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Poverty Reduction Support Credits: Nicaragua Country Study

IEG Working Paper 2010/8

Manuel Hinds

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Nicaragua Country Study

Manuel Hinds

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Contents

ACRONYMS V

ACKNOWLEDGEMENTS VI

EXECUTIVE SUMMARY VII

1. BACKGROUND 1

2. PRSC DESIGN 6

To what extent is there a discernable difference between the PRSC series and other adjustment lending/development policy lending? 6

3. PRSC PROCESS 13

How effective have PRSCs been as a vehicle to help Nicaragua operationalize a country-driven poverty reduction strategy? 13

How effectively have the PRSCs contributed to donor harmonization around a country-owned, medium-term poverty reduction strategy? 16

How well have PRSCs been aligned with country policy formulation, budgeting, and planning processes, and how effectively have they contributed to predictable resource flows? 19

4. PRSC RESULTS 19

How effectively have PRSCs helped Nicaragua strengthen its public financial management systems? 19

Outcomes 22

How relevant and effective a vehicle have PRSCs been in helping Nicaragua set conditions for poverty reducing growth? 24

How effectively has the PRSC helped advance the dialogue and achieve results in sectors that deliver services to the poor? 29

Education 31

Health 32

Water and Sanitation 33

Assessment of Overall Outcome 33

PRSC Contributions to Poverty Outcomes 34

5. BANK PERFORMANCE 37

6. CONCLUSIONS AND LESSONS LEARNED 39

REFERENCES 41

TABLES

Table 1: IMF PRGF and Bank Adjustment Operations Before PRSCs, 1991-2002 3
Table 2: Activities Supported by Structural Adjustment Loans and PRSCs 6
Table 3: Targets for PFM 22
Table 4: Targets of PRSCs Regarding Economic Growth 26
Table 5: Macroeconomic Targets of PRSCs 26
Table 6: Targets of PRSCs Regarding Services to the Poor 30

FIGURES

Figure 1: Investment in Social Sectors as Percent of Total Public Sector Investment and Total Sector Expenditures .. 8
Figure 2: Disbursements by Calendar Year Quarter (USD millions) 12
Figure 3: Rates of Growth of GDP in Real Terms 28
Figure 4. Exports and Commodity Prices: Rates of Annual Change 29
Figure 5: Headcount Poverty Rates 35
Figure 6. Extreme Poverty Rates 36

APPENDICES

Appendix A: Overview of Autonomous Schools, Health Service Delivery, and Pension Reform 41

Appendix B: Key PFM Indicators 47
Appendix Table 1. Summary of PEFA Indicators 47
Appendix Table 2. Ratings on Budget Credibility 48
Appendix Table 3. Ratings on the Relationship between Policies and Budget 49
Appendix Table 4. Ratings on External Audit and Scrutiny 50
Appendix Table 5. Scope and Transparency 51
Appendix Table 6. Predictability and Control of Budgetary Execution 52
Appendix Table 7. Accounting, Registry, and Reports 53
Appendix Table 8. Donor Practices 54

Appendix C: Public Expenditures and Budget 55
Appendix Table 9. Total Public Expenditure by Sector (percent of GDP) 55
Appendix Table 10. Total Expenditures by Functional Allocation (percent of total) 55
Appendix Table 11. Financial Structure of the National Public Sector Budget, 2007 56

Acronyms

AAA	Analytical and advisory activities
APR	Annual Progress Report
BSG	Budget Support Group
CAS	Country Assistance Strategy
CFAA	Country Financial Accountability Assessment
CONAPAS	National Commission for Drinking Water and Sanitation
CPAR	Country Procurement Assessment Report
CPIA	Country Performance and Institutional Assessment
CUT	Single treasury account
DR-CAFTA	Dominican Republic-Central America Free Trade Agreement
EC	European Commission
ERC	Economic recovery credit
FSLN	*Frente Sandinista de Liberación Nacional*
FY	Fiscal year
GAP	Budget Support Group
GBS	General budget support
GDP	Gross domestic product
GNI	Gross national income
GTZ	German Technical Co-operation
HIPC	Highly Indebted Poor Country (initiative)
ICA	Investment Climate Assessment
ICR	Implementation Completion & Results Report
IDA	International Development Association
IDB	Inter-American Development Bank
IEG	Independent Evaluation Group
IMF	International Monetary Fund
INSS	Social Security Institute
JFA	Joint financing arrangement
KfW	*Kreditanstalt für Wiederaufbau* (German development agency)
M&E	Monitoring and evaluation
MDG	Millennium Development Goal
MDRI	Multilateral Debt Relief Initiative
MDTF	Multi-Donor Trust Fund
MHCP	Ministry of Finance
MINSA	Ministry of Health
MTEF	Medium-Term Expenditure Framework
NGO	Nongovernmental organization
ODA	Official development assistance
OED	Operations Evaluation Department
PAM	Performance assessment matrix
PCR	Project Completion Report
PD	Program Document
PDVSA	Venezuelan oil company
PEFA	Public Expenditure and Financial Accountability
PER	Public Expenditure Review
PET	Public expenditure tracking survey
PFM	Public financial management
PNHD	*Plan Nacional de Desarrollo Humano* (national development plan)
PPP	Purchasing power parity
PRGF	Poverty Reduction and Growth Facility (IMF initiative)
PRS	Poverty reduction strategy
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PSAC	Programmatic structural adjustment credit
SAC	Structural adjustment credit
SAL	Structural adjustment loan
SECEP	Secretary of Coordination and Planning
SETEC	Technical Secretariat of the Presidency
SIGFA	System for Financial Management and Auditing
SNIP	National System for Public Investment
SWAP	Sector-wide approach
TA	Technical assistance
TF	Trust fund
USD	U.S. Dollars
WTO	World Trade Organization

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Executive Summary

Nicaragua's state domination of productive capacity from the late 1970s to 1990, coupled with the civil war of the 1980s, left the economy with hyperinflation, large fiscal and current account deficits, and an external debt that was six times gross domestic product. As a result, economic activity declined at a sharp rate. By 1993, per capita income had fallen by a full 60 percent from the 1977 level. By the early 1990s the country was receiving aid equivalent to more than 70 percent of GDP. Subsequent administrations tried to address the country's economic problems through fiscal and monetary discipline and market-oriented reforms to redefine the role of the state. There were some successes — for example, decisive government action reduced inflation to around 10 percent by 1995 — but many reforms failed due to their slow pace and to continued political volatility.

The Bank supported the reform agenda with two economic recovery credit operations in the early 1990s. The results were less positive than expected, as the government's capacity to privatize state-owned enterprises and otherwise reform the public sector wavered in the face of political instability. The lack of political consensus prompted the Bank to withdraw from structural adjustment lending for several years. An opening for re-engagement was provided in 2002 when, after several failed attempts, Nicaragua successfully implemented the International Monetary Fund's (IMF) Poverty Reduction and Growth Facility (PRGF). This allowed the Bank to respond to the government's request for assistance to close a financing gap through fast-disbursing budget support in the form of a programmatic structural adjustment credit. While technically a structural adjustment loan, the credit supported objectives based on budget-based goals already attained in implementing a Poverty Reduction Strategy Paper (PRSP), which had been prepared by the government in 2001. In this sense, the credit was the last structural adjustment loan and the precursor to the Poverty Reduction Support Credits (PRSCs).

The first of Nicaragua's two PRSCs was approved in September 2003, in time to support the 2004 budget exercise. The IMF and the Bank agreed to support comprehensive debt service relief under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative to allow public resources to be redirected to poverty-reduction programs, while the reduced debt overhang served to boost investor confidence. The result was a strengthened macroeconomic framework and disbursement of the second tranche of PRSC 1. By this time, Nicaragua's political landscape had shifted once again, with the 2006 elections. While the new government has not embarked on a radical economic reform agenda, the change in government has posed new challenges for PRSC-supported reforms and put its poverty-reduction objectives under increased scrutiny.

The core of PRSC operations have been public sector reforms dealing with government financial and personnel management, including: legal establishment of the single treasury account principle; creation of this account in the Ministry of Finance registries; creation of an integrated System for Financial Management and Auditing; and creation of a civil service system and incorporation of all government workers into the system. The PRSCs also supported an ultimately abortive effort to create a private pension system to absorb all pensions in the country. Although these are the typical reforms supported by structural adjustment loans, this does not imply that the PRSCs are not oriented toward poverty reduction. One of the main obstacles to eliminating poverty in Nicaragua has been its slow rate of economic growth. Thus, focusing poverty-reduction operations on activities to improve economic performance and strengthen the institutional setting for government makes sense in the Nicaraguan context.

PRSC results in Nicaragua have been mixed. The credits supported important reforms that have strengthened public financial management, particularly in terms of fiscal discipline. The centralization of treasury balances through the single treasury account was a major step forward. Although the government has created a mechanism that could become a second vehicle to fund government operations, it would be a significant setback for the PRSC reform agenda if the single treasury account were bypassed. Poverty reduction was an area of PRSC weakness: according to the 2007 Poverty Assessment, total poverty remained constant at 46 percent of the population from 2001 to 2005. Perhaps even more disturbing, the PRSC 1 Implementation Completion & Results Report (ICR) found that extreme poverty rose during the first credit's time frame, increasing from 15.1 percent in 2001 to 17.2 percent in 2005.

As for the Bank's performance, the relevance and technical quality of its work has generally been high, although the Bank failed to conduct the proper analysis to understand the exact fiscal implications of a proposed pension reform. The Bank has been effective in donor harmonization and contributed decisively to the creation of the Budget Support Group, a donor group that provides budget support aligned with a unified performance assessment matrix drawn from Nicaragua's poverty reduction strategy. The Bank played a crucial role in keeping donor-government dialogue alive during a crucial period of adjustment to the Sandinista administration. The last contribution has been the subject of some controversy, as some donors thought it would be difficult to work with the new administration and others were willing to try. As coordinator of the Budget Support Group, the Bank was able to keep the possibility of budget support alive, which was a substantial contribution.

The Nicaragua PRSC experience offers several lessons:

- While the PRSCs were not clearly different from structural adjustment loans in Nicaragua, they showed greater potential as a tool for poverty reduction.
- Poverty cannot be significantly reduced over a single budgetary period. A poverty reduction strategy is meant to be broken down into strategic steps to be taken in budgetary periods. The multi-year budgetary framework is a good instrument to do that.
- Building a culture of monitoring and evaluation — and an institutional framework to assess and publicize results — is an important for moving from ideology to empirical evidence and experience.
- Lack of adequate, reliable information perpetuates a lack of trust in data, which undermines policy design.
- PRSC operations are most effective when they are strategic and focused on advancing long term poverty reduction objectives.
- Building borrower ownership requires involving officials in the design of operational policies and strategies to embed them into day-to-day budget management.

- There is no automatic recipe for meeting the objectives of the PRSCs in Nicaragua. There is a narrow path between taking government objectives uncritically, even when they run counter to the Bank's "best practices", and intervening excessively. The extent to which the Bank will be successful in attaining and maintaining this delicate balance will depend on the judgment and sense of perspective it brings to the task over the long term.

1. Background

1.1 *Economic performance*. At the beginning of the 1990s, state-owned companies accounted for 29 percent of Nicaragua's GDP. A lack of fiscal and monetary discipline had led to marked instability. In 1990, the fiscal and current account deficits had reached 29 percent and 36 percent of GDP, respectively, and the external debt was over 600 percent of GDP. Hyperinflation was severe, with 1991 prices 916 million times those of 1985. The public sector grew to 50 percent of GDP as a result of expropriations and the explosive growth of government bureaucracy and expenditures. Most state-owned enterprises lost money and required subsidies to survive, adding to fiscal deficits. In the context of this instability, coupled with the lingering effects of a decade of civil war throughout the 1980s, economic activity declined at a very sharp rate. By 1993, the country's per capita income measured in constant 2000 purchasing power parity dollars had fallen by a full 60 percent from the level in 1977.

1.2 Reform efforts in the 1990s and early 2000s met with mixed success. Decisive government action reduced inflation to rates around 10 percent by 1995; inflation remained around this level for more than 10 years, and then rose to 16 percent in 2007. Because Nicaragua was one of the most heavily indebted countries in the world, it was declared eligible by the World Bank and the International Monetary Fund (IMF) for the Heavily Indebted Poor Countries (HIPC) initiative. Nicaragua reached the HIPC decision point in December 2000 and the completion point in January 2004. . Total debt service relief was estimated at USD 3.3 billion in net present value terms, 72 percent of total debt outstanding after the full use of traditional debt relief mechanisms. The final settlement left Nicaragua with a total stock of debt equivalent to 56.2 percent of GDP.

1.3 Stabilization was unsuccessful in two areas: the current account and balance of payments and the fiscal deficit. At around 15.8 percent of GDP in 2006 and 2007, the current account balance deficit remained large, attributable to large amounts of capital donations and credits provided by external donors, which have averaged 20 percent of gross national income since 1993. By the early 1990s the country was receiving aid equivalent to more than 70 percent of GDP.[1] Fiscal adjustment has also posed a challenge, although the situation has improved in the last few years. In 2006 and 2007combined, the public sector attained surpluses equivalent to 0.2 percent and 1.2 percent of GDP.

