



**Office of Evaluation and Oversight, OVE
Inter-American Development Bank**

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***Country Program
Evaluation (CPE):
Nicaragua (1991 – 2001)***



Office of Evaluation and Oversight

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EXECUTIVE SUMMARY

This report presents the Office of Evaluation and Oversight's evaluation of the Bank-Nicaragua program from 1991 to 2001. The purpose of the report is to provide an account to the Bank's Directors regarding the development results achieved by the Bank in the country. In addition, it offers reflections and ideas regarding the past program of the Bank with the country as an input into the preparation of the next Bank country strategy for Nicaragua.

Country program evaluations seek to assess four elements of the Banks program: relevance (did the program address the major development challenges facing the country); coherence (did the program integrate the full range of Bank instruments and co-ordinate Bank actions with those of other development actors), efficiency (did the Bank deliver its promised outputs in a timely and cost-effective fashion), and efficacy (did the program produce the intended development outcomes for the country).

Country program evaluations always confront serious problems of attribution, particularly at the outcome level. Development of a country is a complex business, with multiple actors involved and an acute dependence on external events beyond the control of either the Bank or the country. Nicaragua is no exception to this general rule. What does make the Nicaragua case slightly different from other countries is that the Bank's support looms very large in the economic life of the country. Yearly averages of Bank's commitments were 30% and disbursements were 20% of the total received by the country. In addition, gross disbursements were 50% of the country's gross capital formation. Given the sheer weight of Bank financial support, the significance of its interventions in the development path followed by the country is likely to be appreciably larger than in countries where the Bank was a less significant financial contributor.

Country Context and Development Challenges

Nicaragua represented a unique and extremely challenging context for the Bank's intervention. The Bank's program was in a context that combined: *structural vulnerability* (to macroeconomic and natural shocks); a country in the midst of an *acute political and economic crisis*; an economy *in transition* from a command economy towards a market-oriented one, and a polity moving from a violent to a peaceful process of resolving political disaccord and obtaining social consensus on development issues.

In this context, the principal development challenges were: 1) stabilization of the macro economy, creating mechanisms to deal with the country's extreme structural vulnerability to external shocks, and reduction of the extreme external debt burden; 2) re-activation of production by the private sector, particularly in agriculture, the lynchpin of the country's economy; 3) promotion of pro-market structural reforms, led by the creation of a modern and efficient financial sector and the reduction of the infrastructure gap; 4) developing efficient mechanisms of governance for the new market-oriented development model, paying particular attention to the issue of corruption which has been a major problem for all countries undergoing the transition from plan to market; 5) effectively managing the country's natural resource assets and substantially increasing the quality of its human resource assets.

The Bank's Programmatic Intent

Through an analysis of Bank programming documents, seven major thematic goals can be observed, albeit with differing emphasis over time. These seven goals, which encompass the development challenges mentioned in the previous paragraph, are:

- Obtain macroeconomic stabilization with particular reference to the reduction of the fiscal deficit and foreign debt overhang;
- Reactivate, diversify and expand agriculture, while strengthening the sector exports, and to recover and preserve the country's natural resource base;
- Create a modern private financial sector;
- Reduce the infrastructure gap;
- Improve governance, with an emphasis on administrative and regulatory capacity;
- Increase human capital, through interventions in health and education;
- Reduce poverty.

Several evaluative observations can be made with regard to the Bank's programming intent. First, the proposed program was highly *relevant* to the country's development challenges. Two major areas of concern, however, are largely absent from Bank programming documents: structural vulnerability; and the problem of corruption during the transition. All the other areas are covered in great depth.

Second, the Bank's intent is not expressed in terms of measurable goals, and there are virtually no proposed indicators to measure either ultimate success or progress toward final goals in any major line of activity. While this was the general pattern for Bank programming documents in the 1990s and Nicaragua is not an exceptional case in this regard, the program as a whole had low evaluability at the level of country, sectoral or thematic level. A key exception to this general rule is health, where the Bank established clear targets for the reduction of infant and maternal mortality.

