8	7.3	7.2	7.3
Interest rate (i), %	5.6	4.2	4	4.1	4.6	4.6	4.6	4.6	4.4	4.2	4.6	3.7
$g_Y - i$	-3.8	1.6	1.2	-0.4	-3.7	-1.6	-1.2	-0.6	0.4	3.1	2.6	3.6
$c = (I - S) / Y$	25.3	29.8	26.0	26.1	23.0	31.9	35.7	38.6	42.7	40.2	39.4	35.7
$d = (I - S$ – Tied Aid) / Y	10.7	16.2	11.1	15.2	13.4	22.3	26.7	29.5	33.4	31.6	32.0	30.0
$c / (g_Y - i)$ *	-6.7	18.5	22.3	-64.6	-6.2	-20.4	-29.9	-61.3	96.3	13.0	15.1	9.9
$d / (g_Y – i)$ *	-2.8	10.0	9.6	-37.6	-3.6	-14.3	-22.3	-46.8	75.5	10.2	12.2	8.3

Source: Based on data provided by Banco Central de Nicaragua. Interest rate refers only to foreign debt. I = investment, S = Savings, Y = GDP. * Three-year moving average.

In reality, however, the amount of new debt that Nicaragua acquired was large. The figures in Table 4–5 show that the gap between investment and saving was generally equal to around one third of GDP (see coefficient *c*), which implies a huge dependence on external finance. Even if tied aid is assumed to be used entirely to finance investment (coefficient *d*), the investment-savings gap remains very large. The final two lines of Table 4–5 show the ratio of debt-to-GDP that would be sustainable in the long run, according to this type of analysis. In many of the years this figure is in fact negative, implying that, far from having a debt, the country requires a surplus! This indicates that, as far as the investment-saving gap is concerned, Nicaragua's debt position is definitely not sustainable in the long run.

The final form of long-term sustainability indicator concerns the gap between the government's income and expenditure. In this case the condition for long-run sustainability is that the growth rate of government income should exceed the average rate of interest on debt. Here, it should be noted, the debt refers, not just to the government's foreign debt, but also its domestic debt. Table 4–6 shows that the government's income increased strongly during the period of stabilisation in the early 1990s, but that subsequent growth was more modest, and that government income actually declined slightly in the last two years.[86] Unfortunately, figures are not available for the average rate of interest on both the foreign and the domestic debt, and the table therefore employs that for just the foreign debt. It can be seen that the growth of government income exceeded the interest rate on the foreign debt by a large margin in the early 1990s, and by a smaller margin in most of the rest of the 1990s, but that it was below the interest rate in the last two years. This indicates that, based on just the external debt, it would, in principle, have been possible to have maintained a sustainable level of debt, at least until the final years, although even then there was only a small margin for new debt. In practice, however, there was a substantial fiscal deficit throughout nearly the whole period. The gap between expenditure and income was equal to about one third of income for most of the time (coefficient *e*), and even after taking account of substantial foreign donations, the gap was still frequently equal to ten per cent or more of income (coefficient *f*).

[86] Government income includes tax and non-tax income, but not donations.

Table 4–6 Long-term sustainability: Government income–expenditure gap

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Growth of T (g_T), % *	35.7	30.7	41.5	8.6	5.3	3.2	8.4	10.0	7.9	4.2	-0.9	-0.4
Average interest on debt (i), %	5.6	4.2	4.0	4.1	4.6	4.6	4.6	4.6	4.4	4.2	4.6	3.7
(g_T - i)	30.1	26.5	37.5	4.5	0.7	-1.4	3.8	5.4	3.5	0.0	-5.5	-4.1
$e = (G - T) / T$, % *	137.4	33.7	36.3	35.4	35.4	35.5	38.3	22.7	18.5	45.0	55.9	71.6
$f = (G - T –$ Donations$) / T$, % *	31.4	25.1	-1.2	11.1	9.6	14.3	9.3	6.0	4.7	10.7	22.4	28.2
$e / (g_T - i)$	4.6	1.3	1.0	7.8	50.9	-24.8	10.0	4.2	5.3	–	-10.1	-17.4
$f / (g_T - i)$	1.0	0.9	0.0	2.5	13.8	-10.0	2.4	1.1	1.3	–	-4.1	-6.8

Source: Based on data provided by Banco Central de Nicaragua.
T = Government income, *G* = Government expenditure. * Three-year moving average.

The last two lines of Table 4–6 indicate the ratio of debt to government income that should be sustainable in the long run. It might be noted that, according to the criteria for sustainability established by the HIPC Initiative, the ratio of debt to government income should not exceed 2.5. The figures in the table are, once again, negative in some years, indicating that sustainability would require a surplus rather than a debt. The penultimate row of the table shows that, without donations, the level of debt that emerges was rarely at a sustainable level. The final row, which includes donations in government income is a little more favourable, but even here the figure that emerges is positive and less than 2.5 in only half the years, indicating that the prospects for sustainability were not strong.

The position concerning long-term sustainability in relation to the fiscal gap is, in fact, even less favourable than suggested by these figures. This is because, in addition to the foreign debt, the government also incurred a large domestic debt in the 1990s. The rapid build-up of the domestic debt since the mid-1990s can be seen from the figures in Table 4–7, and by 2001, the total stood at 1.6 billion US dollars.

The largest item in the domestic debt is the *Bonos de Pago por Indemnización* (BPIs). These are bonds issued to compensate property owners considered to have been unjustly expropriated under the Sandinista government, but where it is not practical to return the property, often because it had been distributed to poor farmers.[87] BPIs were first issued in 1993, and have a maturity of 15 years, with a ten year grace period on capital repayments, and interest rates of between 3 and 5 per cent, depending on when they were issued. They are denominated in cordobas but are indexed to the US dollar. At the end of 2001, their value amounted to USD 763 million. Until now, the government has only had to meet the interest payments, but from 2004 the first repayments of capital will become due.[88]

The second largest item is the *Certificados Negociables de Inversion* (CENIs). As noted above, these were initially created in 1995 in order to enable the Central Bank to conduct monetary policy through open market operations. They are short-term instruments, mostly with a maturity of 6 or 12 months, and, like the BPIs, they are denominated in cordobas

---

[87] The Chamorro government considered that the expropriation of property from the Somozas, who ruled Nicaragua from the 1930s until 1979, and their closest allies, was legitimate.
[88] The repayments should be equal to 20 per cent per year of the face value of the bonds falling due. Expectations that the government will be able to meet these payments are low, and the bonds are currently traded in a secondary market at around 35 per cent of their face value. According to indications from the Ministry of Finance, it seems likely that these obligations will be met by issuing new bonds.

but indexed to the US dollar. The CENIs however, pay much higher rates of interest than the BPIs. Rates have generally been at least 15 per cent, and they reached 23 per cent immediately prior to the elections in October 2001, although they have since fallen to under 9 per cent.[89] At the end of 2001, the value of outstanding CENIs amounted to USD 558 million. Of this USD 347 million worth were issued to finance liabilities incurred through the closure of four private banks in the course of 2000 and 2001. The largest of the four banks collapsed as a result of fraud, but in a broader sense, the failure of all the banks was linked to weak supervision and the rapid drive to create private banks in Nicaragua which was one of the policies insisted on by the international financial institutions. A significant part of the remaining CENIs was issued to finance non-budgeted spending by the Alemán government, especially in the period prior to the elections in 2001. An emergency programme for coffee producers, hit by the sharp fall in world prices, was also financed with CENIs.

Table 4–7 Nicaragua: Domestic public debt (USD million)

	Initials	1996	1997	2000	2001
Debt with the private sector		**461.4**	**898.9**	**1,050.9**	**1,480.3**
Bonos de Pago por Indemnisacion	BPI	348.5	427.0	639.2	763.2
Certificados de Beneficio Tributario	CBT	24.3	16.1	0.4	0.1
Other domestic private debt		41.9	75.3	85.3	95.8
Certificados Negociables de Inversion	CENIs	45.8	344.0	278.0	558.0
Bank closures				73.0	347.3
Auctions				205.0	200.5
Coffee				0.0	10.1
Titulos especiales de Liquidez	TEL				41.1
Foreign currency bonds	BOMEX	0.8	0.5	48.0	22.1
Inter-institutional debt		**24.4**	**48.8**	**45.1**	**165.5**
Treasury bonds		24.4	48.8	9.3	137.1
Discounted by the Central Bank	BT	24.4	48.8	9.3	102.0
Discounted by other public institutions		0.0	0.0	0.0	35.1
Titulos Especiales de Inversion	TEI	0.0	0.0	35.8	28.4
Total		**485.8**	**947.8**	**1,096.0**	**1,645.9**

Source: Banco Central de Nicaragua, *Informe Annual,* 2001, p. 107. Cordoba values converted at end of year exchange rate.