1.4 Investment momentum has persisted throughout changes of government; exports continued to increase at an average annual rate of 12 percent and foreign direct investment increased by almost 50 percent in 2007 compared to 2006, while in 2008 it reached USD 626 mil-

1 This peak partially reflected the debasement of the local currency, which reduced the country's gross domestic product to low figures in terms of dollars. The reduction of inflation rapidly eliminated this effect.

lion (an increase of 30 percent above 2007 levels). Most of the foreign direct investment has been directed to the energy and telecommunication sectors. In mid 2009, however, that momentum has become seriously threatened by the cumulative effects of the global financial crisis.

1.5 *Track record on macroeconomic policy and structural reform*. Governments from the 1990s engaged in reforms to redefine the role of the state and focus on meeting the demand for public goods, turning away from activities that could be performed by the private sector. They also tried to spur private sector-led growth and designed programs to modernize the state, privatize state-owned enterprises, and facilitate operation of the private sector. Though well-intentioned, many of these reforms failed due to: their slow pace and the incomplete implementation of the reforms themselves; the damage done to the confidence of the private sector in the 1980s; and the country's continued political volatility.

1.6 Since early 2007, the new administration has continued to make progress on economic reforms inherited from the previous administration. This continuity has been key for sending the markets appropriate signals, especially for maintaining macroeconomic and financial sector stability. One of the first achievements of the new government was to successfully negotiate a three year Poverty Reduction and Growth Facility Program with the IMF as an important policy tool to continue to strengthen the healthy macro situation left by the previous President.[2] Some reforms were implemented before the successful first review of the PRGF, including penalization for energy theft and others which are under discussion with the Fund mission.

1.7 *Bank support through adjustment lending prior to the Poverty Reduction Support Credits (PRSCs)*. The International Development Association (IDA)[3] supported the market-oriented reforms that started in 1990 with three structural adjustment operations, two in the early 1990s and one roughly 10 years later. The long hiatus between the second and the third operations was the result of the protracted failure of the administrations of these years to bring fiscal stability and growth to the Nicaraguan economy. Table 1 shows how Nicaragua repeatedly failed to successful complete the IMF's Standby and Poverty Reduction and Growth Facilities (PRGF) approved before 2002. Only after Nicaragua successfully completed the 2002 Facility did the Bank approve the third structural adjustment operation, the 2003 programmatic structural adjustment credit (PSAC), also shown in Table 1.

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2 Although the PRGF has been delayed, a Fund mission was sent in August 2009 to discuss the pending reform agenda with the government, and the 2nd and 3rd PRFG review was finalized November 2, 2009.
3 The International Development Association (IDA) is the part of the World Bank that helps the world's poorest countries. Established in 1960, IDA aims to reduce poverty by providing grants and interest-free credits for programs that boost economic growth, reduce inequalities and improve people's living conditions. IDA complements the World Bank's other lending arm–the International Bank for Reconstruction and Development (IBRD)–which serves middle-income countries with capital investment and advisory services (www.worldbank.org).

Table 1: IMF PRGF and Bank Adjustment Operations Before PRSCs, 1991-2002

IMF Facility	Date of Arrange-ment	Date of Expi-ration or Cancellation	Amount Agreed	Amount Drawn	Drawn/ Agreed	Bank's IEG Outcome Rating
Standby Arrangement	Sept-18-91	Mar-17-93	40.9	17.0	41.7%	
PRGF Commitments	Jun-24--94	Jun-23-97	120.1	20.0	16.7%	
PRGF Commitments	Mar-18-98	Mar-17-02	149.0	115.3	77.4%	
PRGF Commitments	Dec-13-02	Dec-12-06	97.5	97.5	100.0%	
Total IMF			407.4	234.0	57.9%	
Bank Structural Adjustment Operations						
Economic Recovery Credit 1	Sep-26-91	June-30-92	110.0	110.0	100.0%	Satisfactory (PPAR)
Economic Recovery Credit 2	May-27-94	June-30-96	60.0	60.0	100.0%	Satisfactory (PPAR)
Programmatic Structural Adjustment Credit	Dec-18-02	Dec-31-2003	15.0	15.0	100.0%	Satisfactory (ICR review) The rating is tentative
Total Bank			185.0	185.0	100.0%	

Source: World Bank

1.8 The structural adjustment operations carried out in the 1990s were the economic recovery credits (ERCs) 1 and 2. The first operation, for USD 110 million, was approved in September 1991 and closed in June 1992; the second, for USD 60 million, was approved in May 1994 and closed in June 1996. These operations aimed to achieve price stability, modernize the state, arrest the decline of GDP, and revive growth in a sustainable, equitable manner. The results of the first economic recovery credit were not as positive as expected, as the government's resolve to privatize key state-owned enterprises and otherwise reform the public sector wavered due to continued political instability. Even so, OED[4] rated both operations as *satisfactory*, believing the measures taken were essential for the country's future development. The lack of political consensus between the country's executive and legislative branches prompted the Bank to withdraw from structural adjustment lending for several years.[5]

1.9 *Situating the PRSC in the country assistance program*. The opportunity for resuming IDA's non-project support presented itself after Nicaragua implemented successfully the 2002 Poverty Reduction and Growth Facility and the macroeconomic conditions appeared to be improving. These findings permitted the Fund to successfully conclude its third Poverty Reduction and Growth Facility review in October 2003. It was in this context that the Nicaraguan authorities requested the Bank's assistance in the form of fast-disbursing budget support to help close the external financing gap and avoid potential interruptions in poverty reduction due to funding shortfalls. The Bank responded in December 2002 with the programmatic structural adjustment credit (PSAC), a hybrid between a structural adjustment loan and a new kind of operation, the PRSC.

4 The Operations Evaluation Department (OED) of the World Bank was renamed the Independent Evaluation Group (IEG) in 2005. The two words are used interchangeably in this report depending on the time period in question (pre-2005 or beyond).
5 Bank assistance continued through project loans to support the Fondo de Inversión Social de Emergencia (Fund for Social Emergency Investment) as well as loans for other poverty-reduction, health, and education projects.

1.10 While the credit was meant to be the first PRSC, the government had not yet put in place the required environment for programmatic lending through PRSCs. The Country Assistance Strategy (CAS) identified the deficiencies: the government could not ensure that the program would support implementation of its Poverty Reduction Strategy Paper (PRSP), and public financial management and procurement could not ensure transparent, economic, and efficient use of government resources (World Bank 2002b). Although it was called a structural adjustment loan, the credit was similar to the PRSCs in its support for budget-based objectives based on goals already attained in implementation of a Poverty Reduction Strategy Paper (PRSP), prepared by the government in collaboration with the Bank, Fund, and civil society groups. In this way, the credit was the last structural adjustment loan and the precursor to the PRSCs.[6]

1.11 The programmatic structural adjustment credit was based on Nicaragua's first Poverty Reduction Strategy Paper, prepared in 2001 under the name of *Estrategia Reforzada de Crecimiento Económico y Reducción de la Pobreza.*[7] The 2002 Country Assistance Strategy allocated USD 120 million of assistance to Nicaragua over the period FY03-FY05 in the base case and an additional US 40 million in the high case lending scenario. After approval of the Country Assistance Strategy, the initial allocations were increased by around USD 45 million over the FY04-FY05 period, due to Nicaragua's good performance. Nicaraguan authorities requested that USD 35 million of the additional IDA allocation be assigned to PRSC 1, and the Bank agreed. The larger allocation to PRSC 1 was in line with the rationale for increased programmatic lending, set out in the Country Assistance Strategy. PRSC 1 (now USD 70 million in total) was prepared in two tranches to ensure satisfactory implementation of the reform program in a difficult political environment.[8]

1.12 The first PRSC was approved in September 2003, less than a year after the approval of the poverty reduction strategy and in time to support the 2004 budget exercise. At approximately the same time, the Fund and the Bank agreed to support comprehensive debt service relief under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative. In January 2004, Nicaragua reached the HIPC completion point. The debt relief allowed more public resources to be

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6 The Poverty Reduction Support Credit (PRSC) represented a major departure from the prior adjustment lending model of the World Bank. Introduced in early 2001 in the context of global changes in aid architecture that recognized the importance of country ownership, government reform commitment, and multi-dimensional poverty reduction, PRSCs were intended to aid country-owned Poverty Reduction Strategies, support comprehensive growth, improve social conditions, and reduce poverty. Compared to previous adjustment lending, PRSCs aimed to ease conditionality, provide more predictable annual support and strengthen budget processes, all in a results-based framework. Many of its principles were reflected in the Paris Declaration of Aid Effectiveness. Within four years of their introduction, PRSCs came to account for almost 60 percent of IDA policy based lending and a quarter of total Bank policy based lending. From FY01-FY08, the Bank approved 87 PRSC operations amounting to US$ 6.6 billion. By end-September 2009, PRSC approvals increased to 99 operations, with another 20 in the pipeline.

7 The strategy had four pillars: broad based economic growth with an emphasis on productive employment generation and rural development; greater investment in the human capital of the poor; protection for vulnerable populations; and strengthening of institutions and good governance

8 PRSC are envisaged as being one-tranche operations as they are designed to support a yearly budget. At the time of the design, however, designing an operation with two tranches was not seen as unnatural for a PRSC.

directed to poverty-reduction programs, while the reduced debt overhang served to boost investor confidence, likely contributing to growth of remittances and private investment in 2005.[9] The Fund approved Nicaragua's participation in the Multilateral Debt Relief Initiative (MDRI) in December 2005, which the Board approved in March 2006. These developments led to a strengthened macroeconomic framework that resulted in successful completion of the Facility reviews, extension of the program until end-2006, and disbursement of the second tranche of PRSC 1.

1.13 The Bank aimed at coordinating the PRSCs with the budget in three ways. First, the PRSCs supported activities in the budget. Second, the PRSC's annual schedule was set so that the design of each operation would coincide with the budget preparation cycle. Third, the Bank promoted the creation of the Budget Support Group (BSG, also known as GAP after its Spanish name) among donors. The group began to coalesce in 2003 and began to operate in 2005, the year PRSC 1 was approved and became effective. In May 2005, the Bank and other Budget Support Group donors signed a joint financing arrangement (JFA) with the government. The arrangement included wording on "fundamental principles"[10] and committed signatories to base policy conditionalities of their budget support operations on a common performance assessment matrix (PAM), reviewed jointly once a year. The matrix's pillars would be based on a Poverty Reduction Strategy Paper, which would state the government's strategy to reduce poverty, thereby uniting government, Bank, and other donors. Budget Support Group members agreed to manage the process in accordance with an annual schedule: review poverty-reduction goals in May; make firm financing commitments in August so the government could include them in the planned budget; and present to the Assembly in November. The expectation of donors and government was that general budget support would amount to USD 100 million per year, of which the Bank would provide USD 20-25 million.

1.14 The first performance assessment matrix was based on the Poverty Reduction Strategy Paper-1 of 2001 and served as the basis for the programmatic structural adjustment credit and PRSC 1. The Poverty Reduction Strategy Paper-1 was modified in 2005 to become the basis for a revised performance assessment matrix, which in turn was the basis for PRSC 2.

1.15 The original idea was that PRSC 2 would be the last operation in the first series of the PRSCs. Subsequent PRSCs would be based on a new Poverty Reduction Strategy Paper to be produced without interrupting the budget support. The end of the first series, however, was not as smooth as planned due to the 2006 elections, which resulted in the loss of acceptance of the PRSCs' objectives and embedded strategies; in addition, the new government gave its full focus to reaching an agreement with the IMF.[11] In the process, it failed to comply with the deadlines that would make it possible to design the budgetary support for 2008. The government tried to

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9 Much of Nicaragua's external debt relief must go toward internal debt payments as well as poverty reduction programs. Its debt burden is largely attributable to the financial crisis of 2001 and the large internal debt that was incurred to resolve this, in addition to the reimbursement of confiscations that occurred in the 1980s. In February 2008, the government paid some USD 100 million in BPI bonds.
10 It was an alleged breach of these principles that led to the hiatus in budget support by bilateral donors in 2008 and 2009.
11 On October 9th, 2007 the Fund approved a three-year USD 111 million loan to Nicaragua.

resolve this problem by presenting a new performance assessment matrix, but the matrix lacked strategic objectives and the required detail to link it to the budget. As a result, there was no PRSC or any other development policy operation in 2008, and the government opted instead to prepare a new Poverty Reduction Strategy Paper to support the goals established in the November 2007 performance assessment matrix. In FY 2009, the government pushed for a DPO, but still had not met the conditions for doing a PRSC series. Finally, the government settled for undertaking an investment operation focused on Competitiveness for micro, small, and medium sized enterprises; and in lieu of additional IDA financing that they had hoped for, they agreed to use USD 20million originally allocated for the first part of the next PRSC series.

2. PRSC Design

To what extent is there a discernable difference between the PRSC series and other adjustment lending/development policy lending?