Third, the program revealed in the Bank's documents is not very coherent in terms of the integration of Bank instruments. The program did not discuss in any detail how to optimise the product-instrument mix nor about alternative means of obtaining particular goal. This issue of product mix became important during the execution of the program, particularly the choice of policy-based instruments vs. investment loans, and the use of technical cooperations vs. loans, but no strategic guidance on these questions was provided in the programming documents. Similarly, little discussion can be found regarding the analytical and sector work required for developing operations in various sectors.

But perhaps the greatest concern regarding instrument mix is the failure of programming documents to address the financial characteristics of Bank lending. Nicaragua began the period with an extremely large external debt overhang, and the World Bank consequently declared the country eligible only for concessional finance. The IDB, however, extended a number of early loans from the Bank's Ordinary Capital (with an interest rate subsidy from the Intermediate Financing Facility (IFF) that lowered rates somewhat). IFF terms, consistently higher than FSO terms over the period, made a larger contribution to the country's debt problem than would have been provided by equivalent FSO financing. Since FSO funding sufficient to fund the entire

program was not available, there is an important (and still unresolved) debate regarding whether it would have been better for the country to receive less funding on FSO terms rather than more on a mix of OC and FSO. Without presuming to resolve this debate, it is important to note this debate was not articulated in the Bank's programming documents. Instead, the programming documents announced a strong preference for the highest possible level of concessionality in the program, a goal which was not met in the actual program delivered.

Fourth, Bank programming documents do not explicitly locate the Bank within the universe of development finance actors, and hence did not provide an indication of its comparative advantage or the potential synergy with those other actors. As an aid-dependent country, the issue of donor coordination is particularly important for Nicaragua, but was not explicitly addressed in Bank programming documents. It is important to note, however, that the Bank's *actions* (as opposed to its programming documents) suggest a keen awareness of the donor coordination issue, with the Bank seeking and receiving the Chair of the Consultative Group for Nicaragua in 1996.

Fifth, the predictive value of programming documents—in terms of both number of projects and dollar lending envelope—declined sharply over time. In the early 1990s' the Bank's program as delivered corresponded almost exactly to the program actually delivered. After this period however, the predictive value of programming documents declines, so that by the end of the decade the majority of projects actually done were not included in prior programming documents. In addition, disbursement predictions for approved loans had a high forecast error, contributing to budgetary uncertainty in the country in light of high aid dependence. However, high marks must be given to the flexibility the Bank showed in re-orienting existing operations and approving new operations in response to Hurricane Mitch of 1998.

Sixth, the Bank stopped formal programming for the country in the mid 1990s. The last Board approved CP was in 1996, which purportedly contained "the strategy proposed for the period 1996-97" but is still in effect. Bank programming in Nicaragua is thus *de facto* being conducted on a year-by-year basis instead of over a medium-term-programming horizon, and without any formal, Board approved, programming documentation.

The Program In Execution

The Bank deserves considerable credit for timely and substantial engagement with the country. It was the first multilateral lender to resume operations in the country following the hiatus of the 1980s, and remained the largest provider of resources to the country throughout the 1990s. Net financial flows from the Bank to the country were positive in every year except 1991, and have increased steadily over time.

Balancing this positive record, however, are four structural characteristics of Bank financing which are more problematic: First, disbursements were highly volatile, more volatile in fact than were the country's primary expenditures and GDP. This ran counter to the Bank's stated objective of fostering stability, and may in fact have contributed to instability of both the budget and GDP.

Second, the forecast error in projections of Bank disbursements was high, making it difficult for country authorities to predict or control future spending associated with Bank disbursements.

Third, Bank disbursements were pro-cyclical with respect to public primary expenditure, economic growth, and foreign reserves. When economic activity turned down, so did Bank disbursements, contributing to cyclicity in the economy. There is evidence from cross sectional studies that unpredictability, volatility and procyclicality could reduce the welfare gains potentially available from aid. While the Bank does not have sole responsibility for this pattern, and aid disbursements from other donors appear to have similar characteristics, the way in which aid was disbursed suggests that the Bank and other donors, *ceteris paribus*, contributed towards making macroeconomic management more difficult for the country and delivered their substantial financial flows in a manner which reduced to a degree the welfare benefits of those investments, relative to their potential.