Because of the very high interest rate paid by CENIs, the interest rate on the domestic debt is much higher than that on the foreign debt. In a study by Sebastion Edwards (2001, p. 32), which draws on Central Bank data, the interest rate on the domestic debt is assumed to be 15 per cent. This would imply that the average interest rate on external and domestic debt would be around 6 per cent by the end of the period.[90] In that case, the margin by which the growth of government income exceeds the average rate of interest (the third line in Table 4–6) would be further reduced, especially at the end of the period,

[89] Details of the CENIs interest-rate structure are given in Table IV-16 of the Central Bank's monthly publication, *Boletin Económico,* which is available on the Bank's web site, www.bcn.gob.ni

[90] This is a rough estimate based on a weighted average of 6.4 billion dollars external debt at 4 per cent, and 1.6 billion dollars domestic debt at 15 per cent. Edwards' estimate may be a little high in view of the lower rate on BPIs.

when the domestic debt was largest. This further strengthens the implication that, even if Nicaragua's debt were to be reduced to a sustainable level, the growth rate of government income is not sufficient to cover the interest that has to be paid, let alone to enable the government to finance a deficit and increased borrowing.

At a time, when Nicaragua has been striving to make some headway in dealing with its external debt, the growth of the domestic debt represents a major problem for the government, and raises a number of important questions. One question concerns the impact of the domestic debt on the financing of investment. According to the Central Bank, CENIs have mainly been purchased by private banks. They have, consequently, provide the banks with a very secure, and highly remunerative alternative to financing productive investment. As several of the private sector representatives we interviewed stressed, a lack of financing is one of the major constraints faced by both agricultural and industrial producers, and this problem may have been exacerbated by the existence of attractive financial alternatives for the banks.

A second issue concerns that beneficiaries of the present situation. While the main purchasers of the CENIs are the banks, they are in part acting for wealthy Nicaraguans, and, in some cases, foreign residents. Furthermore, while the cost of servicing the domestic debt is high, a number of senior government officials are in fact closely linked to the banks, and face a potential conflict of interest. The most striking examples are the Minister of Finance, Eduardo Montealegre, who stems from the Banco de Crédito Centroamericano, and President Bolanos' principal economic adviser, Carlos Pellas, who is one of the main owners of the Banco de America Central.[91]

A third issue involves the impact of the HIPC Initiative on the domestic debt. According to the Central Bank, it should be possible to refinance the domestic debt in international markets with longer maturities and lower interest rates than those that it currently has to offer in order to raise capital through CENIs. However, under the terms of the HIPC Initiative, countries are only allowed to engage in new external borrowing if it is on concessional terms, and further borrowing on non-concessional is strictly prohibited.

Finally, while the analysis in chapter 3 indicated that the relief that will be forthcoming under the HIPC Initiative might be considerably less than has been expected, it is likely that a significant part of any relief that is forthcoming will have to be dedicated to servicing the domestic debt, rather than to promoting development and poverty reduction.

4.8 Conclusion

As a result of debt relief, the main indicators of indebtedness in terms of GDP and exports have improved considerably, although they still remain very high by international standards. While part of the improvement in the indicators is due to debt relief, around one half is due to the fact that a decade of economic stagnation or decline came to an end, and from 1994 both exports and output began to increase. Nevertheless, the economy remains vulnerable to climatic and world market conditions, and in 2001, growth slowed notably.

Despite debt relief, government spending on debt service actually increased through much of the 1990s, and social spending remained flat. It was only in the aftermath of hurricane Mitch, when Nicaragua received substantial additional foreign aid, and special relief on debt service from the Paris Club, that social spending increased. Some social indicators, including life expectancy and infant mortality, registered an improvement, but

[91] See *Envio,* Number 247, October 2002.

figures for child malnutrition showed a worrying deterioration. Household surveys indicate that the proportion of the population living in poverty has declined, but the figures for poverty are still very high, and in some regions of the country have increased. Furthermore, as a result of population growth, the total number of people living in poverty has increased.

Private investment, which was very low in the early 1990s, picked up markedly from 1996. However, while the reestablishment of financial order in the early 1990s will have contributed to this, it is difficult to identify a more direct link with the process of debt relief. Rather, it seems that the resumption of economic growth, and the election of a more strongly anti-Sandinista government were probably of greater direct significance.

Finally, despite the improvement in Nicaragua's short-term debt indicators, the outlook for future long-term debt sustainability is bleak. The country has large gaps between exports and imports, savings and investment, and government income and expenditure. These are currently financed from abroad by new loans and donations. The long-term sustainability indicators show that, even if the current debt were written down to a sustainable level, unless the financial gaps were covered predominantly by donations, the need for new external finance would result in the debt once again rising to an unsustainable level.

5 RELEVANCE

This final chapter assesses the relevance of debt relief, by answering the question whether debt relief has enhanced economic growth and poverty reduction. In so doing, we draw on the findings of the earlier chapters. If debt relief had any effect on Nicaragua's economic growth, it could have been through its flow effect, its stock effect and through the conditions attached to the relief. The first section analyzes the impact of debt flow and stock reductions on economic growth, while the second section looks at the effect of the conditions for debt relief on economic growth. During most of the 1990s, poverty reduction was not an official objective of, nor a condition for debt relief, so it is a bit artificial to try and trace this relationship over the evaluation period. Nevertheless, there may have been an effect on poverty reduction through the impact of debt relief on growth and through possible increases in social expenditure as a result of debt relief freeing government resources. The third section examines these effects, and also analyzes the possible effects of the HIPC Initiative and its accompanying PRSP on poverty reduction. The final section draws some conclusions on the relevance of Dutch debt relief.

5.1 Debt relief and economic growth

Figure 4—3 shows that economic growth has been positive since 1994, with a peak in 1999 as a result of the large aid inflow after hurricane Mitch. However, as a result of population growth of about 3% per year, growth per capita has been modest over the 1990s. To what extent has this growth been due to debt relief?

Chapter 3 shows that the flow effect from debt relief has been limited, because most debt relief provided over the 1990s was on debt stocks on which no service payments were being made. Part of the debt flow relief, especially during the early 1990s, was also on debts that were not being serviced. Furthermore, some stock reductions and flow reschedulings increased the debt service flow later in the decade. Actual debt service paid remained more or less constant over the decade, in spite of a lower debt stock. In most years, debt service paid exceeded the flow effect from debt relief.

However, the flow effect from debt relief cannot be separated from the flow effect of aid, and in particular of liquid aid. If we combine both flows, a positive balance results. The last section of chapter 3 finds that without aid and debt relief, imports would have been at the very low level of only about USD 200 million during the early 1990s, which would probably have meant a further contraction of GDP. So if we add aid, there has been an important flow effect on the balance of payments, particularly in the early 1990s. In the second half of the 1990s, if there had been no aid or debt relief, the level of imports would only have been about 60% of actual imports, if debt service had been paid at actual values. In this period, and partly due to abundant foreign grants and loans, imports continued to rise while exports stagnated. Given the high and rising share of consumer goods, it can be doubted whether all these imports have been used well from a development perspective. In addition, foreign aid was partly in the form of loans, and this contributed to creating an economic situation that was less sustainable in the long run.

Since actually paid debt service has not decreased over the 1990s, there could be hardly any positive effect from debt relief on government expenditure. Also in this area, aid flows did have an effect, in particular on public investment, as most of it is financed by foreign aid. Public investment has been at around USD 200 million since 1992, but increased to over USD 300 million in 1999-2001 as a result of the additional aid inflows in the aftermath of hurricane Mitch. Public investment may have crowded in some private investment. Especially during the first half of the 1990s, public investment often meant the

reconstruction of much needed infrastructure, that allowed private investment to increase later on. Private investment was low for a long time, but began to increase in 1996, after Nicaragua registered positive growth rates.
Debt relief during the 1990s led to a significant reduction in Nicaragua's debt stock, from about USD 10 billion to around USD 6 billion. The main reductions came about in 1995 and 1996, and were the result of large write-offs by the former Soviet Union, Mexico, Germany (for debt inherited from former East Germany) and private creditors (through a commercial debt buyback, partly financed by official creditors). As a result of these reductions, Nicaragua's debt sustainability indicators improved. The debt/GDP ratio declined from more than 600% in the early 1990s to about 300% later in the decade, and the debt/exports ratio from 3,000% to about 700% (see Figure 4—1). However, these ratios were clearly still at unsustainable levels by the end of the decade. As a result of debt relief, the gap between debt service due and debt service paid did become much smaller in the late 1990s, although it rose again in 2001.

The fact that the debt was still grossly unsustainable by the end of the 1990s is probably the main reason why the debt stock reductions are unlikely to have had any influence on private investment or on the inflow of foreign private capital. Although private investment increased from 1996 onwards, other factors such as the resumption of economic growth since 1994 were probably more important. Foreign direct investment (FDI) was very low in the early 1990s and began to increase steadily from 1993 onwards. But this was probably the result of the return of financial stability and capitalist order in the 1990s.