2.1 *Design and content*. A modest number of differences could be detected between PRSCs and their predecessors in terms of objectives and content. The PRSC operations aimed at improving the country's ability to use its budget as a tool to benefit the poor in three ways. First, in terms of objectives, the PRSCs would focus on the reduction of poverty. Second, in design, they would be flexible enough to adapt to the needs of each country in its particular circumstances. Third, in processes, operations would support poverty reduction strategies fully owned by the borrower, be focused on results, and be designed with ample stakeholder participation.

2.2 There were two dimensions to the differences between the PRSCs and structural adjustment loans in terms of design, with the first related to objectives. While the main objective of adjustment operations was to stabilize the economy and reform its structures to create the basis for sustained growth, the PRSCs focused on supporting the government in the sustainable reduction of poverty. Certainly the objectives overlapped. Poverty reduction was one of the expected results of the structural reforms; by the same token, efficient structural reforms are a precondition for the reduction of poverty. Yet the shift in emphasis was expected to result in more sharply focused operations with faster returns in terms of poverty alleviation.

Table 2: Activities Supported by Structural Adjustment Loans and PRSCs

	ERCs	PSAC	PRSC 1	PRSC 2
Pillar 1. Broad-based Growth and Competitiveness				
Economic Policy formulation	Support for economic policy formulation	Support for economic policy formulation	Support for economic policy formulation	Support for economic policy formulation
	Support for stabilization policies	Support for stabilization policies	Support for stabilization policies	Support for stabilization policies
	Trade Liberalization			Approval of CAFTA

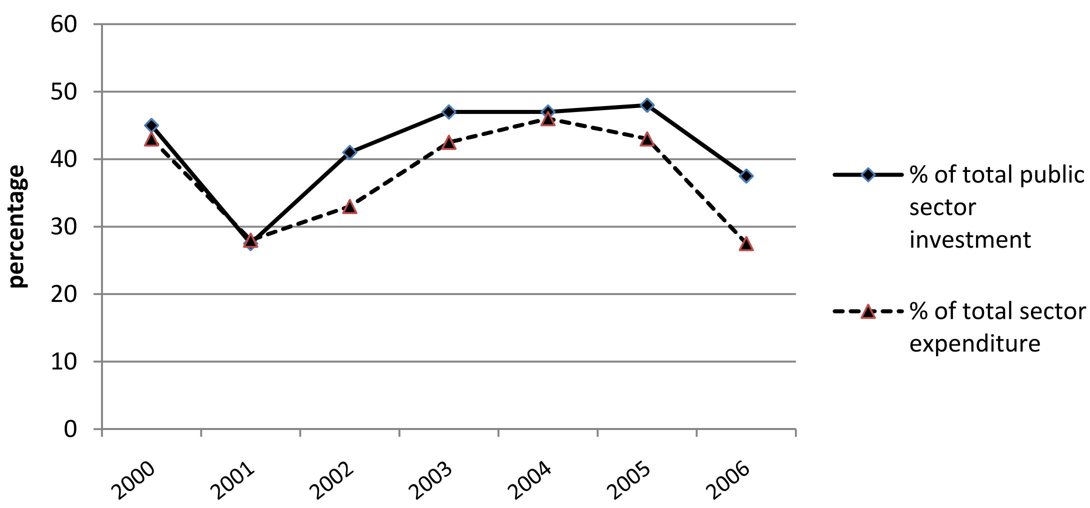
Privatization	Privatization of all state-owned companies	Divest 51% of shares in state-owned telecom company		
Private Sector Development	Property Rights Banking discipline	Creation of agric tech markets	Property Titles in indigenous territories	Registration of indigenous titles
	ERCs	PSAC	PRSC 1	PRSC 2
Private Sector Development	Improve Financial Information Develop Private Financial system Improve Labor Productivity	Create a foundation to finance provision of agricultural services		
Pension Reform		Appoint Superintendent and authorize 2 private funds	Reduce cost of Pension Reform	
Pillars 2 and 3. Human Capital of Poor and Vulnerable Populations				
Access to Water		Increase access to water and sanitation in 1.4%	Approve National Water & Sanitation Strategy	
Education And Health		School Autonomy Law	Increase # of autonomous schools	Reduce fiscal impact of autonomous schools
		General Health Law, results-based management system for 13 municipalities	Target share of social expenditures in budget	Target share of social expenditures in budget
Social Protection Policy			Approve a Social Protection Policy	
Pillar 4. Building Public Institutions and Governance				
Public Sector Reform	Military demobilization & labor mobility	The introduction of a single Treasury account		Financial Administration Law
	Improve State-Owned Banks	Implementation of integrated financial management system (SIGFA) Prepare report on poverty-focused expenditures Regulations to measure poverty reduction	Balance Municipal Finances Improve public investment management Create Rural Electrification Fund	Incorporate civil servants into career

Sources:Government of Nicaragua, World Bank

2.3 The Poverty Reduction Strategy Papers that served as the basis for the two PRSCs defined the poverty reduction strategy as resting on four main pillars (see Table 2): Pillar 1 — Broad-based growth and competitiveness; Pillar 2 — Investment in human capital of the poor; Pillar 3 — Protection for vulnerable populations; and Pillar 4 — Building public institutions and governance. These pillars are not significantly different from those of any structural adjustment operation and could be used to describe structural adjustment loans. The difference is that structural adjustment loans could be expected to emphasize pillars 1 and 4, while the PRSCs emphasize pillars 2 and 3. Table 2 compares the activities supported by the Nicaraguan structural adjustment operations of the 1990s with those supported by the hybrid operation of the 2002 programmatic structural adjustment credit and with those supported by the two PRSCs. As seen in the table, the structural adjustment operations of the 1990s did not support activities in the social pillars, 2 and 3. Except for some minor reforms contained in the programmatic structural adjustment credit, these appeared only in the PRSCs. This comparison suggests there was a substantive difference between the PRSCs and the structural adjustment loans.

2.4 But this difference becomes smaller due to three considerations. First, the social activities supported by the PRSCs in pillars 2 and 3 were isolated measures, not linked in an explicit way to the advancement of strategic objectives. In fact, there were no measures dealing with health in the PRSCs[12], and those dealing with education supported the extension, to all schools, of the Autonomous School System, a system created in 1993. Second, most of the activities supported by the PRSCs were contained in pillars more associated with structural adjustment loans 1 and 4. Third, though the PRSCs did not contain an explicit scale of priorities, the core of operations was in public sector reforms dealing with government financial and personnel management, including: legal establishment of the single treasury account principle; creation of this account in the Ministry of Finance registries; creation of an integrated System for Financial Management and Auditing (SIGFA); and creation of a civil service system and incorporation of all government workers into the system. The PRSCs also supported an ultimately failed effort to create a private pension system that would have absorbed all pensions in the country. All these activities were much bigger and more strategic than those supported in the social sectors; they were also the typical reforms supported by structural adjustment loans. And they were the core of the PRSCs. On balance, Table 2 suggests that the PRSCs differed from the structural adjustment loans only moderately. In short, the series of PRSCs could be described as structural adjustment loans with some social components.

Figure 1: Investment in Social Sectors as Percent of Total Public Sector Investment and Total Sector Expenditures



Source: PER 2001-2006, March 2008, World Bank

12 The lack of an explicit focus on health in the PRSC was largely because the PRSC was part of a much larger coordinated donor effort; agreement between donors and the government stipulated a clear division of labor in which the health sector would be addressed by other types of donor support.

2.5 It is important to note that rating the difference between the PRSCs and the structural adjustment operations as moderate does not imply that the operations were not oriented toward poverty reduction. It is well known that the most important variable associated with poverty reduction is economic growth, and a main obstacle for the elimination of poverty in Nicaragua during the last thirty years has been its slow rate of economic growth. Moreover, Nicara-Nicaragua lacks the institutional strength needed to use the budget as an instrument of policy to deliver social services in an effective way. Thus, focusing poverty reduction operations on activities aimed at improving economic performance and at strengthening the institutional setting of the government, activities that formed the core of the structural adjustment loans, makes sense in the circumstances of Nicaragua. Yet supporting reforms aimed at improving the state's ability to work more efficiently should not preclude supporting strategic "pro-poor" reforms such as investment in human capital, providing access to social services, and generating broad-based growth. Moreover, as shown in Figure 1, investment in social sectors declined as a percent of total public sector investment and as a percent of total social sectors expenditures during the implementation of the PRSCs.[13]The fact that the PRSCs concentrated mostly on the reform of the state and much less on measures aiming at generating a broad-based growth and better access of the poor to social services is an important weakness in these operations.

2.6 *Flexibility*. The second dimension of difference was the emphasis on flexibility, which was supposed to be embedded in the design of the PRSCs through two features. First, the loans would not be linked to specific activities but would instead provide general support to the budget. Second, they would be programmatic. Different from the average structural adjustment operation, the PRSCs were approved based on a multiyear strategy — the Poverty Reduction Strategy Paper — and their disbursement was not conditional on the fulfillment of conditions to be met in the future. Instead, they were approved and disbursed on the basis of actions already taken in the pursuit of the multiyear strategy. Each operation had expected results, which in turn would be the triggers for the approval of the next operation.

2.7 Yet government officials that worked in the design and implementation of the PRSCs told the IEG mission that, even if some of the features of the PRSCs (especially their programmatic nature and their general budget support) made them more adaptable to the needs of the country than structural adjustment loans, the operations were not noticeably more flexible than previous operations. They point out that, in practice, the conditions that had to be met to get access to the funds were as exacting as those under the structural operations and did not allow for significantly more flexibility. In fact, they noted (as did those on the Bank side), that the PRSCs contained an excessive number of conditions and triggers[14] Moreover, they stated their

13 Recent data from the Bank's Nicaragua country team for 2007-2009 show that government expenditures on poverty increased from US$536.4M (the yearly average from 2002-2006), or 11.7% of GDP, to US$791.3M in 2008, or 13.2 percent of GDP. The education and health sectors combined received over 29 percent of total public expenditures in 2009

14 After the two tranche PRSC 1, the PRSC was modified accordingly, and its use evolved both in general and in Nicaragua.

belief that the Bank "forced the government to take severe political costs" in the implementation of the programs that the PRSCs supported.

2.8 These officials cited as an example of the lack of flexibility the Bank's insistence on including in the PRSCs the delivery of property titles to the indigenous population in the north of the country, although the government did not think this action took priority in its strategy. The government delivered only one title; thus, USD 5 million was deducted from the second disbursement of PRSC 1 since this condition was a trigger.[15]Having said this, there is a consensus in Nicaragua that the Bank has recently become much more flexible. However, this change is not due to the PRSCs themselves but rather to the Bank's accommodation of the sharp change in political orientation of the government since the 2006 elections. Officials of previous administrations resent this new flexibility as much as the rigidity of the previous years and point out that the Bank became more flexible, not just with the PRSCs, but more generally, when the new administration took over.[16]

2.9 One example is the Bank's acceptance of the abandonment of the Autonomous Schools Project.[17] They also point to the Bank's support for the adoption of a health care model focused on payments for a basic package of health services in accordance with the ability to pay. Among some officials interviewed, there was the perception that the new government had abandoned the model, and that the Bank had not defended it (in actuality, the model was approved and expanded geographically and now incorporates many strategies (chronic malnutrition, reproductive health, AIDS) that were developed on paper but not institutionalized territorially. Similarly, while the Bank had required the previous government to take civil society into account, they note that the Bank is now less insistent because the government is reluctant to enter into discussions with nongovernmental organizations.[18] In short, in the view of these former officials and

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15 Another trigger—for creating autonomous schools—was delayed, but the Bank was flexible in accepting this, once the new Minister of Education (who had been previously unaware of this condition) issued a decree declaring some schools autonomous

16 Bank staff refute this claim, citing several instances in which the Bank responded to unsatisfactory progress by the government with delays or reductions in funding. For example, a FY09 development policy credit was delayed due to some uncertainty surrounding the CENIS (government bonds) and the possibility that the GON would not respect their payment (even though there was no specific trigger on this).The government was also recently obligated to reimburse the Bank over $750K from the current health operation for failing to respect Bank procurement procedures – one of these cases being from the previous administration.

17 Bank country staff note that, when this model was abolished in the first few days of the new administration, the Bank was virtually the only defender of the model (aside from the one Minister of Education who started the program). However, the Bank lacked evidence of the model's effectiveness in terms of better outcomes and, according to some Bank sector specialists, "did not sufficiently monitor [the] program and put in place the necessary evaluations that would have corrected deviations and improve[d] program design."

18 Bank country staff note that the Bank was, indeed, very active with civil society during the PRSC period, particularly on the conditionality of the Access to Information law; it promoted the creation of a group of NGOS that worked closely with the government and the National Assembly to design the new law which was finally passed under the current administration. The Bank also concentrated on the promotion of social auditing of major social public policies; it held an extensive national consultation on the

some other local observers, the Bank's flexibility has become excessive and is eroding its credibility.