Fourth, despite the declared intent of limiting operations to concessional terms, over 38% of the loans made between 1991 and 1993 were only moderately concessional, coming from the Ordinary Capital with an interest rate subsidy rather than from the highly concessional Fund for Special Operations. These loans contributed to worsening the country's external debt profile, a problem that eventually led to a Bank debt-reduction operation and the inclusion of the country in the HIPC initiative.

Turning to the specifics of the operational program as delivered, the following pattern is encountered:

- The loan portfolio's (value of \$1.4 billion dollars with 49 separate operations) distribution was: 35% for infrastructure; 21 % for social investment; 12% macro-structural (a catch all mainly for some PBLs); 10% for agriculture; 10% for governance; 7% for financial sector and 4% for others.
- The TC portfolio's (value of \$77 million with 180 separate operations) distribution was: 35% to the social sector; 32% to governance; 10% to infrastructure; 7% to agriculture; 2% to the financial sector; and 13% to others.
- Other Bank Group activities included: MIF, since 1995, which provided \$18.9 million in 27 separate operations; the IIC approved \$27.8 million in 7 separate operations. PRI approved one operation valued at \$24.8 million, and \$4.2 million in 8 operations were provided under the Small Projects Program.
- The program's declared objective of "maximizing" of co-financing led to a leverage ratio of \$4 in cofinancing for every \$10 in Bank lending, i.e. about the Bank's average.
- The numbers of non-financial products were below the Bank's average.
- The portfolio had a strongly pro-poor bias: 56% of the dollar value and 57% of the number of projects were classified as SEQ compared to the Bank's averages of 43% and 45% respectively.
- The portfolio had a higher than bank average ranking for gender: 19% of the number compared to the Bank average of 14% and 23% of the dollar value compared to 10% of the Bank's average.

An evaluation suggests that the Bank *delivered*, in terms of financing, an operational program that was relatively close to the one anticipated in programming documents regarding financing of strategic goals that the Bank has set for itself, even though the capacity to anticipate specific operations declined. Although the programming documents contained no clear priority statements, the percentage allocation of the portfolio can be used as a rough indicator of the de facto prioritisation of the different goals. The loan program actually delivered placed most importance on infrastructure and social investment, followed by stabilization and governance. The TC program emphasized social services, governance and infrastructure. Project design resulted in a greater than Bank averages in a pro-poor and pro-gender bias. The environmental and natural resource objectives mentioned in the programming documents are absent from the actual program delivered.

An important shift in emphasis in the distribution of the program is evident over the course of the decade. At the outset, (1991-92), financial, agriculture and infrastructure projects were given priority over social sectors “...not because Nicaragua has no needs in these sectors but because, in a tight resource rationing setting, the judgement is made that these needs can be attended in a few years, but only if the economy first starts moving again.”¹ Later on, social sector and governance projects claimed a significantly greater proportion of the lending program.

Regarding the efficiency of delivery the following pattern is encountered:

- 55% of the number and 43% of the dollar value of the active investment projects’ disbursements profile fell below the Bank-wide portfolio average in 2001.
- Over a quarter of the country’s portfolio was on “alert” in 2001, with the social sector portfolio with the highest alert percentage: 24%.
- There is almost a one to one relationship between projects approved and number of executing agencies.
- The process of calculating the supervision rate index for projects in execution took nearly 21 months². The inconsistencies and contradictions found in the data sent by Management in three different occasions, led OVE to request AUG for a special audit on technical and financial supervision visits for the period 1998-2002. The auditor’s report concluded that the “review of the three prior COF/CNI’s submissions to OVE of inspection visit data covering the years 1998 through 2002, disclosed that the data on inspection visits reported to OVE was largely inaccurate.” and that “the system for planning, recording and tracking of inspection visits for the period covered was not fully functional or reliable and warrants immediate and substantial improvement”. A fourth set of data was created by COF/CNI and validated by AUG. This fourth set constitutes the basis for OVE’s supervision rate index presented in this report. Based on the information provided, the supervision rate index for projects in execution increases from 37% in 1998 to a peak of 68% in 2001 and then drops to 62% in 2002. The total average over the period was 52%.