Growth during the 1990s has been based on an expansion of agricultural production, on an expansion of construction and commerce, and recently also on an expansion of the export processing zones. This does not augur well for the future. Growth already declined to 3% in 2001 as a result of the low international coffee prices, the end of the post-Mitch construction boom and the slowdown of the US economy. Further growth in agricultural production would require investment, and financing for these investments is hardly available. Domestic interest rates are very high, and the fully privatised financial sector prefers to invest in high-yielding government bonds or in commerce, rather than in more risky production activities.

In sum, debt relief hardly freed resources for the Nicaraguan goverment. Although a substantial debt stock reduction was achieved, this did not have the expected effect on the debt overhang because the debt remained at unsustainable levels. Debt relief has been too limited to have had an impact on growth. The question is whether this will change with the HIPC Initiative. The HIPC Initiative is expected to bring the NPV of debt down by 72%. However, in the short term there will not be any positive flow effects from the HIPC Initiative. First, the multilateral debt relief will be provided on the debts contracted before 2002, and is given as a fixed percentage of debt service due. Since the multilateral banks began to lend to Nicaragua in 1991 and these loans carry a ten year grace period, debt service due will increase every year from 2001 onwards. This means that although HIPC relief will increase in future years, so will the remaining multilateral debt service that has to be paid . As far as the Paris Club debt is concerned, the expected 90 (in some cases 100) per cent forgiveness on the stock of pre-cutoff date Paris Club debt will not make any difference to actual debt service payments, because Nicaragua has not paid debt service on pre-cutoff date debt to these creditors since hurricane Mitch. Debt service to other creditors could even increase with the HIPC Initiative, if agreements are reached with these “sleeping creditors” . This means that the current high level of debt service payments will continue, and could even increase.

The reaching of the HIPC Completion Point is expected to bring about a further reduction of the debt stock, thus further lowering the gap between debt service due and debt service paid. At the same time, however, new debts will continue to be contracted, especially with the multilateral institutions. The long-term sustainability analysis indicates that, if Nicaragua's debt were reduced to a sustainable level, the rate of growth of output and exports achieved after 1994 would, if continued, be sufficient to support a small amount of new borrowing, but that the actual level of new borrowing far exceeds this amount.

Sustainability is further complicated by the fact that the government has also acquired a substantial internal debt, equal to USD 1.6 billion the end of 2001. This carries a much higher rate of interest than the external debt, and has provided local banks with a secure and highly remunerative investment, probably to the detriment of the financing of domestic production. A further irony is that, because the terms of the HIPC Initiative prohibit countries from contracting additional external domestic debt on non-concessional terms, the government is prevented from refinancing the internal debt abroad, even though this would enable it to obtain more favourable terms with longer maturities and lower interest rates than at present. As a result, it is likely that a significant part of any relief arising from the HIPC Initiative will have to be diverted to servicing the internal debt.

5.2 Debt relief conditions and growth

Paris Club creditors held only about 13% of Nicaragua's debt in 1990, but they are important since they have been the main aid donors and they dominate the multilateral institutions. This group of creditors was the only one to attach policy conditions to its debt relief.[92] Until 1999, the main condition for debt relief was that Nicaragua had an agreement with the IMF. Once an IMF arrangement was in place, the Paris Club made its own agreement with Nicaragua, usually covering the same period as the IMF arrangement. It was adhered to, no matter whether the IMF programme got off-track. As donors, Paris Club creditors usually did not come up with policy conditions for their aid. However, the small group of bilateral donors that also provides programme aid (liquid resources) based their decisions on the existence of an IMF agreement, and also on whether the country remained on-track. In some cases other policy conditions were added, generally related to good governance. As a rule , bilateral donors have not interfered in macroeconomic and reform policies, and just followed the judgements of the IFIs.[93] The question is whether the main condition of Paris Club creditors and donors, i.e. the consecutive IMF agreements, have contributed to economic growth in Nicaragua.

A first finding of this study (and also of a previous similar study by one of the present authors, see Dijkstra 1999) is that overall compliance with IMF targets was generally weak. The same is true as regards meeting the policy conditions attached to the adjustment loans made by the World Bank and the IDB that accompanied the IMF agreements. Fiscal and monetary targets were usually only met during the first year after an agreement was reached, and this compliance was to a large extent due to generous flows of liquid resources in the first year of the agreement. Otherwise, Nicaragua has been almost permanently off-track with the IMF. Although measures were taken such as cuts in government spending or tax increases, very often these were nullified by increases in spending in the larger public sector (losses of state banks, for example), or softened by allowing tax exemptions. While the visible fiscal cuts and tax and tariff increases usually had adverse income consequences for the poor and the middle income groups (lower salaries for teachers and health workers, reduced availability of public health care at all, price increases for public transport, electricity, etc.), the much less visible countervailing actions usually benefited the rich.

---

[92] The US (which is a member of the Paris Club) had many additional policy conditions for its aid and debt relief.

[93] The exception is Sweden, that has several times invited well-known economic experts such as Vittorio Corbo to come to Nicaragua and to advise the Nicaraguan government.

In the area of the structural reforms, doubts can also be raised about whether the prescribed policies enhanced economic growth. The change in power from a socialist oriented government to a capitalist order in 1990 already brought about substantial reforms, such as the liberalisation of foreign exchange and the privatisation of state owned enterprises. The IFIs, in particular the World Bank and the IDB, underestimated the nature of the institutional changes required for these changes, and the potential political disruptions that would accompany them. They went on to prescribe immediately many more liberalisation measures, thus risking more political upheavals, and overburdening administrative and institutional capacities. In other countries, for example Uganda, the World Bank displayed more comprehension for these matters, stating, for example: "With the benefit of hindsight, it was important to avoid the temptation of burdening the reforms programme with other measures, such as public enterprise or financial sector reform, … " (World Bank, 1997: 11). As also argued in Dijkstra (1999), more realistic reform targets would have led to more compliance, and would have avoided the disruptive stop-go process in the disbursement of programme aid. It would also have enhanced political stability.

In addition, several of the required measures proved not to be wholly beneficial for Nicaragua. First, on the instigation of, in particular, USAID and the IDB, private banks were promoted as early as 1991, long before an adequate regime of banking regulation and supervision was in place. Private banks were in the interest of rich entrepreneurs. They could use them to attract money and to invest in speculative and risky activities. Several of these banks failed later in the 1990s, at a high cost for the government.

Second, the IMF and the World Bank also called for rapid trade liberalisation, and tariffs were reduced rapidly between 1991 and 1993. This was in the interest of some big import houses, but harmed domestic manufacturing industry, including many small-scale enterprises. A more gradual process would probably have had a less destructive effect. In addition, there were exemptions to the tariff reductions, and these proved to benefit enterprises whose owners were close to the government (Dijkstra, 1996). Overall tariff levels were raised again in the following years, so that tariff reductions remained a condition for the next two ESAFs. During the discussions on the second ESAF in 1997 it was also found that, despite the "trade liberalisation", companies still needed permits for importing, and that this also allowed the government to exercise discretion. At the instigation of the IMF, these permits were abolished in 1997, but only after an intense debate in the National Assembly – clear evidence that important interests were affected.

Third, in the early 1990s there was a lot of discussion about the properties that had been nationalised during the 1980s. If these could not be returned to former owners, the donors required indemnity payments. Since the Nicaraguan government did not have the cash money for these payments, bonds were issued on a large scale. These BPIs (Bonos de Pago de Indemnización) were the beginning of the domestic debt of Nicaragua, falling due from 2004 onwards and constituting a heavy fiscal burden.

Fourth, the donors demanded that public utility enterprises be privatised.[94] As described in earlier chapters, this was only implemented much later. On the one hand, there was strong domestic resistance to privatisation, on the other, there was limited foreign interest in these enterprises. Donor pressure finally led to their sale, but were there any gains to the government? The profitable state telecommunications company, for example, was

[94] According to some, the most important reason for this demand was that it would provide the government with cash for the indemnity payments.

divested in 2001 at a very low price, and Nicaraguan companies complained about tariff increases afterwards.

Fifth, the state banks were finally closed or sold off, but at a very high cost to the multilateral institutions, which had first spent large amounts of money to “restructure” them and then covered the remaining losses or subsidised private banks willing to take over parts of the state banks. Although closures of these state banks were perhaps unavoidable , given their large bad loan portfolios and the political interference in the banks, these measures did not help solve the general financing problem in Nicaragua: the very high domestic interest rates and the lack of financing for domestic production and investment.

All in all, during most of the 1990s there has been very little discussion of the fiscal, monetary and reform targets set by the IFIs. Bilateral donors just followed the judgements of the IFIs and they disbursed programme aid if Nicaragua performed well in the eyes of the IFIs. This lack of discussion on economic policies probably affected the quality of these policies. A first sign that bilateral donors had become more critical of the contents of agreements with the IFIs was visible in the context of the preparations for ESAF 2 in late 1997. As described in chapter 2, a group of bilateral donors called for more attention to social spending in the ESAF agreement. With the enhanced HIPC Initiative and the elaboration of the PRSP, this attention to poverty reduction has increased. The next section looks at the (potential) effects of this increased attention.