2.10 *Government opinion on differences between the PRSCs and earlier lending operations*. The government's opinion on PRSC design changed radically after the election of 2006. Officials from the administration that negotiated the operations believe that the design of these operations met the challenges of poverty reduction of the time. Officials from the current administration are critical of its design and argue that it did not help Nicaragua in attaining strong broad-based growth, poverty reduction, or sustained institutional improvement. The criticisms of the current government are focused on the orientation of economic development implicit in the design of the Poverty Reduction Strategy Papers and on the models of school administration, health service delivery, and pension reform that they promoted.[19] The first two of these areas were considered successful by previous administrations, but a failure by the new administration. Pension reform was abandoned by the previous administration.

2.11 Officials with the current government believe that strategies supported by the programmatic structural adjustment credit and the PRSCs did not aim at broad-based growth but favored the growth of large enterprises at the expense of the rest of the country. The government also believes that the PRSCs had too many triggers and conditions and that they lacked priority. The government sees this as a manifestation of a lack of focus in the previous government and emblematic of the Bank's basic approach to development. In the future, it would like to focus on a smaller number of programs with a higher potential for poverty reduction.

2.12 Although highly critical of the reforms associated with the PRSCs, the government has not announced any plan to undo them, although it has signaled a change in direction for economic reform. As an example of the direction it wants to take, the government has announced that it would like to center its economic efforts on developing the productive capacity of rural families through a program called "Zero Hunger." The program would provide each rural family with a pregnant cow, a pregnant pig, some chickens, and food to feed the animals. The program would be accompanied by a prohibition on selling the animals and a prison sentence for those that violated it. A second program "Zero Usury," would finance these families with subsidized credits. While the government says that it intends to reach the entire population with these programs, it allocated less than USD 20 million to them in the 2008 budget. According to local observers interviewed by the Bank's Independent Evaluation Group (IEG), the government did not have enough budgetary headroom to allocate a larger amount and did not succeed in finding a donor willing to fund the projects.[20]

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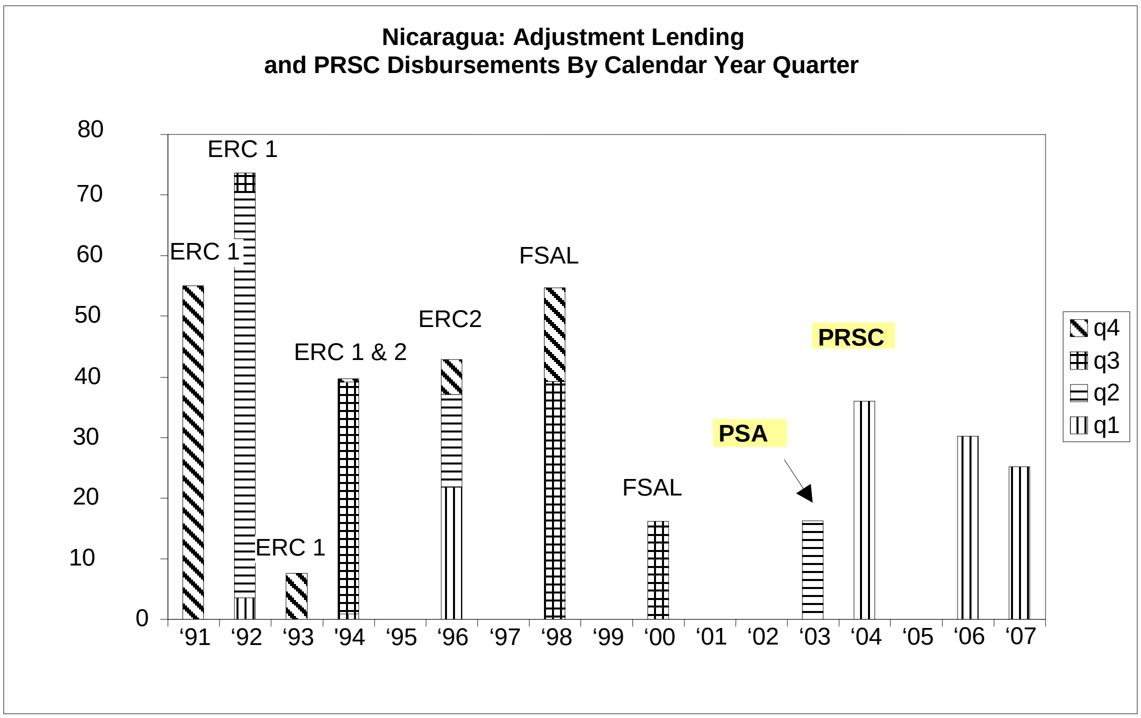
new FY 2007-2012 Country Partnership Strategy; and it is currently beginning the implementation of a major development program in Nicaragua's Caribbean Coast with local and international NGOs as implementation agencies. However, the Bank has avoided working with some NGOS whose political profiles, it feels, now exceed their operational profiles.

19 Appendix A provides more detail on the school administration, health service delivery, and pension reform models.

20 Bank country staff note that the government has, since this time, evolved its menu of anti poverty programs, and the IDB has recently approved $20 million each for "improved versions" of these Zero

2.13 *Regularity of disbursements*. Attaining regularity and predictability of disbursements requires a difficult balancing act between the need to disburse on a regular basis and the need to make sure disbursements take place only after borrowers meet the requisite conditions. Structural adjustment loans gave almost absolute priority to the second objective. As a result, disbursements of these operations were quite irregular in terms of size, frequency, or both (see Figure 2). In this way, even if there were disbursements in each year from 1991 to 1994, the amounts disbursed varied substantially in each year. Then, from 1994 to the last adjustment operation, disbursements took place only once every two years. It is clear that it became difficult for the Ministry of Finance to count on the availability of the structural adjustment loan disbursements.

Figure 2: Disbursements by Calendar Year Quarter, USD millions



Source: World Bank, IEG calculations based on loans documentation

2.14 The PRSC was conceived as a vehicle to finance the budget in a regular, predictable way. This objective was attained at the beginning of the process in terms of frequency, if not in terms of amount. The Bank disbursed the programmatic structural adjustment credit in 2003 and the first tranche of PRSC 1 in 2004. According to the PRSC logic, the second tranche should have been disbursed in 2005. The government met the conditions to disburse this tranche in only 2006, leaving 2005 without budget support. PRSC 2 was disbursed on time, in 2007. The regular-

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Hunger, Zero Usury programs. Major rural electrification and urban and rural water and sanitation programs are also being implemented.

ity stumbled again in 2007-2008, as the government failed to comply with deadlines agreed to with the Bank and Budget Support Group (BSG) members. However, this failure cannot necessarily be attributed to the PRSCs. Evidence indicates that, if the government had been on time in producing an operational Poverty Reduction Strategy Paper in 2007, the approval of the next PRSC would have occurred on time. Bank country staff assert that this was due to the request of the government for an investment operation and that, if the government had insisted on receiving budget support, they could have resorted to an ordinary development policy loan in the absence of an updated PRSP.

2.15 Nonetheless, it can be said that, overall, PRSCs have not resulted in regular and predictable disbursements. Yet this statement must be qualified in two ways. First, the PRSCs have been more regular than structural adjustment loans. Second, the irregularity that remains cannot be attributed to either PRSC design or implementation. Instead, it has been the result of the government's lack of compliance with the conditions of disbursement (in the case of PRSC 1) or deadlines established for the processing of the Poverty Reduction Strategy Papers and the PRSCs.

2.16 Regarding the regularity of the disbursements of other Budget Support Group members, the 2006 Public Financial Management report rated donor practices with the lowest grading among 7 indicators (1.5 out of a maximum grade of 7), based on its performance in terms of predictability and information provided by donors on their projects (Government of Nicaragua 2006). The report noted, however, that the joint financial agreement signed by most of the members of the Budget Support Group in May 2005 has had a positive effect in aligning the disbursements of this group with budget needs. It also noted that the discrepancies between needs and disbursement dates were attributable to government's delays in meeting conditionalities.

3. PRSC Process

How effective have PRSCs been as a vehicle to help Nicaragua operationalize a country-driven poverty reduction strategy?

3.1 *PRSC alignment with national development strategy and sector strategies*. PRSCs were intended to be designed around a program formulated by the government to reduce poverty in the medium and long term. The PRSCs in Nicaragua formally met this condition. They were based on the Poverty Reduction Strategy Paper drafted by the government in 2004, entitled "Plan Nacional de Desarrollo 2005-2009," which updated an earlier "Estrategia Reforzada de Crecimiento Económico y Reducción de la Pobreza," prepared in 2001. Yet, while this condition was formally met, in the opinion of most people interviewed by IEG, the country has not yet moved toward a country-driven strategy. The initial versions of the government's strategy papers have been rhetorical, with limited connection to the actions needed to attain objectives.

Traditionally, the Bank has stepped in to propose strategies that were then approved. Both structural adjustment operations and PRSCs exhibit this pattern.

3.2 *Ownership*. Officials in the government at the time of the design of the PRSCs commented that, while it was true that the operations were based on the Poverty Reduction Strategy Paper, the latter was designed primarily by a small group of Bank technicians, who worked on their own with help from selected officials from the Ministry of Finance and Technical Secretariat of the Presidency (SETEC), with limited contributions (other than data) from other government institutions.

3.3 The degree of support that existed in the government for the policies and reforms in the PRSCs was generally strong. The ownership problem was visible in two aspects of the process. First, while the government may have agreed with the Bank in terms of objectives, it was the Bank that formulated objectives in an operational way. Second, the Bank included certain objectives and activities that were not supported by the government, allegedly in some cases, despite government opposition. Such was the case with the inclusion of the titling of properties in the Atlantic Territories, which the government (at least the previous administration) did not see as a priority activity.[21]

3.4 Despite these problems, most interviewees thought that the government had made progress over the years in terms of acquiring the ability to design operational programs. However, the government's ability to operationalize a strategy for the period immediately after the election was judged, at least initially, to be low for two reasons. The administration's statements of objectives and policy have not been clear enough to serve as the basis for operational programs; as a result, even highly skilled technicians would have problems interpreting and translating such statements into operational programs. One such problem may have been the design of the new health care strategy, which constitutionally provides for universal free coverage for all kinds of illnesses in a country with limited fiscal resources. Second, the new government dismissed some persons who had accumulated experience in the formulation of operational strategies under the previous administrations (with the exception of technicians within the Ministry of Finance, who were largely spared).

3.5 The government's difficulty in designing an operational strategy became evident in the delays that led to the 2007 interruption of the PRSCs and Budget Support Group activities. As previously noted, while the new government denounced as inadequate the strategies contained in the previous Poverty Reduction Strategy Paper, it was unable to produce a replacement in time for it to become the basis for a new series of PRSCs and for the 2008 budget support program. It produced a matrix of 20 policies that, in the opinion of most observers, was not clear enough to serve as the basis for a program; indeed, some measures may go against Bank best practice. As in previous occasions, the Bank stepped in to operationalize the matrix with a development policy credit. As a result of the vagueness of the government's performance assess-

21 Bank country staff aver that titling of Indigenous lands has always been a priority of Nicaragua's two Autonomous regions where the majority of Nicaragua's ethnic populations live, and the Bank's investment operation- PRODEP- has been financing this component for over eight years The current administration has now granted and registered an additional 11 Indigenous territorial titles,

ment matrix, the IDA credit program document included the following as one of the risks of the planned operation:

> Finally, there is a risk of being surprised by the content of the forthcoming poverty reduction strategy paper that is currently under preparation. It is possible that once the PRSP update has been completed, important elements of the strategy may turn out contrary to IDA best-practice recommendations and present an inadequate framework for a new PRSC series. To mitigate this risk, Bank staff are seeking to engage the authorities in early discussions on the elements of the PRSP, in an effort to warn against potential pitfalls (World Bank 2008b).

3.6 Thus, as has been the case before, it is Bank staff who are interpreting a government document to distill from it an operational program and a credit design.

3.7 *Participation*. During the last decade, the Bank placed crucial importance on the participation of the civil society in the formulation, implementation, and evaluation of policies and strategies. Frequently it did so against the resistance of the previous Nicaraguan governments, insisting that such participation was essential to PRSC processes. Under the current administration, participation of independent civil society in the formulation, implementation, and evaluation of strategies is extremely limited, at least partly because—according to Bank country staff—the extreme political polarization of the country at the moment can make it difficult to decide who is independent. As noted above, the Bank's acceptance of this development has also been interpreted as a sign of excessive flexibility.

3.8 *Effects on governmental policy dialogue*. The first two PRSCs contributed to promoting government policy dialogue, both internal to the government and with other participants, including the private sector, nongovernmental organizations, and donors. The dialogue was not as extensive and intensive as would have been desirable, and it is not clear whether it represented an improvement relative to what was done during the design and implementation of structural adjustment loans. As noted before, however, the new government excludes the nongovernmental organizations from policy dialogue.

3.9 *Results focus*. The focus on results is one of the main requirements of the PRSC design, and efforts have been made to attach indicators to measure the success of each activity supported in the loans. This is easy to do when dealing with indicators that are under the control of the government — such as the fiscal deficit as a percent of GDP, the size of the debt, or the number of people employed in the government. The PRSCs were quite result- oriented in all results that could be measured in this way, which tended to be those linked to activities that were similar to those supported by structural adjustment loans.