¹ Country Programming Paper 1991

² Time elapsed between September 2001, when OVE received the first set of data and May 2003, when OVE received the fourth set of data.

The following evaluation conclusions can be asserted. The country's disbursement performance is poor. The problems with the timely disbursement on individual projects contribute to the overall pattern of disbursement volatility noted earlier. The extensive use of executing agencies has clearly not solved the execution problem, and may in fact be part of the problem. Also, Management has not been consistent in carrying out and documenting its financial and technical inspection visits in Nicaragua. The average inspection rate for projects over the period was 52 percent, while the Bank operations policies call for 100 percent coverage. This situation is troubling, both because of the high corruption ranking of Nicaragua and because inspection visits are an essential instrument for the discharge of the Bank's fiduciary responsibilities.

A related issue concerns the relationship between the execution of the Bank's portfolio and the activities of other development actors. Several studies have revealed a considerable problem of donor coordination, with different donors pursuing their own individual objectives (often through dedicated executing units) with little regard either for possible synergies or for the administrative burden this places on the country's budget and civil service.

Results achieved

It would be no exaggeration to say that Nicaragua today is a different country from that of the early nineties, as it has shifted from a socialist command economy to a market-oriented one, and has, since the mid- nineties, moved to a peaceful process of building a new social contract. The debt burden has been reduced, economic growth has resumed and social indicators have improved. In 2002, despite problems, it is no longer in an acute economic and political crisis. All this in the context of natural shocks with a cumulatively cost the country over 150% of 2001 GDP. As the country's largest provider of aid, the Bank's help in these achievements needs to be acknowledged.

The Bank had set itself seven strategic goals. Each is evaluated at three levels: the degree that outputs were realised; the extent that the Bank's operations resulted in reforms; and the progress towards the realisation of the strategic goals. In a reading of the following, it must be kept in mind not only the low evaluability of the program and projects but also the caution regarding attribution. Outcomes are influenced by a gamma of factors beyond the Bank's control, including actions by other actors and unanticipated exogenous shocks. Keeping in mind this caution the results of the Bank's seven strategic goals are evaluated.

1. Obtain macroeconomic stabilization with particular reference to the reduction of the fiscal deficit and foreign debt overhang. The Bank's direct support for stabilization was through conditionalities associated with PBLs, through institutional strengthening (tax administration, Central Bank etc.), through improvements in the delivery of public services encouraged by individual investment operations, and through debt reduction loans and participation in the HIPC initiative.

A substantial fiscal adjustment took place during the first half of the 1990s, aided both by Bank interventions (particularly in supporting tax reform) and by the "peace dividend" of military demobilization. By the middle of the decade, however, progress on the deficit stalled, and a sharp reversal started in 1998, which has left the fiscal deficit at over 14% of GDP in 2001. To this should be added the very large "quasi fiscal deficit" of the Central Bank, which has absorbed

on its balance sheet much of the bad debt associated with the banking crisis. Considering the two together, the country today faces an even larger fiscal deficit than at the start of the decade. This while the stabilization goal was partially achieved, the goal of a sustainable fiscal framework was not.

A similar pattern is evident with respect to debt. The resumption of growth in GDP and exports early in the decade helped improve the country's debt ratios, but steady positive net borrowings from multilateral financial institutions throughout the decade soon began to erode this progress. The Bank supported a debt reduction operation on its own which made a positive, albeit small, contribution to the country's debt sustainability problem, but the fundamentally untenable nature of the debt situation eventually forced a more comprehensive debt reduction approach when the country became eligible for the HIPC program. While the Bank has strongly supported Nicaragua in the HIPC process, it is likely that planned debt reduction will be inadequate, and that HIPC conditionalities will worsen the already severe fiscal problem (See Below).