5.3 Debt relief and poverty reduction

Debt relief can lead to poverty reduction via three channels:

- through its contribution to economic growth, provided that this growth is sufficiently pro-poor to reduce poverty;
- when debt relief frees resources and these resources lead to more social spending so that social indicators improve or can be expected to improve in the future;
- through the conditions attached to debt relief, if these conditions are focused on poverty reduction policies, and if they are implemented.

We concluded above that there was very little, if any, impact of debt relief on economic growth. We also concluded that debt relief freed very little resources. However, if we add aid, there was a sizable flow effect from aid plus debt relief. This could have induced increases in social spending. In turn, and with some time lag, such increases could have improved the well being of the poor.

In practice, social spending registered a low in 1991 despite the parallel fall in defence expenditure (Table 4—1). Between 1992 and 1998, social spending remained at about the same level in nominal USD terms, while falling between 1995 and 1998 as a percentage of total expenditure. In the post-Mitch years, social expenditure was higher in both absolute terms and as a share of total spending. This confirms the importance of aid as opposed to debt relief in increasing the availability of government resources. However, it is likely that most aid during the period was directed to investment projects in the social sectors, so that a (more or less) stable spending level during the 1990s will have been accompanied by lower recurrent expenditure, with long-run risks for the quality of teaching and health care, and the maintenance of facilities. Social indicators point to a mixed outcome. The official figures for life expectancy and infant mortality in the 1990s record a continuation of the steady improvement registered in previous periods. However, figures for child malnutrition and for school enrolment evidence a worrying deterioration in the second half of the decade. The results of household surveys show a decline in the incidence of both poverty and extreme proverty at a national level, although some parts of the country registered a deterioration. Furthermore, because of population growth, the results imply that the actual number of people living below the poverty line will have increased.

As explained earlier in this chapter, until 1999 conditions for aid or debt relief did not include policies leading to poverty reduction or increased social spending. This changed with the enhanced HIPC Initiative. In order to qualify for HIPC relief, Nicaragua had to elaborate a Poverty Reduction Strategy Paper (PRSP) in a participatory way. Chapter 3 concluded that there has been an extensive consultation process, but that this does not seem to have had much influence on the contents of the PRSP. The influence of the IFIs has been dominant in setting the actual spending priorities proposed in the PRSP. This dominance of the IFIs in the formulation of the strategy has reduced both participation and ownership.

Several criticisms have also been raised against the contents of the PRSP. The most important of these is that there is insufficient attention to economic growth, production and employment and that the strategy is too welfare-oriented., As also occurred in the 1990s, debate on the most appropriate macroeconomic policies and strategies again seems to be lacking. Most donors are satisfied that a PRSP has been produced. But, if the PRSP does not contain a sound strategy for growth and poverty reduction, implementing this strategy – and focusing all aid activities on this strategy, as seems to be the current aid policy of the Netherlands – will only hamper the country’s sustainable growth prospects.

When it comes to the spending priorities as defined in the PRSP and the allocation of the supposed HIPC savings, these are focused on ten particular projects and programmes. They are almost entirely related to the second and third pillars of the strategy (investment in human capital, and protection of vulnerable groups, respectively). The IFIs also required the detailed monitoring of these ten projects. This micromanagement of the use of resources has been shown earlier (White and Dijkstra, 2003) to be ineffective and inefficient: it is ineffective because money is fungible, and inefficient because the detailed monitoring and reporting on specific projects distracts attention from improving overal budgeting and monitoring systems. If the PRSP and its conditionality were to increase attention to improving these general budgeting and accounting systems, there could be positive “systemic effects”.

The period in which Nicaragua attempted to qualify for HIPC was one in which donors, and especially bilateral donors, were very unhappy with the Nicaraguan governance. Donors complained about increasing corruption, about the lack of independence of the judiciary and the Comptroller General’s Office, and about the lack of a serious commitment to poverty reduction. Furthermore, in 1999 it was already clear that government spending had begun to exceed IMF targets and this non-compliance with the IMF deteriorated further in the following years. Nevertheless, the country was admitted to the HIPC Decision Point in December 2000 and saw its full PRSP endorsed by the Boards of the IFIs in August 2001. This occurred despite the concerns about governance and despite the failure to meet IMF targets. In both cases, other donor objectives changed the balance in favour of Nicaragua. Pressure for debt relief was decisive in the first, and preventing an election victory by the opposition in the second. This continuous approval in the midst of donor dissatisfaction about Nicaragua’s policies has led to the formulation of an extensive list of conditions for the Completion Point. It appears that the return to an on-track position with the IMF is the most severe of these, and the most difficult from the viewpoint of the government.

5.4 The relevance of Dutch debt relief

The overall conclusions on relevance of debt relief also hold for Dutch debt relief. Although a relatively large percentage (67%) of Dutch debt relief had a flow effect, and so reduced the debt service burden, Nicaragua’s overall debt service burden did not register a decrease during the evaluation period. Dutch debt relief also helped in reducing the debt stock, but the overall stock reduction was still too limited to have any effects on economic growth. Doubts can also be raised on the relevance of the conditions set for debt relief during the 1990s, the existence of an IMF agreement and the accompanying conditionality from the World Bank and the IDB. They were only weakly implemented, and to the extent they were, it is doubtful whether these policies enhanced economic growth.

In late 1998, Nicaragua was selected by the Netherlands as one of the 17 programme countries on which bilateral aid would be concentrated. The selection criteria included good policy and good governance. However, donors in general, and Dutch Embassy staff in particular, were very dissatisfied with governance during the Alemán administration (1997-2002). This general dissatisfaction did lead to more prior conditions for the different steps of the HIPC Initiative, but so far this has not prevented Nicaragua from qualifying. Contradictions were also visible within the Netherlands. On at least two occasions generous decisions on macroeconomic support in the Hague conflicted with the more critical stance of the Embassy: the provision of budget support at the end of 1999 and the full forgiveness of the bilateral aid debt stock in August 2001. This reduced the effectiveness of conditions set for aid and debt relief.

The HIPC Initiative also implies that PRSPs are elaborated on the basis of ownership and participation. Once these PRSPs exist, it is envisaged that donors will integrate their aid allocations with the PRSPs, and coordinate the monitoring of their aid with the monitoring of the PRSPs. The Netherlands is one of the warm supporters of this aid strategy. However, in the Nicaraguan case it seems that a) there are many doubts about whether the PRSP and the actual strategy outlined in it will enhance sustainable growth and poverty reduction; b) there has been very little ownership and very little effective participation in the concrete strategy, as IFI influence has been dominant; and c) the monitoring of the strategy as currently foreseen seems to imply ineffective and inefficient micromanagement, distracting the attention of the government and donors from improvements in broader budgeting and accounting procedures.

ANNEXES

ANNEX A REFERENCES

Abrego, Lisandro, & Ross, Doris C. (2001). Debt Relief under the HIPC Initiative: Context and Outlook for Debt Sustainability and Resource Flow (Working Paper 01/144). Washington: IMF.

Andrews, David, Boote, Anthony R., Rizavi, Syed S., & Singh, Sukhwinder. (1999). Debt Relief for Low-Income Countries: The Enhanced HIPC Initiative (Pamphlet Series No. 51). Washington DC: IMF.

Banco Central de Nicaragua. *Boletín Económico*, available from www.bcn.gob.ni

Banco Central de Nicaragua. (2001). *Nicaragua: Indicadores Económicos 1960-1999*. Managua: Banco Central de Nicaragua.

Berthélemy, Jean-Claude. (2001). HIPC debt relief and policy reform incentives. Paper for WIDER Conference on Debt Relief, Helsinki.

Bulmer-Thomas, Victor. (1987). *The Political Economy of Central America since 1920*. Cambridge: Cambridge University Press.

Castro-Monge, Ligia Maria. (2001). "Nicaragua and the HIPC Initiative: The tortuous journey to debt relief". *Canadian Journal of Development Studies*, 417-453.

DGIS. (1990). Memorandum: Report of the International Donor Conference on Nicaragua, Rome, 6-7 June (Plv-124). The Hague: Directorate General for International Cooperation (DGIS).

Dijkstra, A. Geske. (1996). "The impact of structural adjustment programs on manufacturing: Lessons from Nicaragua". *World Development*, 24(3), 535-547.

Dijkstra, Geske. (1999). Debt, Dependence and Fragile Development: Programme aid to Nicaragua (Sida Evaluation Report 1999/17: 4). Stockholm: Sida.

Dijkstra, A. Geske. (2002). "The effectiveness of policy conditionality: Eight country experiences". *Development and Change*, 33(2), 307-334.

DWH/MC. (2000). Report of the PRSP process in Nicaragua and Honduras (Memorandum). The Hague: Ministry of Foreign Affairs.

Edwards, Sebastian. (2002). Debt Relief and Fiscal Sustainabaility (NBER Working Paper 8939). Cambridge: National Bureau of Economic Research.