3.10 However, poverty reduction programs and activities are particularly challenging in this respect, because poverty reduction involves complex, long-term processes that are affected, in still poorly-understood ways, by many different factors, many of which are beyond the control of the government. Thus, isolating the impact of a single activity on overall results may be close to impossible. Moreover, trying to do so without establishing a clear connection between actions taken and expected results would give a false perception of orientation to results. This problem existed in PRSC 1. Some of the expected results could not be traced to any proposed action, and some actions were expected to produce results that depended heavily on many other actions. In addition, some of the indicators were difficult to measure in Nicaragua, so that it was not clear whether they had gone up or down or stayed the same after implementation of the loan.

3.11 For example, PRSC 1 included as indicator number 1 a reduction of the proportion of people living in extreme poverty from 15.1 percent in 2001 to 14.3 percent in 2005. Rather than going down, the indicator went up to 17.2 percent or remained unchanged at 15 percent (depending on the measurement).[22] More fundamentally, the loan documents did not contain a reason to explain the combination of actions that would result in the expected reduction of extreme poverty. It is difficult to determine precisely what occurred in this instance, and whether the deterioration of the indicator was the result of shortcomings in the government's strategy. Another example in PRSC 1 is indicator 7, which specified that the primary education completion rate would improve from 38.5 percent in 2002 to 44 percent in 2005. This indicator was much simpler than poverty reduction and could have been linked to certain aspects of the strategy supported by the loan. But such a linkage was never established in the loan documents. This situation improved in the second operation. PRSC 2 did not include disconnected indicators such as these.

3.12 *Monitoring and evaluation system*. The monitoring and evaluation system of the Nicaraguan government is weak; in fact, it does not exist except for the generation of statistics and indicators, which are deemed unreliable by many observers. The unreliability of the data can be largely attributed to lack of competence in the design and collection of indicators. Some observers also believe the system is not entirely protected from political manipulation. The culture of monitoring and evaluation still does not exist in the government. The Bank or other donors have written or funded practically all the reviews of projects and strategies available. Scheduling meetings/interviews for studies such as this one, or collecting the necessary data from the government side, has proven very difficult. The Bank, however, has maintained a program of economic and sector work that includes ongoing monitoring of the economic situation of the country (with the IMF) as well as the poverty situation (with the poverty assessments) and progress in the reform of the state and social policies.

How effectively have the PRSCs contributed to donor harmonization around a country-owned, medium-term poverty reduction strategy?

3.13 *Relationship to other general budget support programs*. The PRSCs played an important role in the creation and operation of the institutional setting necessary to harmonize the donor community around a country-owned, medium-term poverty reducing strategy. The Budget Support Group was established in 2003 and began to operate in 2005.

3.14 The group has worked reasonably well in tying their support funds to the Nicaraguan budgetary process. Yet, it still falls short of operating as a closely coordinated team acting as a

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22 According to data produced by the Implementation Completion Report, extreme poverty increased to 17.2 percent. According to the data of the 2007 Poverty Assessment, it remained constant at 15 percent.

single entity in its discussions with the government. In fact, as the government has pointed out several times, with the exception of the multilateral institutions (the World Bank and, very recently, the Inter-American Development Bank), the Budget Support Group members do not have much freedom to make decisions regarding the kind of programs they would support. Most of them have mandates to finance certain activities that are politically important in their home countries, such that discussions with the government centers mostly around lobbying for the inclusion of such activities in the budget and then committing to funding them at a certain level. If these activities are not included, the donor cannot pledge resources to the budget. Thus, the discussions between these Budget Support Group members and the government are less of an open discussion of strategies than exercises aimed at matching what the donors can fund with what the government may want. Also, most donors in the Budget Support Group have relatively less technical capacity to analyze government proposals and, thus, often provide more general opinions regarding poverty-reduction issues. There are exceptions, of course, such as the German Technical Co-operation (GTZ) and KFW who command considerable technical expertise in a range of issues. In general, however, only the multilaterals—namely the World Bank and the Inter-American Development Bank (IDB)—have the technical scope and resources to engage in a full policy dialogue with the government and to provide analysis and support over a wide range of issues.

3.15 *Performance assessment framework and policy matrix*. It is important to note that, although the matrix of policies supported by the PRSCs is derived from the performance assessment matrix, it is not identical to it. This is because the Bank negotiates with the government the contents of the PRSCs, changing the matrix in the process. Some donors and some officials from the government complained that divergences between the two matrices create confusion and additional paperwork, suggesting, in fact, that the Bank should adopt the performance assessment matrix for its PRSCs. This sounds reasonable. Yet, the process through which the matrix is modified to become the matrix of policies for the PRSCs produces the only serious discussion of the Poverty Reduction Strategy Paper in operational terms — in effect, this discussion provides a needed reality test. To equalize the two matrices would require either: eliminating the Bank-government detailed dialogue that leads to the final design of the PRSCs (which would not be reasonable), including the other donors in a dialogue which they mostly lack the technical ability to sustain (which would be wasteful), or automatically adjusting the matrix to accommodate the results of the Bank-government dialogue (which the other donors would not accept). In practice, the differences between the matrices are so small that this is a non-issue, if the sensibilities of the other donors are excluded.

3.16 As discussed earlier, in 2007 the Government did not meet the procedures established for the design of the budget support operations[23]. There are two dimensions to this. First, the government failed to meet the established deadline to produce a Poverty Reduction Strategy

23 The Performance assessment matrix was produced and negotiated with the donor community (Budget Support Group) on the basis of: 1) a general acceptance of the previous Plan Operativo del Plan Nacional de Desarrollo, finalized by the previous administration in late 2006; and 2) the PEF (Plan Economico Financiera) negotiated with the IMF within 6 months of assuming the government. This was accepted by the donor community as an interim measure while the government prepared a new national development plan.

Paper. Second, the government produced a new performance assessment matrix even though it had not yet produced the Poverty Reduction Strategy Paper that should have been the basis for it. In October 2008, the government presented its new Poverty Reduction Strategy Paper (the Plan Nacional de Desarrollo Humano—PNDH) to the donor community. Since then, however, it has decided to produce an updated version that reflects the effects of the current international and national economic crisis. That updated version, which was prepared with Bank technical assistance and reflects the effects of the global crisis, was presented to donors in November 2009.

3.17 *Effects of a single PAF on policy dialogue and PRSC program.* As previously noted, the ability of most Budget Support Group members to conduct a full policy dialogue with the government is quite limited, mostly because they lack staff with the required skills. The Bank discussed the PRSCs with the government exclusively and, in areas with an impact on macroeconomic affairs, with the IMF. They were then presented to members of the Budget Support Group, which did not have a say in loan design.

3.18 *Joint missions and progress reviews*. There are no joint missions to work on the strategic aspects of the Poverty Reduction Strategy Papers or the PRSCs. It is difficult to believe that they will take place, at least in the medium term, because, as noted, the Bank operates on a much broader front and with a much deeper technological expertise than the rest of the Budget Support Group members — with the IDB being the only exception. In fact, the Bank shares the results of its economic and sector work with all the members of the Budget Support Group, and this, together with the studies shared by the Fund, has served as the foundation for the Budget Support Group's knowledge base.

3.19 *Collaboration on underlying analytical and diagnostic work*. As noted, there is limited scope for much collaboration, given that the Bank has a comparative advantage in the technical areas. However, there is a strong collaboration between the Bank and the Fund. There have been joint missions to produce papers on specific issues, such as the Informe de Desempeño de la Administración Financiera Pública, delivered as a draft on December 31, 2006, by the government of Nicaragua, the IDB, the European Commission, the UK's Department for International Development (DfID), and the Bank. But such collaborations are few and far between.[24]

3.20 *Alignment of technical support for capacity building around PRSC*. This has taken place only in some specific cases involving co-financing — such as the case of water supply, which relied on co-financing from KFW.

3.21 *Relationship with the IMF*. The relationship of the Bank and the Budget Support Group with the IMF is close. The Fund makes periodic presentations of the macroeconomic situation of Nicaragua to the Budget Support Group members — something that most of them appreciate,

24 According to interviews with Bank country staff point out that "there is a growing tendency to improve donor coordination for analytical and diagnostic work as well as alignment of technical assistance around the PRSC," which is being discussed within the framework of the Mesa Global de Donantes. There is also active donor dialogue with the government in the health, water and sanitation and education sectors.

as they lack the technical skills to analyze the situation on their own. Some donors told IEG that having the opportunity to listen to these briefings is one of the main benefits belonging to the Budget Support Group. In the case of the Bank and the PRSCs, the relationship is normally close, particularly because the HIPC process required both institutions to work together in drafting reports on the country's progress on poverty reduction (World Bank and IMF 2002).

How well have PRSCs been aligned with country policy formulation, budgeting, and planning processes, and how effectively have they contributed to predictable resource flows?

3.22 *Alignment with domestic processes*. The PRSCs were closely aligned with the country systems and would have been fully predictable if the government had met the established deadlines regarding the formulation of an operational poverty reduction strategy. In reality, the flows were predictable under PRSCs 1 and 2 and ceased to be predictable when the government missed its deadlines in 2007.

3.23 *Effects on program content and outcomes*. The PRSCs provided the only opportunity to discuss the budget from a strategic point of view. The discussion of the operationalization of the program objectives also provided valuable feedback on the program content and outcomes.

3.24 *Exit strategy*. There was no discussion of an exit strategy in the sense of foreseeing an end to the PRSC operations. However, at the time of the preparation of the PRSC 2, the Bank made it clear to the government that this operation would close the first PRSC series. To avoid ambiguity, the meeting to discuss PRSC 2 recommended that all references to trigger actions for an eventual PRSC 3 should be dropped from the Program Document. Instead, the document described the policy, structural, and institutional reforms that should be the topic of ongoing dialogue with the authorities and that were likely to feature prominently in the content of a future PRSC. That is, the end of the first PRSC series would represent only a shift of gears in a longer sequence of PRSCs. The lack of an exit strategy seems to be an implicit recognition of the fact that Nicaragua is still far from achieving the ultimate objectives of the PRSCs.

4. PRSC Results

How effectively have PRSCs helped Nicaragua strengthen its public financial management systems?

4.1 The improvement of the public financial management system was quite important in the design of the PRSCs, and rightly so. At the time of the design of the PRSCs, the government of Nicaragua lacked the institutional capacity to use the budget as an instrument of policy — not all the revenues and expenses went through the budget, and the elaboration of the budget was a routine exercise that did not reflect the government priorities. There was no formal connection between the government objectives and policies and the budget. Thus, improving the public financial management system was a prerequisite for the implementation of poverty reduction policies.

4.2 *Diagnostic work*. The diagnostics underlying public financial management reforms were carried out well before the PRSCs were designed. The main problems were the following: first, the government lacked a regulatory mechanism to consolidate all government financial operations into a single account (Cuenta Unificada del Tesoro, or CUT, single treasury account); second, there were no procedures or mechanisms to ensure that all government financial operations were carried out in a safe and consistent way; third, there were no controls on key financial operations, such as the contracting and recording of public debt; fourth, budget planning was undertaken as a rote exercise that rigidly projected ahead the previous year's revenues and expenditures, without providing an opportunity to align expenditures with the government's policy objectives; fifth, there was no unified system to record and control public sector investments; and sixth, municipalities lacked a framework to force them to operate fiscally in a transparent and orderly way. The Bank supported reforms to resolve these problems through the aegis of the structural adjustment loans, the programmatic structural adjustment credit, and the two PRSCs. A major achievement was the approval of PFM Law 550 in August 2005.

4.3 The PRSCs also supported the enactment and implementation of a coherent Civil Service Law in 2003, also essential for the state's orderly operation. One of the most notable problems in this respect was that, since the 1980s, external aid had helped erode the government's already-limited institutional capacity by creating parallel institutions financed directly from abroad. External donors created their own execution units that controlled budgets, which were not controlled by the Ministry of Finance and were not accountable to the relevant ministries or other national authorities. By 2004, the Ministry of the Economy alone had more than 400 of these units; other ministries had comparable numbers. Staff in these units were considered "consultants," even if their tasks were executive, and were paid much higher wages than their colleagues in government offices. Indeed, ministries looked not to the Ministry of Finance, but to the donor representatives, to get needed funding. In short, true financial unification of the government required creation of a centralized treasury account and simultaneous unification of public sector personnel. Recognizing the need, PRSC 1 supported enactment of the Civil Service Law, and PRSC 2 backed the integration of government employees into the civil service system.

4.4 *Public financial management content and design*. The PRSCs supported the following public financial management reforms:[25]

PRSC 1

- All internal revenues and expenditures of the central government are channeled through the single treasury account.

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25 Civil service reforms are included in this case study among the public financial management measures.

- The Ministry of Finance initiated the introduction of externally funded revenues and expenditures in the single treasury account.
- The presidency issued a presidential decree, satisfactory to the Bank, establishing a single, unified official registry of public investments, complementing the regulations of the National System of Public Investments.
- The Secretary of Coordination and Planning (SECEP) initiated the routine calculation of the recurrent cost implications of the Public Investment Program, and the Ministry of Finance initiated plans to create a Medium Term Expenditure Framework (MTEF) on this basis.
- The Secretary of Coordination and Planning and the National System for Public Investment (SNIP) implemented complementary regulations of the National System of Public Investment by incorporating all public investment projects/programs into the official registry of public investments, including those financed by grants.
- A presidential decree was issued to modify the regulations of the Law of Municipalities in a fiscally sustainable manner, by balancing, within the limits imposed by law, municipal expenditures with resources transferred to municipalities. The 2005 budget conforms with the approved decree.
- The National Assembly approved a Civil Service Law satisfactory to the Bank.