2. Reactivate, diversify and expand agriculture, while strengthening the sector exports, and to recover and preserve the country's natural resources base. Bank's projects supported the reactivation of agriculture by dismantling state intervention and obtaining a private sector subject to market forces. Complementary support included: increased access to markets (particularly in construction of rural roads); promotion of agricultural services (including certification), and the development of agricultural stock markets. Most outputs were realized: many miles of roads were constructed giving access to a significant number of producers, certification began, the construction of sanitation laboratories as well as quarantines was realized, a agriculture product market was created, and reform led to the dismantling of the previous policy regime.

Several sector outcomes were also positive. Agricultural GDP grew at more than double rate of the overall economy, it generated more employment than any other sector of the economy, and agricultural exports grew significantly. However, export diversification was not realized, and the emphasis on export crop has resulted in the country becoming a net importer of staples.

An extremely important issue in this sector is the possibility that the vast majority of output and employment growth in agriculture was the result of unique, one-time events that cannot be repeated. The country's "peace dividend" was heavily concentrated in the agricultural sector, when the ending of conflict opened up rural areas for production and provided increased labour supply as the armies demobilized. Agricultural commodity prices were also buoyant earlier in the decade, a trend that is worsening rapidly, particularly for coffee, the country's principal export crop. Thus the sustainability of agricultural growth and rural poverty reduction is a major concern as the recovery effects have largely worked themselves out and there is a limit for further labour supply shifts to compensate for falling wages.

The Bank strategic goal regarding the environment did not result in a significant direct portfolio. However, Nicaragua is an example of how to mainstream the environment agenda. In fact, this agenda was pushed through a number of non-environment classified projects, ranging from "social" to "infrastructure" and "agriculture".

3. Create a modern private financial sector. Most investment projects' outputs (consultants hired, staff trained, studies made etc) were realised, although a troubled PBL was disbursed

through essentially waivers. Bank's operations supported most of the major banking sector reforms, including the creation of a banking superintendency. The privatisation of the banking sector was fully achieved. The increase in the efficiency of financial intermediation was only partly achieved, and critical indicators have worsened since 1997.

Resumption of credit to the private sector goal was achieved, but the prudential lending goal was not, as indicated by the sharp rise in non-performing goals, and bank bankruptcies. Many of causes were the same that had led to the closure of public banks; although a case could be made the existence of the superintendency contained the crisis. The goal to obtain an independent well functioning central bank, despite significant progress, is endangered given the rise of the quasi-fiscal deficit (without an equivalent rise in the Bank's reserves).

4. Reduce the infrastructure gap. The Bank invested heavily in transportation, electricity supply and water. In each sector, operations combined the financing of physical assets (roads, power plants, water and sewer systems) with the reform of the public institutions involved in the sector. After 1994, the introduction of private sector participation into infrastructure was a central theme of Bank operations.

As a general rule, it can be said that the overwhelming majority of Bank projects met their objectives for creating physical assets, but that institutional reform and privatisation objectives were generally not fulfilled. A policy-based loan of the mid nineties, promoting reforms required a number of waivers to disburse, and recent Bank documents continue to contain numerous references to managerial inefficiencies in public agencies in all three sectors. Private participation in electricity has advanced, but the same cannot be said for Bank initiatives to encourage private involvement in road maintenance and water supply. Of greater concern is that outcome measures in the three sectors are either not collected (road loadings, financial self-sufficiency in energy and water) or show little improvement over the period. The conspicuous exception is water, where both rural and urban access to potable water has increased markedly (although sewage coverage has declined).

The overall evaluative conclusion is that Bank operations have clearly helped rehabilitate and expand physical infrastructure assets, but that ongoing problems of management of these assets make it difficult to determine whether the promised flow of improved infrastructure services is taking place.