Evans, Trevor. (1995). "The impact of structural adjustment on the public sector in Nicaragua". In Trevor Evans, Carlos Castro, & Jennifer Jones (Eds.), *Structural adjustment and the public sector in Central America and the Caribbean* (pp. 166-246). Managua: CRIES.

Everingham, Mark. (1998). "Neoliberalism in a new democracy: Elite politics and state reform in Nicaragua". *The Journal of Developing Areas* (Winter), 237-263.

Gillis, Malcolm, Perkins, Dwight H., Roemer, Michael, & Snodgrass, Donald R. (1996). *Economics of Development*. (4th ed.). New York/London: Norton.

Gobierno de Nicaragua, Ministerio de Cooperación Externa. (1996). *Negociaciones de deuda externa: 1990-1996*. Managua: Ministerio de Cooperación Externa.

Gobierno de la República de Nicaragua, SETEC, & FSS. (2002). Mecanismo para el Manejo de Recursos HIPC, Borrador a febrero 2002. Managua: SETEC/FSS.

Government of Nicaragua. (2000). A Strengthened Poverty Reduction Strategy (I-PRSP). Managua: República de Nicaragua.

Government of Nicaragua. (2001). A Strengthened Growth and Poverty Reduction Strategy (PRSP). Managua: República de Nicaragua.

IDA, & IMF. (2000). Nicaragua: Decision point document for the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative. Washington: IMF and IDA.

IDA and IMF. (2001). Nicaragua PRSP: Joint Staff Assessment. Washington: World Bank and IMF.

IMF. (1992). Nicaragua: Review under Stand-By Arrangement (EBS/92/17). Washington: IMF.

IOB. (2002). *Nederlands schuldverlichtingsbeleid 1990-1999*. The Hague: IOB.

Leogrande, William M. (1996). "Making the economy scream: the US economic sanctions against Nicaragua". *Third World Quarterly*, 17(2), 329-348.

Meijer, R. (1991). Report of Paris Club meeting with Nicaragua, December 1991 in Paris (in Dutch). Amsterdam: NCM.

Neira, Oscar. (1996). "Una puente sobre el puente: El ESAF y sus perspectivas". In Oscar Neira (Ed.), *ESAF; Condicionalidad y deuda: Nada por nada o nada por menos?* (pp. 45-55). Managua: CRIES.

Nieuwsdienst La Ventana. (2002). Nicaragua: Vorige president beschuldigd van fraude, huidige ook (Vol. 2002): *La Ventana* (email).

O'Connell, Stephen A., & Soludo, Charles C. (2001). "Aid intensity in Africa". *World Development*, 29(9), 1527-1552.

Paris Club. (1995). Agreed Minute on the Consolidation of the Debt of the Republic of Nicaragua. Paris: Paris Club.

Paris Club. (1998). Agreed minute on the consolidation of the debt of the Republic of Nicaragua. Paris: Paris Club.

Sutcliffe, Bob. (2001). *100 Ways of Seeing an Unequal World*. London: Zed Books.
Weinert, Richard. (1981). "Nicaragua's debt renegotiation". *Cambridge Journal of Economics*, 5, 187-94.

White, Howard N., & Dijkstra, A. Geske. 2003. *Programme Aid and Development: Beyond Conditionality*. London: Routledge.

World Bank. (1997). Implementation Completion Report Uganda, Structural Adjustment Credit 1 (No. 16797). Washington: World Bank.

World Bank, IMF, IDB, & Government of Nicaragua. (1990). Nicaragua: Medium-term economic outlook and financing scenarios.

World Bank. (2001a). Global Development Finance (Vol. 2001): World Bank.

World Bank. (2001b). Nicaragua Poverty Assessment: Challenges and Opportunities for Poverty Reduction, Volume 1: Main Report (Report 20488-NI). Washington: World Bank.

ANNEX B

Table B—1. Scenario 1: No aid, no debt relief, exports 5% higher than actual, debt service paid as actual, all other flows as actual

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Sources:												
Exports	314	258	212	257	318	443	443	548	544	518	613	562
Remittances	15	15	10	25	50	75	95	150	200	300	320	336
Aid	0	0	0	0	0	0	0	0	0	0	0	0
Net private capital	-179	-45	129	173	197	240	374	870	344	538	379	412
Debt forgiveness	0	0	0	0	0	0	0	0	0	0	0	0
Debt rescheduling and interest capitalisation	0	0	0	0	0	0	0	0	0	0	0	0
Arrears accumulation	600	784	1081	774	1223	687	563	153	91	98	106	58
Change in reserves	33	-2	5	100	-69	9	-79	-212	50	-51	38	108
Total	783	1010	1437	1329	1720	1454	1396	1509	1229	1403	1456	1477
Uses:												
Imports	77	-768	119	170	186	353	524	996	798	1018	1035	1056
Net non-factor services	67	96	70	68	43	73	75	19	11	42	32	37
Debt service (due)	639	1682	1248	1091	1491	1028	797	494	420	343	389	384
Payment of arrears	0	0	0	0	0	0	0	0	0	0	0	0
Total	783	1010	1437	1329	1720	1454	1396	1509	1229	1403	1456	1477
Scenario imports/actual imports (%)	14	-115	15	25	24	40	50	73	57	60	63	65

Source: Elaboration of Table 3—3.

Tabel B—2. Scenario 2: No aid, no debt relief, exports 5% higher than actual, debt service paid as actual, all other flows as actual

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Sources:												
Exports	314	258	212	257	318	443	443	548	544	518	613	562
Remittances	15	15	10	25	50	75	95	150	200	300	320	336
Aid	0	0	0	0	0	0	0	0	0	0	0	0
Net private capital	-179	-45	129	173	197	240	374	870	344	538	379	412
Debt forgiveness	0	0	0	0	0	0	0	0	0	0	0	0
Debt rescheduling and interest capitalisation	0	0	0	0	0	0	0	0	0	0	0	0
Arrears accumulation	639	1682	1248	1091	1491	1028	797	494	420	343	389	384
Change in reserves	33	-2	5	100	-69	9	-79	-212	50	-51	38	108
Total	822	1908	1604	1646	1988	1795	1630	1850	1558	1648	1739	1803
Uses:												
Imports	116	130	286	487	454	694	758	1337	1127	1263	1318	1382
Net non-factor services	67	96	70	68	43	73	75	19	11	42	32	37
Debt service (due)	639	1682	1248	1091	1491	1028	797	494	420	343	389	384
Payment of arrears	0	0	0	0	0	0	0	0	0	0	0	0
Total	822	1908	1604	1646	1988	1795	1630	1850	1558	1648	1739	1803
Scenario imports/actual imports	20	19	36	72	58	79	73	98	81	74	80	85

Sources: Elaboraiton of Table 3—3.

ANNEX C LIST OF PERSONS MET

Government of Nicaragua

Secretaría Técnica de la Presidencia (SETEC)
Mr Mario Arana, Director
Mr Amando Navarrete Mena, Adviser

Ministry of Finance and Public Credit
General Direction for Public Credit
Ms Mayela Castillo Sánchez, General Director

Central Bank of Nicaragua
Mr Mario B. Alonso Icabalceta, President
Mr Mario J. Flores, General Director
Mr José Márquez Ceas, Director International Area
Mr Carlos Sequeira L., Vice-manager External debt administration

Ministry of Education, Culture and Sports
Mr Silvio de Franco, Minister
Ms Miriam Zablah de Bandes, Vice minister
Mr Luis Adolfo Medal Mendieta, General Manager Education

Multilateral institutions

Iinternational Monetary Fund
Mr Joaquín Harnack, Resident Representative

World Bank
Mr Ulrich Lächler, Representative

Inter-American Development Bank
Mr Eduardo Balcarcel, Representative

United Nations Development Programme
Ms María Rosa Renzi, Director

Bilateral donors
The Netherlands Embassy
Mr Kees Rade, Director Development Cooperation
Mr Matthijs Wolters, Counsellor

Japanese Embassy
Mr Kunio Shimizu, Embassador
Ms Mayumi Hashimoto, Officer for the Economy and international cooperation

US AID
Ms Marilyn A. Zak, Director
Mr Efraín J. Laureano, Economist

Swedish Embassy
Ms Karin Metell

UK, DFID (Department for International Development)
Ms Georgia Taylor, Representative for Central America and Development Adviser

Swiss Embassy, COSUDE (Swiss Agency for Development and Cooperation)
Mr Jürg Benz, Representative for Central America

German Embassy
Ms Sabine Schmitt, First Secretary and Officer for cooperation
Mr Helge Jahn, Director KfW Nicaragua

Spanish Embassy
Mr David Navarro García, Counsellor

Private Sector

CADIN, Chamber of Industries
Mr Gilberto Solís, Executive Secretary

APENN, Nicaraguan Association of Producers and Exporters of Non-Traditional Products
Mr Roberto Brenes, General Manager

(State) Office for the Free Zone
Mr Gilberto Wong, Executive Secretary
Ms María Elsa Mejía, External Relations

Delmor
Mr Zacarías Mondragón García, General Manager

NGOs and Unions

Coordinadora Civil
Ms Ana Quiroz, Coordinadora
Mr Richard Sembrana

UNAG, National Union of Farmers and Cattleholders
Mr Alvaro Fiallos
Mr Edgar Guerra

FNT, National Workers Federation
Mr Gustavo Porras (also member of the National Assembly for the FSLN)
Mr José Angel Bermúdez

Independent experts

NAC Consultores
Mr Nestor Avendaño, Economist

ANNEX D EVALUATION OF DEBT RELIEF 1990-1999, IOB

TERMS OF REFERENCE FOR COUNTRY CASE STUDIES

The evaluation of Dutch debt relief policy and expenditures aims to answer the following research questions:

- to what extent were the political and financial interventions (the inputs) **efficient** in terms of outputs such as debt and debt service reduction (DDSR) and increases in imports an government expenditure?
- to what extent were these inputs and outputs **effective** in producing desired outcomes such as improvement of debt sustainability, improvement of creditworthiness and investment?
- to what extent were these inputs, outputs and outcomes **relevant** by contributing to the longer-term impacts of economic growth and, ultimately, poverty reduction?