PRSC 2

- The National Assembly approved a satisfactory Financial Administration Law, and the executive branch began its implementation.
- The Civil Service Law has begun to be implemented, with 12,620 public servants having been accredited as of September, 2009.

4.5 Table 3 shows the targets expected by the PRSCs in public financial management. All expected reforms were attained, some in a timely fashion, others with some delay. Although these reforms are not yet sufficient to create an environment for the efficient management of social service delivery, such delivery could not be improved without these reforms. Thus, these reforms were relevant and strategic for the eventual improvement of the delivery of such services.

Table 3: Targets for PFM

PRSC 1				
Indicator	Baseline Value	Original Target Values (from approval documents)	Formally Revised Target Values	Actual Value Achieved at Completion or Target Years
Indicator 5:	Public employees incorporated into the administrative career as a percentage of total public employees increase from 0% in 2002 to 15% - 20% in 2005.			
Value	0% public employees	15% - 20% public employees		32.40%
Date	12/31/02	12/15/05		12/31/06
Comments	Target surpassed with delay (50% achievement by 2005, 162% by 2006). 1,812 employees were incorporated to the administrative career by 2005 and another 4,023 by 2006, out of a total universe of 18,000 potential incorporations.			
Indicator 6:	Percentage of foreign resources channeled through CUT increases from 15% in 2003 to 100% in 2005.			
Value	15% foreign resources channeled through CUT	100% foreign resources channeled through CUT		100%
Date achieved	12/31/03	12/31/05		12/31/05
Comments	Target reached (100% achievement). By 2005 all foreign cooperation to Nicaraguan public agencies was channeled through the CUT.			
PRSC 2				
Indicator 5	Number of public employees for which due diligence for incorporation has been completed.			
Value	0 employees incorporated	3,970 employees incorporated Due diligence 1,450 additional		5,834 employees incorporated.
Date achieved	12/31/05	12/31/06		12/31/06
Comments	Target surpassed (147% achievement).			
Indicator 6 :	The National Assembly has approved a Financial Administration Law satisfactory to IDA and the Executive has begun its implementation.			
Value	Deficient legal framework for public financial management.	Law approved		Law approved and being implemented.
Date	12/31/03	10/31/06		12/31/06
Comments	Target reached (100% achievement).			

Sources: PRSCs Implementation Completion Report (IEG 2008a, 2008b)

OUTCOMES

4.6 *Public financial management processes*. There has been a clear and substantial improvement in public financial management processes. Several important reforms have been implemented in the Public Finance Management framework. Notably, in August 2005, the Financial Management and Budget Regime Law No. 550 was passed, which implements several public financial management best practices, including setting strict limits on the procedures for budget modifications. The Integrated Public Financial Management System (SIGFA) supported the implementation of the law through the systematization of rules, procedures, and guidelines to ensure the application of the law's mandate for the central government. Other important budgetary measures that have strengthened public financial management in Nicaragua, particularly in terms of fiscal discipline, are the centralization of treasury balances through the single treasury account, and the controls for contracting and recording public debt. In addition, some progress has been made in implementing the Medium Term Expenditure Framework among public entities to change the budget formulation so that it is oriented toward results rather than incremental assignments. In addition, the government committed itself to increase the social expenditures to 11.0 percent of GDP in PRSC 1 and to 13.6 percent of GDP in PRSC 2. Despite some progress in building a sound public financial management system, several important challenges lie ahead. These include: strengthening the comprehensiveness and transparency of the budget; budget planning and results budgeting; predictability and control in budget execution; accounting, recording and reporting; and external scrutiny and auditing.

4.7 *Alignment of public expenditures with policy priorities*. Despite the progress made in terms of improving budget management, Nicaragua is still far from having a close alignment of public expenditure with policy and poverty reduction expenditures, for two main reasons. First, the share of recurring current expenditures in the budget is very high. This reduces the authorities' ability to shift expenditures from one activity to another. Second, the staff of several important ministries and other government institutions are still learning the art of operationalizing strategic objectives and translating them into budgetary entries.

4.8 A Bank study on the effectiveness of public investment in spurring growth and reducing poverty in Nicaragua provides several examples of these problems. One of the examples provided is the methodology used by the Ministry of Health to analyze the health problems and budget its expenditures. The report says:

> The Ministry of Health (MINSA) planning department has the information and the tools to rank health problems. The planning department uses the Hanlon method, which ranks health problems along five dimensions, "magnitude," "importance," "vulnerability," and "cost." Each dimension is assigned from one to five points and a ranking of the health problems is obtained as a result. However, the MINSA does not use the Hanlon method to allocate funds, but rather MINSA's financial administration department allocates on the basis of historical patterns. Poverty and dynamism considerations are not taken into account (World Bank 2007a).

4.9 The study found a similar problem in the Ministry of Transport and Infrastructure, but found that the Ministry of Education had in place a system that helped allocate budgetary resources in a rational way.

4.10 *Expenditure predictability*. The public financial management reforms are recent, and government staff are still in the process of learning the new procedures. They have not yet produced results in terms of expenditure predictability. A worrying development is the weakening of the single treasury account principle, as discussed below.

4.11 One of the main achievements of the public sector financial legislation issued with the support of the Bank was the establishment of the principle of the single treasury account and the design of management and accounting systems in such a way that this principle would guide public finances. The principle states that all government incomes and revenues and all of its expenditures should flow through a single account, in such a way that no government transaction could be carried on outside it. This principle is the basis of transparent and efficient financial management, and the basis of the budget.

4.12 Yet the Nicaraguan government after 2006 is believed to have created a mechanism that could effectively become a second vehicle to fund the operations of the government, away from the purview of the National Assembly and the auditing institution of the state. There is a perceived lack of transparency by some in the management of this operation. Resources have been flowing to the government through other vehicles that bypass institutional controls on public sector incomes and expenses. These include direct donations in specie of goods and services, which do not go through the budget and the government's institutional setting[26]

4.13 The violation of this principle contradicts the spirit of the programmatic loans aimed at supporting the institutionalization of the budget. It also weakens the institutional framework of a public sector financial management based on transparency and accountability, and could mean a setback in the course of the Nicaraguan reforms.

How relevant and effective a vehicle have PRSCs been in helping Nicaragua set conditions for poverty reducing growth?

4.14 *Extent of growth focus*. Pillar 1 of Nicaragua's PRSP aimed at generating pro-poor growth, which should maximize the rate of growth of the incomes of the poor. The PRSCs did not emphasize the support of this pillar.[27] The only economic measures that were included among the actions required for the approval of the operation were the maintenance of macroeconomic stability, measures to implement a reduction in the costs of the pension system (eventually abandoned) and, in the case of PRSC 1, the approval of the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA) by the National Assembly (which occurred in October 2005). With these actions, the PRSCs were expected to produce the four results summarized in Table 4.

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26 According to Bank country staff, this off budget aid affects not only Venezuelan cooperation, but also cooperation from the US and some of Japanese cooperation. The transparency of foreign cooperation, especially from Venezuela, is monitored under the current agreement with the IMF, and the GON is required to post information on all external aid on the Central Bank website, which is has done.

27 There are two definitions for measuring pro-poor growth used in recent literature and policy-oriented discussions. The first and relative definition of pro-poor growth compares changes in the incomes of the poor with respect to changes in the incomes of the non-poor. Using this definition, growth is pro-poor when the distributional shifts accompanying growth favor the poor. By focusing on inequality, however, the relative definition could lead to sub-optimal outcomes for both poor and non-poor households. For example, a society attempting to achieve pro-poor growth under the relative definition would favor an outcome characterized by average income growth of 2 percent, whereas the income of poor households grew by 3 percent over an outcome in which average growth was 6 percent, but the incomes of poor households grew by 4 percent. The second and absolute definition avoids these problems by focusing instead on what happens to poverty. Growth is considered to be pro-poor only if poor people benefit in absolute terms, as reflected in an agreed measure of poverty. See http://www.undp.org/povertycentre/newsletters/OnePager1.pdf

4.15 A summary inspection of these results shows that only one of them — reducing the time required to register a new company — was within the purview of the government to carry out. The other three were events that would, supposedly, take place in the economy as a result of some actions or policies that the government would implement. There is no mention in the loan documents of the mechanisms that would link the economic measures of PRSC 1 with the results expected from that operation (the increase in foreign investment and increase in non-traditional exports). The expected results materialized in both cases, but it is not possible to attribute this to actions taken under the PRSCs.

4.16 *Macroeconomic management*. As noted, the PRSCs included macroeconomic stability as a condition that should be met in order to receive approval for the individual operations. As shown in Table 5, there were two specific activities mentioned among the expected results in this regard: the reduction of the fiscal deficit from 10.5 percent of GDP in 2002 to 6.3 percent in 2005 (a target that was overachieved, as the deficit went down to 5.1 percent in 2005) and the reduction of the total public debt to GDP ratio from 198.1 percent to 116.0 percent in 2005 (a target achieved with a delay). In both cases, the targets were reachable and largely depended on actions that the government could take (debt forgiveness was conditioned to government actions).

Table 4: Targets of PRSCs Regarding Economic Growth

Indicator	Baseline Value	Original Target Values (from approval documents)	Formally Revised Target Values	Actual Value Achieved at Completion or Target Years
PRSC 1				
Indicator 10:	**Firm registration time has decreased from 28 days for basic procedures in 2003 to 17 days in 2005.**			
Value	28 days for firm registration	17 days for firm registration		14 days for firm registration
Date achieved	12/31/03	12/31/05		12/31/05
Comments	Target surpassed (127% achievement). The indicator was surpassed for the target year, but deteriorated to 17 days in 2006, still on target and a considerable improvement vis-à-vis the base value.			
Indicator 11:	**Index of non-traditional exports has increased from 100 in 2002 to 107.6 in 2005.**			
Value	100 index of non-traditional export	107.6 index of non-traditional export		163
Date achieved	12/31/02	12/31/05		12/31/05
Comments	Target achieved. Even though methodology to calculate index is in doubt, value of non-traditional exports increased from USD 257 million in 2003 to USD 478 million in 2006 (86 percent increase), i.e. more than aimed for.			
Indicator 12:	**Value of foreign private investment has increased from USD 204 million in 2002 to USD 237 million in 2005.**			
Value	USD 204 million of foreign private investment	USD 237 million of foreign private investment		USD 238 million
Date achieved	12/31/02	12/31/05		12/31/05
Comments	Target slightly surpassed (103% achievement). The amount of foreign private investment had further increased to USD 290 million in 2006.			
PRSC 2				
Indicator 1	**FOB value of exports to the United States (excluding free zones) on an annual basis**			
Value	USD 202.3 million	USD 344 million		USD 325.5 million
Date achieved	12/31/02	12/31/06		12/31/06
Comments	Target slightly missed (87% achievement). The FOB value of exports in 2006 was revised in 2007.			

Source: PRSCs Implementation Completion Report, World Bank

Table 5: Macroeconomic Targets of PRSCs

Indicator	Baseline Value	Original Target Values (from approval documents)	Formally Revised Target Values	Actual Value Achieved at Completion or Target Years
PRSC 1				
Indicator 3:	**Fiscal deficit as percentage of GDP decreases from 10.5% in 2002 to 6.3% in 2005.**			
Value (%)	10.50	6.30		5.10
Date achieved	12/31/2002	12/31/05		12/31/2005
Comments	Target overachieved.			
Indicator 4:	**Total public debt as percentage of GDP decreases from 206% in 2002 to 116% in 2005.**			
Value (%)	198[1]	116		137.70
Date achieved	12/31/2002	12/31/05		12/31/2005
Comments	Target missed in spite of foreign debt forgiveness programs (HIPC and MDRI), due to large weight of internal debt. Nevertheless, indicator subsequently declined to 108.7% in 2006 as a result of MDRI.			

Sources: PRSCs Implementation Completion Report (IEG 2008a, 2008b)

4.17 *Relevance of growth-enhancing reforms in light of poverty reduction and capacity constraints*. The two economic activities included in the PRSCs (macroeconomic stability and the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA)) are likely to result in pro-poor growth. It has been well established that instability hurts the poor the most. Regarding trade agreements, a recent paper on the likely effects of the trade agreement in Nicaragua found that the impact of the treaty on poverty would not be large unless protection against third countries is also lowered. That is, in the view of this paper, the agreement was a step in the right direction but needs to be complemented with further trade liberalization to have a discernible positive impact on poverty (Bussolo and Niimi 2006).