5. Improve governance with emphasis on administrative and regulatory capacity. Governance was the largest part of Bank's TC portfolio, and may also have been the largest element in the investment loan portfolio if "institutional support" components of investment loans are included as operations in pursuit of a governance objective. Most of this activity was aimed at "institutional support" where the outputs (consultants hired, computers purchased) were generally obtained. Bank's operations successfully supported downsizing. The Bank's attempt at public sector wide reforms, through a policy based loan faltered, and the loan was disbursed through a number of waivers. The Bank was highly engaged in tax and customs administration, outputs of which were generally achieved, and which supported a number of reforms. Increase in fiscal revenue or reduction in evasion could approximate the "more effective revenue collection" target, however, it is difficult to disentangle the impact of tax reform and changes in the economy from that of tax administration per se and there is no evidence regarding the degree of,

and changes in, tax evasion. “Enhancing management efficiency” target could be evaluated by whether a “best practice” semi-autonomous authority was created. It was not.

An evaluation of the improvement, in the late nineties, in governance reveals a mixed picture. In three dimensions governance has worsened: voice and accountability; regulatory quality; and the rule of law. In three dimensions it has improved: government effectiveness has improved (more than the LAC mean), political stability (more than the LAC mean), and control of corruption (less than the LAC mean). Other than political stability Nicaragua remains far below the Latin American mean levels of these dimensions of governance, despite a decade of work with the country by the Bank and a number of other development assistance actors.

6. Increase human capital. Human development indicators have improved although not uniformly. With respect to health indicators, under-5 mortality and child malnutrition rates decreased, although not significantly, and maternal mortality increased. The 1992 CP had actually set targets “*reduce, in the middle-term, infant mortality in 50%, and maternal mortality in 30%*”. Information currently available suggests that these goals are far from being accomplished. With respect to education indicators, primary net enrolment rate has increased, as has the primary efficiency coefficient. However, the country has still one of the worst educational performances among the countries in the region.

7. Reduce poverty. Underlying the pattern of poverty, in addition to the impact of macroeconomic fluctuations, economic growth, and inequality of income, is the inequality of opportunities and capabilities. Inequalities of capabilities are found in education, health, in investing in entrepreneurial activity, and in access to basic infrastructure. Inequality in opportunities –the existence of exclusion- can be found in the labour access to markets, and in investment. Poverty is thus a crosscutting theme, which cuts across the project classifications used in this evaluation as poverty depends directly and indirectly, and to a greater and lesser degree on all Bank interventions. The Bank’s operations had a strong pro-poor and gender bias.

The poverty reduction goal was achieved. The gains in poverty may, however, not be sustainable. The poverty fall can be attributed to a large extent to the positive impact of agriculture job-income creation associated with post-Mitch investment boom. However, the agricultural positive shock is tailing off, and is being replaced by a negative –structural- shock, from falling coffee prices, and the post Mitch investment boom is also tailing off to zero. In addition, preliminary data suggest that the economy is entering into a recession with the associated increase in unemployment rate. Finally, the country’s poverty profile does not suggest significant changes, reinforcing the argument of the temporary nature of the poverty reduction pattern.

Summary and Conclusions

The Bank has been a major actor in the country throughout the 1990s, and its operations have touched on most of the key development issues. Data on the achievement of broad sectoral objectives shows a mixed pattern of results, with many problems persisting throughout the period. It is virtually impossible to attribute sectoral results to Bank actions, however, largely because the Bank does not set such “outcome” objectives for its loans, does not monitor outcome

progress in the course of a loan, and does not carry out the required project completing reporting which would give even a preliminary view of realized outcomes.

Furthermore, a number of the highly favourable outcomes observed during the period may have been the result of one-time positive shocks that are unlikely to recur. This suggests that the country, the Bank, and the donor community at large have a significant future agenda in trying to generate the basis for sustained progress in the future.