Country case studies
In the 8 country case studies, the evaluation questions of efficiency, effectiveness and relevance will all be addressed (see attached Table 1: evaluation matrix). In addition, an in-depth analysis is to be made of the nature of the country's debt problem and therefore of the relevance of debt relief as compared to, for example, new loans or grants.

Debt relief is defined as any action that leads to a reduction in the net present value of the debt. The basic assumption for this evaluation is that IF debt relief contributes to economic growth it does so via a reduction of the debt burden. Two effects are possible:

- The reduction of the net present value of the debt *stock* will increase creditworthiness of the country (according to the debt overhang hypothesis), and thereby lead to more private investment and inflows of private capital. This will enhance economic growth.
- The reduction of the debt *flows* (actual debt service) will lead to additional imports and government expenditure. Increased imports may include investment goods or intermediate goods leading to increased use of existing capital stock, and government spending may imply higher public investment and/or more social expenditure.

Since the effects of *Dutch* debt relief cannot be separated from those of debt relief by other actors, the object for the case studies consists of *all* debt relief received by the country, both from official and commercial sources. Where possible and relevant, special attention will be given to Dutch debt relief. The evaluation period covers 1990-1999, but the analysis of the debt problem has to start earlier, in the 1970s.

The country studies seek answers to five broad questions, each of which is to be dealt with in a separate chapter of the report, with chapters 2 to 5 corresponding to the different levels of the evaluation matrix (inputs, outputs, outcomes and impact), while chapter 1 will provide an introduction and background. In addition to the sources mentioned in the Evaluation matrix, the researcher carrying out the case study is expected to take into account the relevant academic literature on the country as well as pertinent previous evaluations. A minimum selection will be provided by the coordinator and her assistant, but the consultation of additional material at the researcher's own initiative will, of course, be welcomed.

1. Debt problem analysis: nature, causes and consequences.

Why had the debt burden become unsustainable by the beginning of the evaluation period, 1990, and what have been the consequences of this unsustainability? Answering these questions involves analytical descriptions of:

1. The build-up of the country's debt, going back to the 1970s, including major creditors, interest rates, degree of concessionality in real terms, that is including any adverse exchange rate effects (see Mistry, 1996: 25-6), etc.
2. Conditionality attached to loans granted before 1990, and degree of compliance (short overview).
3. Trends in GDP, exports, fiscal revenues; causes of slow growth rates: review of important factors such as developments in terms of trade, inflows of foreign aid, loans and FDI, political instability, natural and man-made disasters, adverse policies, etc.
4. Trends in poverty and social indicators before 1990.
5. Debt sustainability indicators: trends in debt/GDP, debt service *due*/exports versus debt service *paid*/exports.
6. Public and private shares of external debt, and changes over time; government take-over of private debt.
7. Extent to which the external debt situation was exacerbated by a domestic debt problem.
8. Net transfers on debt before 1990, and how these compared to aid flows (grants, new loans).
9. Debt relief, if any, provided before 1990 and its influence on debt sustainability indicators. Any bail out of private creditors by official creditors/donors (see Demirgüç-Kunt & Huizinga, 1993).
10. The nature of the debt problem in 1990, in particular, whether the country's inability to pay was caused by insufficient liquidity (short-term problem) or a lack of solvability (long-term problem). Any difference between this ex-post assessment result and the common perception of the debt problem at the time.
11. The consequences of the debt problem in 1990, in particular whether it affected growth rates:
    - through too high transfers on debt leading to lower imports and lower government expenditure;
    - and/or leading to lower growth rates through a heavy debt overhang (high debt stock, so high expected tax on private profits lowering private investment and inflows of private capital).

---

2. Inputs: amounts and modalities of debt relief in the period 1990-1999

What were the inputs into the debt relief process in terms funding, modalities and conditions? Answering this question requires the following data:

1. Overview of amounts and modalities of debt relief: by creditor, by type of debt, by framework for debt relief activities (Paris Club, Multilateral Debt Funds, 5th and 6th dimension, HIPC, etc.), extent of forgiveness, interest subsidy, buy-back, etc.
2. Stated objectives of debt relief.
3. Any conditions attached to the different modalities of debt relief, including assessment of *track records* (see attached Table 2 for possible contents of conditions and track records)

4. Special attention to Dutch modalities, motives, conditions, and objectives for debt relief.
5. The extent to which debt relief was *additional* to other inflows (loans or grants); in general, and for Dutch debt relief in particular; according to the HIPC initiative, debt relief should be additional (Andrews et al., 2000: 16) but practice may be different.
6. Amounts and modalities of new loans and grants 1990-99. Dutch loans and grants.

Assessment:
Was the combination of new funding and debt relief modalities consistent with the perceived and the actual nature of the debt problem (as described in 1.10)? Were these inputs suitable for the improvement of debt sustainability (see Cline, 1995: 29 and Hanlon, 2000)?

---

3. Outputs of debt relief: efficiency analysis

To determine how efficient the inputs were in producing the intended outputs the following data are to be collected and analyzed:

1. Debt service *due* during 1990-1999 as compared to debt service *actually paid* and accumulation versus payment of arrears.
2. The share of (total as well as Dutch) debt relief that effectively relieved the debt burden in that it led to a reduction of actually paid debt service (see Annex 1).
3. The effect of the different modalities of debt relief on actual payment of debt service on the reduced as well as on other debt. Since debt relief usually increases ability and/or willingness to pay other debts, other creditors may benefit. This may be an unintended side-effect and has been established for debt buy-backs (Bulow & Rogoff, 1988), or it may be an intended result: in the context of HIPC agreements, countries may be obliged to start or resume servicing debts that they ignored before.
4. Extent to which debt relief freed resources for the government, with special attention to Dutch debt relief. This follows from 2.6, 3.2 and 3.3. Compare to the amounts of new loans and grants received during the period 1990-1999 (see 2.7).
5. Extent to which debt relief benefited the creditor itself or other creditors (bailing out), with special attention to Dutch debt relief. This follows from 3.2-3.4. Specify whether official or private creditors benefited.
6. Effect of debt relief on the reduction of the nominal debt stock and the net present value (NPV) of debt.
7. Compliance with debt relief conditionality, changes in policies, changes in governance (see Table 2 and Annex 2).
8. To the extent that debt relief was additional and freed resources (3.4): trace its effects in the government accounts (on public investment and social expenditure, in particular) and in the balance of payments (increased imports, if possible broken down by destination: capital goods, intermediate inputs, consumer goods), according to the accounting framework outlined in Annex 3.

Assessment:
How efficient were the chosen modalities of debt relief in reducing the debt burden, in terms of both NPV of debt and actual debt service?

---

4. Outcomes of debt relief: Effectiveness

The effectiveness of debt relief is to be assessed by collecting / analyzing the following data:

1. Trends during the evaluation period 1990-1999 in the debt sustainability indicators: debt/GDP, debt service due/exports, NPV of debt/exports. We focus on trends as most relevant issue for this evaluation. However, the absolute values of these indicators will be compared to subjective sustainability criteria (limits) according to the IFIs (from HIPC documents) but also according to other sources, e.g. Hanlon (2000).
2. Extent to which change in sustainability can be attributed to debt relief. Both the numerators and the denominators of these indicators are not only the result of debt relief, but also of new loans and grants during the period and of the concessionality of those loans (see Annex 4). In addition, the trends in GDP and exports (the denominators) depend on many other factors: policies, political stability, weather conditions, international prices, etc. The possible causes for the developments in the debt sustainability indicators will be analyzed.
3. Improvement, if any, of social indicators (see Annex 5) as a result of debt relief leading to policy changes and changes in governance (as analyzed in 3.6) .
4. Improvement, if any, of social indicators as a result of debt relief freeing government resources for more public investment and social expenditure (3.7).
5. Increase, if any, in private investment as a result of debt relief freeing resources for more public investment: crowding in.
6. Increase, if any, in private investment as a result of debt relief lowering the debt stock, thereby reducing the debt overhang.
7. Improvement, if any, in the creditworthiness of the country leading to new private capital inflows, as a result of a reduction of the debt stock. This implies an analysis of creditworthiness according to ratings, and of figures on private capital inflows (distinguishing between loans, portfolio investment, FDI). It must be born in mind that other factors such as (expected) economic growth, credibility of government policies, and even conditionality attached to debt relief efforts may also have led to improvements in ratings and increases in flows. Debt relief may, on the other hand, have reduced creditworthiness by lowering expectations on future debt service by the country. According to a recent literature review and additional empirical evidence, policy-based lending and the attached conditionality have only limited effect on private flows (Bird & Rowlands, 2000).