4.18 While helpful in the pursuit of poverty reduction, the two economic measures included in the PRSCs were clearly insufficient to spur poverty-reducing growth. The Poverty Reduction Strategy Papers recognized this and included many other economic activities in the government's strategy, such as: i) improving the investment climate by making reforms to the regulatory framework for businesses to decrease bureaucratic costs; ii) strengthening property rights; iii) broadening financial services; iv) promoting exports; v) supporting clusters; vi) increasing the use of technology for agricultural production; vii) and promoting environmentally sustainable growth. Yet, with the exception of the reduction of the time required to register a company, these other objectives did not become operational and were not directly supported by the PRSCs.

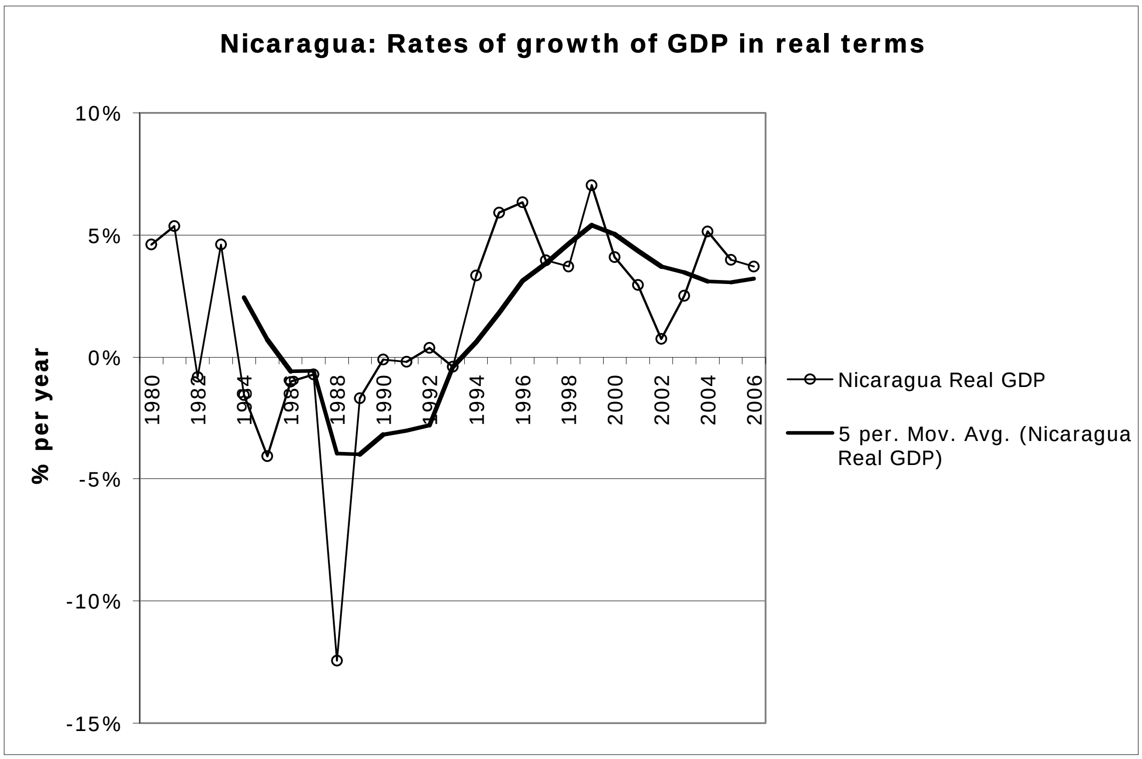
4.19 The strategy embedded by the Bank in the design of the PRSCs was geared to the long term. Although it avowedly supported the four pillars of the government's strategy, it focused on one of them—improving the institutional capacity of the government to design and implement poverty reduction strategies. The main emphasis of the loans was on enabling the government to use the budget as a vehicle for poverty reduction and on providing the legal basis for future improvements in the delivery of services to the poor (for example, the laws on education and health). The pillar of broad-based economic growth was covered by only two activities (the maintenance of macroeconomic stability and, in the case of PRSC 2, the approval of the Dominican Republic-Central America Free Trade Agreement by the National Assembly). The pillar on improving the delivery of services to the poor contained an increase in the number of autonomous schools, without any activity supporting the improvement of health services. The PRSCs' emphasis on developing the institutional capacity of the government was an appropriate one, given that the lack of such capacity is one of the most formidable obstacles in the design and implementation of effective poverty reduction strategies.

4.20 *Outcomes*. The upper panel of Figure 3 shows the path of annual GDP growth and the 5-year average since the 1980s. As seen in the graph, the rates went through three cycles. First, there was a long cycle that spanned the mostly negative rates of the 1980s and the early 1990s. The second cycle went from the early 1990s to the early 2000s, when the rate of growth fell sharply but remained positive. Then, growth started to recover in 2003, right before the PRSC series started. While the growth of the PRSC years was higher than that of the immediately preceding years, it is difficult to attribute this increase to actions taken under the PRSCs. Certainly, earlier domestic measures had an impact on these rates, particularly the liberalization and stabilization of the early 1990s. But the path of the rates of growth is very similar to that of other Latin American countries, where it slowed during the 1998 Asian crisis and again after the 2001 U.S. recession, and then recovered after 2003 as commodity prices increased.

4.21 The high level of dependence of the economy on external factors is portrayed in Figure 4, which shows how closely Nicaraguan exports followed the path of international commodity prices during the last two decades. Altogether, the figures suggest that shifts in the rates of growth of the Nicaraguan economy since the late 1990s have been largely determined by the external factors—the same one that have influenced the rates of growth of most other Latin American countries.

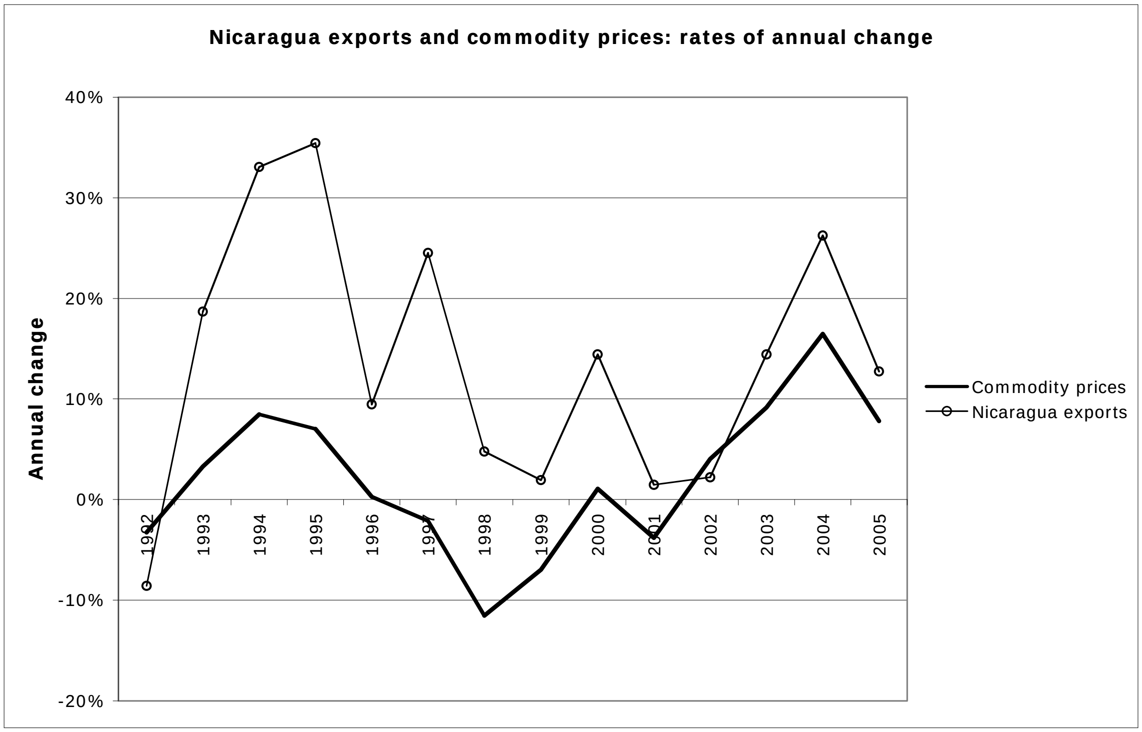
4.22 Overall, the growth performance over the entire period from the early 1990s to today has been moderate. Nicaragua's GDP grew at an average rate of 3.5 percent per year in real terms from 1991 to 2006. During those years, the population grew by 1.7 percent, so that GDP per capita grew at a rate of 1.8 percent per year. These figures are similar to the averages in Latin America but appear disappointing considering the large amounts of external aid flowing into the country.

Figure 3: Rates of Growth of GDP in Real Terms



Sources: World Development Indicators and IFS

Figure 4. Exports and Commodity Prices: Rates of Annual Change



Sources: World Development Indicators and IFS

How effectively has the PRSC helped advance the dialogue and achieve results in sectors that deliver services to the poor?

4.23 *Objectives and policy content*. While the PRSCs avowedly supported pillars 1 and 3 of the Poverty Reduction Strategy Paper (that is, developing the human capital of the poor and providing access to social services for vulnerable populations), the operations supported only a few activities in these areas, and those were not part of a clear strategy to meet the objectives of those pillars.

4.24 *Relevance and design*. The PRSCs supported the delivery of services to the poor in two areas: access to water and education. In addition, the two PRSCs supported increases in the amount of social expenditures as a percent of GDP. In access to water, the objective was to improve it by 1.4 percentage points. In education, the objective was to increase the number of autonomous schools. While the enactment of the General Health Law was supported by the programmatic structural adjustment credit, the PRSCs did not include any specific task in the health area. PRSC 1 included as a condition an increase in poverty-reduced expenditures from 10 percent in 2002 to 11.6 percent in 2005, and PRSC 2 included as a condition an increase of that figure to 13.6 percent. While these objectives were clearly relevant for poverty reduction, they were not part of a clearly defined strategy.

4.25 *Implementation*. Table 6 shows the seven results that the PRSCs expected from the activities they supported (five in PRSC 1 and three in PRSC 2). Of these, one of the indicators could not be measured (the savings attained with the General Education Law). Four were under the full authority of the government, including the increases in the poverty-reduction expenditures, the execution of these expenditures, and the coverage of potable water. The other two were improving the primary completion rate from 38.5 percent in 2002 to 44 percent in 2005 and reducing maternal mortality rate from 100/100,000 in 2002 to 90/100,000 in 2005. However, there was no mention in the loan documents of the policies or actions that would produce such results.

4.26 The education target (improving the completion rate) underscores the unreliability of the official data in Nicaragua. The target was not met in 2005 (the improvement attained was estimated at 49 percent of the target). However, one year later the rate of completion went down again, from 41.2 percent to 39.5 percent. This was still better than the 38.5 percent rate of 2002. It is unclear why this indicator rose, or why it went down later. There was no measure in the program supported by the PRSC that could produce these results (the only educational measure supported by the PRSC was the expansion of the Autonomous Schools, which could not be expected to produce this result). The experience with the single health target in the PRSC 1 was similar. The maternal mortality rate went down at the end of the execution of the loan but it went up a year later. No explanation is offered for the initial reduction or for the subsequent increase in this statistic. Some of the people interviewed by IEG had the opinion that the problem was with the data, not with changes in the underlying reality. Moreover, whether or not the expected result was achieved, there was no health policy specifically supported by the PRSC.

Table 6: Targets of PRSCs Regarding Services to the Poor

PRSC 1				
Indicator	Baseline Value	Original Target Values (from approval documents)	Formally Revised Target Values	Actual Value Achieved at Completion or Target Years
Indicator 2	Proportion of poverty-reducing expenditures in relation to GDP increases from 10% in 2002 to 11.6% in 2005.			
Value	10.20%	11.60%		13.60%
Date achieved	12/31/2002	12/31/05		12/31/2005
Comments	Target largely over-achieved.			
Indicator 7	Primary completion rate has improved from 38.5% in 2002 to 44% in 2005.			
Value	38.5% primary completion rate	44% primary completion rate		41.20%
Date achieved	12/31/02	12/31/05		12/31/05
Comments	Target not reached (49% achievement). Although there was progress, the target for 2005 was not achieved and there was a further deterioration of the indicator in 2006, when it was 39.5%.			
Indicator 8	National coverage of potable water has increased from 72.8% in 2002 to 76% in 2005.			
Value	72.8% national coverage of potable water	76% national coverage of potable water		77.60%
Date achieved	12/31/02	12/31/05		12/31/05
Indicator 9	Maternal mortality rate has decreased from 100/100,000 in 2002 to 90/100,000 in 2005.			
Value	100/100,000 maternal mortality rate	90/100,000 maternal mortality		86.5/100,000
Date achieved	12/31/02	12/31/05		12/31/05
Comments	Target surpassed (135% achievement). The indicator was surpassed for 2005, but deteriorated to 92.0/100,000 in 2006. Still, there was improvement vis-à-vis the base year.			
PRSC 2				
Indicator 3	The net present value of the fiscal impact reduction resulting from the modifications to the General Education Law is equivalent to 7 percent of GDP.			
Value	0 percent	7 percent of GDP		

Date achieved	1/31/06	10/31/06		
Comments	Indicator not available.			
Indicator 7	Budgeted public resources devoted to poverty reduction			
Value	11.6 percent of GDP	13.6 percent of GDP		13.6 percent of GDP
Date achieved	12/31/05	1/31/06		12/31/06
Comments	Target reached (100% achievement).			
Indicator 8	Execution of budgeted public resources devoted to poverty reduction expenditures during first semester, as percentage of annual total budgeted.			
Value	Not available.	40 percent of total		98.5 percent of total during entire year 2006 (13.4 percent of GDP)
Date achieved	12/31/05	6/30/06		12/31/06
Comments	Target shortly missed (98.5% achievement). Percentage achievement calculated as actual public expenditures on poverty reduction as a share of budgeted resources for poverty reduction throughout 2006. The percentage executed up to mid-2006 is not available.			