While attribution of results is a key issue in building a “bottom up” view of the Bank’s impact on the country, from a “top down” perspective there is a real probability that, for Nicaragua, external assistance may be as much a curse as a blessing. External aid is potentially problematic for five reasons:

- aid is more volatile than domestic revenue, contributing to instability in macro planning and budgeting;
- aid in the aggregate has been well in excess of domestic capital formation, suggesting that some part of the consumption boom of the 1990s was externally financed;
- aid in the aggregate tends to push up the real exchange rate, rendering exports less competitive;
- the “aid interface” between the country and the donors is extremely demanding, both in time and resources. Proliferating priorities and executing agencies becomes in itself a governance problem for the country;
- a complex “aid interface” discourages the formation and realization of national development goals, as the logic of the aid relationship forces a narrow, project-specific approach to public policy.

Improving the aid interface is likely to be critical to the future development success of the country, particularly in light of the persisting huge problem of the fiscal deficits and debt. HIPC has gone partway toward addressing these concerns, but three critical shortcomings in the current arrangements are likely to raise problems for the future.

First, the HIPC program was designed to produce adequate debt reduction for the largest possible group of eligible countries at the lowest possible cost. The result is that HIPC formulas are designed to lower debt to just slightly below the level at which debt service becomes an unsustainable burden on the country. HIPC thus leaves countries like Nicaragua in a danger zone, where any deterioration in economic performance threatens to bring the debt problem back as a critical problem for economic management.

Second, HIPC conditionalities mandate actions with significant budgetary implications: the establishment of a private pension fund (with significant fiscal transition costs), the privatisation of the telecommunication company and the electricity company’s power plants, and an increase in “pro-poor” public expenditures. Theoretically, these expenditure increases are to be financed with the proceeds of debt reduction, but these reductions are calculated from scheduled debt service rather than from current debt service levels. Complying with HIPC conditionalities thus requires real increases in expenditure not offset by real decreases in current debt service. HIPC

itself may thus be a negative fiscal shock for a country already struggling with a huge fiscal adjustment burden.

Third, HIPC's assumption of 5.5% yearly growth is questionable, not only is it much higher than the average rate of the last few years, but nowhere is defined the source of that growth. In the context of a recession, the country's immediate options are limited. Fiscal expansion could be excluded due to long-term sustainability considerations and because conventional wisdom imposes a pro-cyclical fiscal stance. A sharp devaluation could be excluded as it may result, given a highly dollarised economy, in a stagflationary impulse rather than an export-led boom. Improving productivity could be excluded, as it results will only be realised over a medium-term horizon.

Under such circumstances, the challenge for the coming period is to devise a development program, which maximizes economic growth (to generate fiscal resources) and dramatically increases the efficiency of public expenditures. A continuation of past trends is unlikely to produce such an outcome.

The evaluation therefore suggests consideration of five themes for the future:

First, the Bank should adopt for the next programming cycle the prioritisation adopted in the early 1990s: growth first, social sectors later, *"...not because Nicaragua has no needs in these sectors but because, in a tight resource rationing setting, the judgment is made that these needs can be attended in a few years, but only if the economy first starts moving again."*

Second, the Bank as chair of the Consultative Group should take the lead in transforming the aid interface, away from multiple individual projects supported by individual donors operating through individual executing agencies and toward a model based on formal agreement between the country and donors regarding concrete development goals spelled out in measurable indicators with clear targets and benchmarks. Donors should support the achievement of goals defined in outcome terms, rather than the completion of projects defined in output terms.

Third, the Bank, in coordination with the government and the donor community, should work to reduce the volatility, unpredictability and pro-cyclicality of aid disbursements.

Fourth, the Bank jointly with the country needs to set in motion a process that enhances vertical and horizontal accountability mechanisms, critical for sustained motion would be a consolidated, transparent, results oriented, budgetary system. The latter will be critical to obtain donor consensus for outcome-based aid.

Fifth, Management should ensure that inspection visits in Nicaragua are carried out in compliance with the Bank's procedures to ensure an effective monitoring of projects. OVE strongly suggests that Management develops and implements an integrated system that supports the day-to-day operational functions in COF/CNI, as has been recommended in past reports from the Bank's Auditor General.

Only the Executive Summary was approved for public disclosure.

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