   ***Field studies**:*
   In the field studies, the trends in social indicators (4.3-4.4) and in private investment and private capital inflows (4.5-4.7) can be analyzed and explained more thoroughly by having interviews with government officials, NGOs, donors and representatives of the private sector.

Assessment:
How effective has debt relief been in increasing debt sustainability, stimulating private investment and improving social indicators, both via the attached conditionality and via the stock and flow effects of debt relief?

5. Impact of debt relief: Relevance

Assessment:
Based on the analysis under 1-4, the final impact of the different modalities of debt relief on economic growth and on poverty reduction is to be assessed.

1. Economic growth was already briefly analyzed in 4.1 and 4.2 as denominator for one of the debt sustainability indicators, but the analysis can now be broadened, taking into account the other outcomes under 4 (4.3-4.7).

2. For poverty, trends in the usual poverty indicators (P_0, per cent of population below poverty line), and P_1, the poverty gap (total shortfall of income of the persons below poverty line) will be collected (if available). For the analysis, it is important that poverty reduction may be achieved through economic growth, through an improvement of the income distribution or (in the longer run) through an improvement in social indicators.

References

Andrews, David, Boote, Anthony R., Rizavi, Syed S., & Singh, Sukhwinder. (2000). *Debt Relief for Low-Income Countries: The Enhanced HIPC Initiative* (Pamphlet Series No. 51). Washington DC: IMF.

Bird, Graham, & Rowlands, Dane. (2000). "The catalyzing role of policy-based lending by the IMF and the World Bank: Fact or Fiction?". *Journal of International Development, 12*(7), 951-973.

Bulow, Jeremy, & Rogoff, Kenneth. (1988). "The buyback boondoggle". *Brookings Papers on Economic Activity, Vol. 2*, 675-98.

Cline, William R. (1995). *International Debt Reexamined*. Washington: Institute for International Economics.

Demirgüç-Kunt, Asli, & Huizinga, Harry. (1993). "Official credits to developing countries: Implicit transfers to the banks". *Journal of Money, Credit and Banking, 25*(3), 431-444.

Easterly, William. (1999). *How did Highly Indebted Poor Countries become highly indebted? Reviewing two decades of debt relief* (Policy Research Working Paper 2225). Washington: The World Bank.

Fishlow, Albert. (1988). "External borrowing and debt management". In Rudiger Dornbusch & F. Leslie C.H. Helmers (Eds.), *The Open Economy: Tools for Policymakers in Developing Countries*. New York: Oxford University Press.

Gillis, Malcolm, Perkins, Dwight H., Roemer, Michael, & Snodgrass, Donald R. (1996). *Economics of Development*. (4th ed.). New York/London: Norton.

Hanlon, Joseph. (2000). "How much debt must be cancelled?". *Journal of International Development, 12*(6), 877-901.

Mistry, Percy. (1996). *Resolving Africa's multilateral debt problem*. The Hague: FONDAD.

White, Howard. (1998). *Aid and macroeconomic performance: Theory, empirical evidence and four country cases*. London: MacMillan.

White, Howard. (1999). *Dollars, dialogue and development*. Stockholm: Sida.

Table 1. Evaluation matrix Debt relief

OBJECTIVES-MEANS	INDICATORS	SOURCES	*EVALUATION CRITERIA*
INPUT ***Debt relief expenditures and modalities;*** Policy dialogue.	***Amounts spent, assigned and contributed;*** Conditions.	Documents for Dutch Parliament "Macro-exercise", assessment memos for debt relief; Global Development Finance; National statistics; WB/IMF country reports.	
Comparison outputs and inputs →			***EFFICIENCY***
OUTPUT ***Reduction debt and debt service;*** Increase imports and government expenditure; Policy change and change in governance.	Total debt (nominal and net present value); Interest payments and amortisation; Balance of payments; Government accounts.	Global Development Finance; World Development Indicators; IMF; National statistics; WB/IMF country reports.	
Extent to which inputs via outputs contribute to outcomes →			***EFFECTIVENESS***
OUTCOME Reduction debt burden; Improvement creditworthiness; Investment.	Debt/GDP; Debt service/Exports; International credit ratings; I/GDP; I_p/GDP.	Global Development Finance; World Development Indicators; IMF; National statistics; Moody's; Standard & Poor; WB/IMF country reports.	
Extent to which inputs via outputs and outcomes contribute to impact →			***RELEVANCE***
IMPACT Economic growth	Change in GDP	World Development Indicators; National statistics.	
Sustainable poverty reduction			

Table 2. Possible aspects of the track record possible policy conditions for debt relief

Area	Policy/target
Macro-economic	Stock of international reserves Government deficit (% GDP) Government expenditure (% GDP) Exchange rate policies (devaluation)
Economic reforms	Tax reforms Public sector reform/civil service reform Composition of expenditure (defense) Privatization of SOEs, public utility enterprises Liberalization of goods markets: prices, domestic trade Liberalization of foreign trade Liberalization of labour market Financial liberalization Other sectoral reforms
Political reforms	Elections Multiparty system Human rights observance Independent judiciary Free press
Governance	Transparency of budgeting Transparency of budget execution Accountability, to parliament, local councils, civil society Anti-corruption measures/sanctions Establishment of and respect for Audit Office Decentralization
Poverty reduction	Social expenditure Social sector reforms Quality of social service delivery PRSP

Annex 1

Effective debt relief

Effective debt relief (DR_e) is debt relief that reduces actual debt service (DS_a)

To be computed from:

$DS_a = DS_d - AA$ (1)

$DR_e = DR - PA$ (2)

Where:

DS = Debt Service
DR = Debt Relief
Subscript *a* = “actual”
Subscript *e* = “effective”
AA = Accumulation of Arrears
PA = Payment of Arrears
Subscript *d* = due

DR_e is still an approximation, since debt relief covering debt service due that would never be paid in the same year, is still included. This often the case with Dutch debt relief on Dutch aid loans. If known, it must be subtracted from the figure for DR_e.

The effectiveness of conditionality

To the extent that debt relief was accompanied by conditionality on future policies, or by conditions regarding past policies or policy outcomes ("track record") the extent of compliance with these conditions must be assessed (with respect to changes in policies and changes in governance, see Table 2). The track record has become important for Dutch debt relief decisions since 1996. The evaluation must therefore investigate whether and to what extent the conditions mentioned in the "macro exercitie" were fulfilled in the case of the involved country. A second issue is whether changes in country's policies or governance can be observed since 1996 that go in the direction of improving the "conditions" stipulated in the macro exercitie. Evidence for this can be looked for in HIPC documentation on the country, Policy Framework Papers, Implementation Completion Reports of SALs and SECALs of WB.

In field studies, information can also come from interviews. Interviews should also shed light on the issue of whether the fact that the Dutch have used this track record as basis for decision making on debt relief, has to any extent *influenced* governance and policies (see below).

In the context of the HIPC initiative, the track record has become important since 1998 and involves an assessment of whether conditions stipulated in earlier IFI programs have been complied with satisfactorily. This can be found in HIPC documents on the country, but an independent assessment by the evaluator is also necessary. For example, earlier evaluation research showed that countries were not always treated equally. As of 1999, the HIPC conditions include the setting up of a Poverty Reduction Strategy Paper (PRSP). For the desk studies it is too early to investigate whether the HIPC track record or the requirement of a PRSP have induced a change in the country's policies or governance. In the field studies, donor influence on policies and governance can be examined.

Donor influence (field studies only)

One thing is to establish that countries have complied (or not) with conditions set by the donor; another is to conclude on effective influence of donors. An earlier evaluation concluded that domestic political factors are most important in policy changes but there is also some room for donor influence, especially if we take other dimensions of the "policy dialogue" into account, i.e. other than the formal, directive conditions laid out by the IFIs and directly imposed on the recipient country's government (White, 1999).

This means, first, that we have to take on a broad political economy perspective in explaining why reforms have come about. Donors usually tend to overstate their roles. Second, it means that we have to consider the policy dialogue as a process with four dimensions as discovered in the previous evaluation: the degree of formality, the channel of influence (directly to government, indirectly through IFIs or indirectly through contact with other donors), whether conditionality is directive (policy monologue) or non-directive, and which instrument is used (White, 99: 53-54; see also a useful table of possible channels and degree of formality on p. 37). Instruments can be debt relief, budget support, project aid or technical assistance.

The earlier evaluation has shown that there may be some influence from donors, but that this is usually carried out through less formal means, non-directive approaches and often using other channels.

The study of donor influence consists of two parts: i) examining Dutch influence, and ii) examining the impact of the HIPC conditions, in particular, the requirement that countries elaborate a Poverty Reduction Strategy Paper (PRSP) and do so in a participatory manner. On the first, field studies can first investigate whether the Dutch Embassy has an infuence strategy that takes the different dimensions into account, and on which particular issues it focused. Second, by having interviews with government officials and with other donor representatives, the effectiveness of that influence strategy can be assessed. Since this may lead to subjective and not very exact statements, the approach will be to single out one or two issues (from the Dutch "track record") on which the Dutch had or have a strong opinion – different from the government's opinion – and examine what happened with this "conflict"

For the second aim, the same interviews with donor representatives and government officials can be used to assess the progress in coming to a PRSP. On this topic, interviews with representatives of NGOs and private sector (civil society) will also be necessary. If possible, also for this part a particular issue on which opinions differ will be singled out and followed, in order to improve the judgement on the extent of influence.

Annex 3

The marginal effect of debt relief: the accounting framework

The approach proposed here is similar to the one described for the Sida Evaluation of Programme Aid (see White, 1999: 94-6). It focuses on the marginal impact of debt relief. This is different from the often used "gap approach" which is considered not very helpful (White, 1999: 89-93). It means that we analyze the influence of effective debt relief (free resources) on balance of payments, internal accounts and on government accounts (a subset of the internal accounts), on the basis of accounting identities.

For the external account, the identity is the following:

$M = AID + PCT + DR_e – DS + X + OKI + \Delta R + EO$ [95] (3)

If DR_e (see Annex 1) increases, one or more of the other items must change. The fact that DR_e is positive, implies that the absolute value of DS (debt service) has reduced (as established in 3.1). The impact of DR on other DS has been established in 3.2 and can be used here. Similarly, it has already been established whether DR was additional, i.e. did not lead to a reduction in aid (2.6). From all these, we can compute the net effective debt relief. It will now be examined whether this net DR_e leads to higher imports and/or reserves, which are the preferred responses for donors. This depends on the effects on OKI, ΔR, EO (often capital flight), X, and PCT. A reduction in X could be a negative effect of AID and net DR_e, for example due to Dutch disease effects. Decreases in PCT, OKI and EO (if capital flight) would also be negative responses to DR_e. Increases in PCT and OKI could be positive second round effects of DR_e.

A next step is to look at the composition of imports. Does the composition of imports change as a result of net DR_e? The preferred outcome would be that imports of capital goods and intermediate goods would increase more than imports of consumer goods. This would point to a higher propensity to invest as opposed to to consume.
For the internal account, the identity is the following:

$I = AID + DR_e – DS + OKI + \Delta R + EO + S$ [96] (4)

The analysis for AID, DS, OKI, ΔR and EO is the same as above. The marginal effect of net DR_e on I depends on what happens to S, domestic savings.

---

[95] M = Imports
PCT = Private Capital Transfers
DR_e = Effective debt relief
DS = Debt service
X = Exports
OKI = Other capital inflows
ΔR = Change in reserves
EO = Errors and Omissions

[96] I = Investment
S = Savings

If savings diminish as a result of the additional free resources (as claimed by Easterly, 1999, for example[97]), this would be a negative effect of debt relief. Ideally, DR_e would be accompanied not only by higher I but also by higher S.

The internal account can be broken down further, allowing for separate government income and expenditure. A change in domestic savings is the sum of changes in private saving and changes in government revenues. Investment can be broken down into government expenditure and private investment (see schemes in White 1999: 95).

According to the "fiscal response" literature (White, 1998), the marginal effect of aid (in this case, net effective debt relief) can be to reduce revenues. The analysis of government accounts must therefore begin by looking at what happens to government revenues. A second possible effect that must be examined is the effect on the deficit. If revenues and deficit remain unchanged, the whole effect of net DR_e is on increased expenditure, which is the intended effect of donors (resources should be freed for other – social – expenses). The third step is to look at the composition of expenditure. Does the freeing of government resources lead to increased priority for social expenditure or for public investment? The trends in the share of these sectors within total expenditure will be examined.

[97] Easterly (1999) does not distinguish between debt relief and effective debt relief, however; and his model that stresses "perverse incentive effects" also overlooks that the continued lending by HIPC countries is probably as much the result of (lending) supply factors than of demand factors such as a high discount rate.

Annex 4

Debt sustainability

In the long run, debt service can be sustainable if the following holds (Gillis et al., 1996: 414):

$D/X = a/(g_E - i)$ (5)

Where D = debt, X = exports, a = the trade gap $(M - X)/X$, M = imports, g_E = the growth rate of exports, and i = the average interest rate on debt.

This means that as long as the growth rate of exports is higher than the interest rate, a sustainable debt/exports ratio can be accompanied by a trade gap a (i.e. by increasing debt). A first issue to be examined is therefore whether the growth rate of exports is higher or lower than the average interest rate of the debt stocks over 1990-99 (as computed in 2.7). If it is lower, it can be argued that the country had a solvability problem and not a liquidity problem, and that new loans would not lead to a sustainable debt service.

The next component to analyze is the trend in the trade gap. This trade gap a is constant if the growth rate of imports is equal to the growth rate of exports, but this is not necessary for the analysis. In our study, the trade gap that leads to this increase in debt $a = (M - X)/X$ must be adjusted for the non-loans part of aid (i.e. grants, A) and for net effective debt relief (DR_e, see Annex 1), so we will look at what happens to

$$\frac{M - (X + A + DR_e)}{X}$$

If the growth rates of exports is lower than the interest rate, D/E is only sustainable if there is a surplus, so $M-(X+A+DR_e) < 0$.

Similarly, the debt/GDP ratio can be sustainable in the long run if (Gillis et al., 1996: 415):

$D/Y = (v - s)/(g_Y - i)$ (6)

Where $Y = GNP$, g_Y = the growth rate of Y, $v = I/Y$, the investment ratio, and $s = S/Y$, the savings ratio.
As long as g_Y is above the interest rate, a sustainable debt/income ratio can be accompanied by a continuing and constant savings gap ($v - s > 0$). This savings gap leading to increased debt must also be adjusted for grants (A) and for net effective debt relief (net DR_e) , so we look at:

$v - s - A/Y - DR_e/Y$

If g_Y is below the interest rate, there must be a savings surplus. The evaluation will examine the trends 1990-99 in g_Y as compared to i, and of v, s, A/Y and DR_e/Y

For the government, we can assess sustainability in relation to the tax capacity (Fishlow, 1988: 220-21). In the long run, the debt burden is sustainable if:

$D/T = \{(G - T)/T\} / (r_t - I)$ (7)

Where T = tax income, G = government expenditure, r_t = growth rate of taxes.

In this part of the analysis, the sustainabality of the debt burden for the government is not only determined by the external public debt, but also by the internal debt. This is a problem for Jamaica, for example. An average interest rate on total public debt will have to be computed. This average interest rate must then be compared with the growth rate of taxes. The latter will probably be related to the growth rate of GDP, but there can also be an independent effect due to, for example, tax reforms. If the interest rate is higher than the growth rate of taxes, the government must have a surplus (G-T) < 0 for debt service to be sustainable.

Annex 5

Social indicators

Social indicators to be analyzed could be taken from the OECD/DAC indicators for social development (Nos. 4-15 of the 21 Indicators for sustainable poverty reduction). These are:

Indicator	Measure	Source
Children under 5 with underweight	%	WDR (WDI)
Enrolment in primary education (%)	%	WDR (WDI)
Share of people with fourth grade	% of adults	HDR (WDI?)
Alphabetization	% of adults	HDR (WDI?)
Gender equality in primary enrolment,	F/m, in %	UNFPA or WISTAT
Gender equality in secondary enrolment	F/m, in %	UNFPA or WISTAT
Gender equality in alphabetization	F/m, in %	HDR
Infant mortality rate	%	HDR
Child mortality rate	%	WDR (WDI)
Maternal mortality rate	%	WDR (WDI)
Deliveries under expert supervision	% of total	UNFPA
Use of contraceptives	% of married women	HDR
HIV ratio	% of adults	UNAIDS

Ministry of Foreign Affairs | P.O Box 20061 | 2500 EB The Hague | The Netherlands

Policy and Operations Evaluation Department

ISSN 15166-3000

ORDERCODE: OSDR0518/E

Ministerie van
Buitenlandse Zaken

OSDR0518/E