Sources: PRSCs Implementation Completion Report (IEG 2008a, 2008b)

4.27 *Results*. The opinion of the people interviewed by the IEG mission in all sectors is that the PRSCs did not attain substantial improvement in the efficiency of the social expenditures or in the delivery of services to the poor. The problem is not particular to poverty reduction. The government has yet to develop its ability to spend efficiently. The September 2007 Report of the Updated Poverty Reduction Strategy, produced jointly by the Bank and the Fund, said the following in this respect:

> Although PRS spending levels were sustained above 13 percent of GDP in 2005 and 2006, as highlighted in the APR, their effectiveness needs to be enhanced. Poverty expenditures are about half the entire budget envelope. However, the results in terms of progress in poverty reduction and intermediate indicators have been disappointing. The APR highlights the need to update the strategy to improve the quality and targeting of PRS spending. Allocation of public expenditures needs to be urgently improved by greater coordination and rationalization of programs and donor support, improved public human resource management, extension of basic service provision to under-served populations, and better program targeting. In this context, the updated PRS would benefit from a discussion of measures envisaged to allow for the improved impact of PRS spending. This would include, among others, stronger public expenditure management and project appraisal, reforms to social sectors, investment in basic social and infrastructure services, such as water, energy and roads, as well as policies and programs aimed at supporting job creation and access to productive assets by the poor, and support to medium- and small-scale enterprises (World Bank and IMF 2007).

4.28 In other words, the government still has a long way to go in gaining capacity to set objectives, translate these into needed operational actions and budget entries, and then turn these into efficient actions.

EDUCATION

4.29 The 2007 Poverty Assessment describes the educational problems of Nicaragua:

> There are substantial inequities in access and quality of preschool, secondary and post secondary education between richer and poorer households, between urban and rural areas, and between regions. Late enrollment, high dropouts, and high repetition rates altogether are preventing children,

> and especially those from poor families from completing primary and secondary education. Young individuals who are poor, indigenous, and who live in households engaged in agriculture attain less than 5 years of education on average. Despite progress, still 20 percent of poor children do not enroll in school at all…Repetition rates for primary education are on average 12 percent, above the regional average, and the annual cost of repetition at the primary level is estimated at U.S. $12 million. Moreover, only 32 percent of young people between 20 and 24 complete secondary education. Thus, most Nicaraguans accumulate little human capital before joining the labor force in their early teen-age years (World Bank 2008c).

4.30 The PRSCs supported only one aspect of all these problems, the structure of school management via the Autonomous Schools Project. The new government abandoned this project after almost 15 years of operations. The program aimed at resolving important problems, but it was too narrow to serve as the basis for a strategic approach to educational reform for the PRSCs. Supporting it could have been a part of a strategy, but it was not the strategy, or even a substantial part of it. That is, even if the PRSCs supported a seemingly worthy project, they failed to support a broader strategy to deal with a sector with severe problems that is crucial for poverty reduction.[28] For this reason, this report rates the impact of the PRSCs on the delivery of educational services as having significant shortcomings in achieving stated objectives.

HEALTH

4.31 The PRSC did not support any specific action in health but still had one expected result in terms of maternal mortality. As mentioned before, the loan documents do not establish a causal relationship between some measure supported by the loan and the attainment of this objective. Moreover, this was an extremely narrow target, given the gravity and variety of the problems affecting the delivery of health services in the country. These range from lack of targeting to large inefficiencies in the delivery of services. According to the 2007 Poverty Assessment:

> Inequity in public healthcare services in Nicaragua is such that even services which are free-of-charge, like immunizations and reproductive health, tend to favor the better-off rather than poor households…Out-of-pocket healthcare expenditures represent up to 16 percent of non-food expenditures for the poorest quintile. Ninety percent of Nicaraguans are completely uninsured, but particularly poor families are vulnerable to health shocks that either keep them or take them into poverty…Nicaragua's healthcare system faces major challenges to improve the health status of the population: (i) inefficiencies in allocation and use of public resources, (ii) low level of financial protection for health shocks, (iii) high out-of-pocket health expenses, particularly among the poor, (iv) constraints in quality, access and, thus, low utilization of healthcare services, (v) unregulated private sector, and (vi) limited capacity of MINSA to perform its stewardship role to ensure pro-poor strategies and an efficient health system. Efforts to face these challenges should be made within an equity framework, mostly because the poor and indigenous populations obtain very little benefits (World Bank 2008c).

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28 To be fair, the PRSC's were designed in 2003 -2004, at which time the government was still designing its national health and education strategies, which were ready in 2005. Thus, there were no specific sector strategies for the Bank to support, although it did contribute to the analytical work of the strategy.

4.32 That is, the PRSCs failed to support a strategy to deal with a sector with severe problems that is crucial for poverty reduction. For this reason, it is concluded that the impact of the PRSCs on the delivery of health services had severe shortcomings in achieving stated objectives.

Water and Sanitation

4.33 The 2007 Poverty Assessment described water and sanitation problems in this way:

> The relatively poor overall performance of the water and sanitation sector is predominantly due to: a) political and institutional shortcomings of the sector, and b) insufficient public budgetary resources. The sector's relative inefficiency and ineffectiveness is largely related to slow increases in coverage which is concomitant to its current lack of sustainability. In October 2005, CONAPAS elaborated and approved a coherent sector strategy in line with the National Development Plan, and further recent steps are promising. Nevertheless, a serious commitment at the political level is needed if the sector performance is to be improved significantly (Government of Nicaragua 2007; World Bank 2008c).

4.34 The PRSCs addressed the problems of the sector, supporting the approval of the National Water and Sanitation Strategy and engaged with KFW in a series of activities related to this sector. KFW co-financed the operation, with emphasis on water. The objective of the exercise was to rescue the sector from the abandonment in which it had fallen by the early 2000s. The output produced from this cooperation has been instrumental in convincing the government that water and sanitation is a sector that deserves to be a high priority. For this reason, it is concluded that the PRSC has achieved its stated objectives in water and sanitation with only minor shortcomings.

Assessment of Overall Outcome

4.35 The criteria of success of the PRSCs overall are that their objectives, design, and implementation were relevant to the country's priorities and that the objectives were achieved or were likely to be achieved. In this regard, the results of the operations were mixed. Their emphasis in design and implementation was on public financial management. While they also supported the other pillars of the strategy, they did so with measures that were not strategic. This problem is particularly evident in the social sectors, although the support provided to economic policies was also weak. The emphasis on public financial management can be justified because the Nicaraguan government lacked the financial management infrastructure needed to function effectively as a government and effectively deliver services needed by the poor. While acknowledging this fact, the lack of a strategic vision for the other pillars was a serious problem of the PRSCs. In essence, the time it has taken to lay the foundations for efficient implementation of poverty-reducing strategies is too long.[29] At this pace, it will take many years to overcome Nicaragua's poverty-related problems.[30]

PRSC Contributions to Poverty Outcomes

4.36 The government of Nicaragua keeps track of poverty indicators through surveys carried out from time to time. The last four took place in 1993, 1998, 2001, and 2005. The Bank has produced three Reports on Poverty since 1995.[31] Data for the last Poverty Assessment was collected in 2005, before the second tranche of PRSC 1 and the PRSC 2 were disbursed. As shown in Figure 5, poverty tends to be concentrated in rural areas, both generally and in its extreme form. The incidence of extreme poverty is five times as high in rural areas as it is in urban areas. The government is currently planning to collect a new round of the LSMS survey which could allow it to construct new poverty estimates comparable to those done in 2005 and before.

4.37 The programmatic structural adjustment credit and the first tranche of PRSC 1 were disbursed in 2003 and 2004, respectively, during a period (2001-2005) in which poverty indicators had stagnated after improving in the 1990s. This happened as PRSC 1 was aiming to reduce the proportion of people in extreme poverty from 15.1 percent in 2001 to 14.3 percent in 2005. The target was missed by an amount that varies depending on the data source. According to the data produced by the Bank's Implementation Completion Report (ICR), extreme poverty increased to 17.2 percent. According to the data of the 2007 Poverty Assessment, used in Figure 5, it remained constant at 15 percent. In any case, there was no improvement.

4.38 Total poverty also failed to decrease during this period. According to the Poverty Assessment, which has a longer data series than the Implementation Completion Report and permits a comparison with the 1990s, total poverty remained constant at 46 percent of the population from 2001 to 2005. Since these indicators went down during the 1990s, a superficial analysis would conclude that the structural adjustment loans were better than the PRSCs in terms of helping reduce poverty rates. But the poverty-reduction process is extremely complex and potentially subject to substantial lags. One of the factors that affect the rate of change of poverty—economic growth—would tend to reduce poverty immediately; in fact, one of the differences that can be observed between the 1990s and early 2000s is a decrease in the average economic growth rate. The average was 4.6 percent for 1993-2001, but fell to 3.1 percent in 2001-2005. At the same time, the rate of reduction of poverty was 2 percent in the first period and zero in the third. The number of observations is too small to draw any conclusion, although the evidence is

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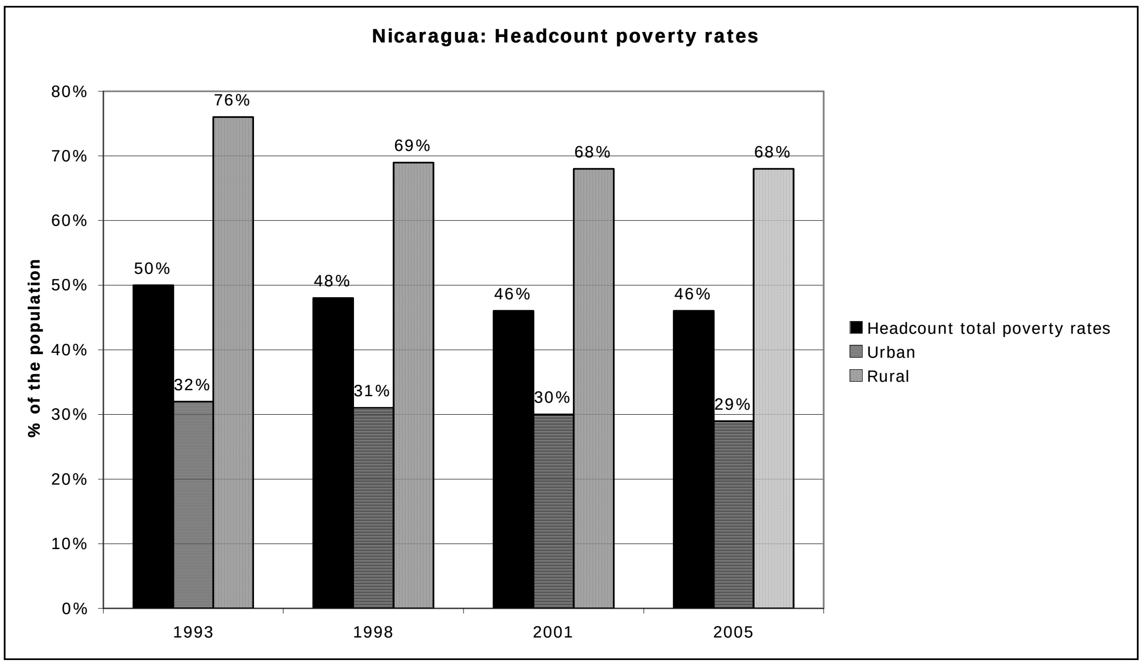
29 Bank country staff aptly note that perhaps the biggest challenge for laying such a foundation is not so much of a technical issue, as a political one—specifically, making sure there is full country ownership and that each new administration does not feel the need to create their own strategy.
30 Bank country team members point out that, since the original PRSP resulting from the aftermath of Hurricane Mitch, there have been several PRSP strategies—at times two per administration, as occurred with the current and the previous administration. Thus, in their view, laying the foundation for the design of a strategy is not the main problem.
31 The last Report on Poverty, which incorporates data through 2005, was produced in 2006 but was officially published in mid 2008, as it took more than a year to get final clearances from the government

consistent with the understanding that economic growth tends to reduce the incidence of poverty very rapidly.[32]

4.39 Other factors, including improvements in the delivery of social services, tend to take a much longer time to bring about results. It is likely that government programs could affect poverty reduction only if sustained over the long term. Most likely, the movement of poverty ratios in the short term are the weighted average of some short-term and some longer-term factors. Thus, the path of poverty within such a short period cannot be used as evidence for the success or failure of PRSC operations.

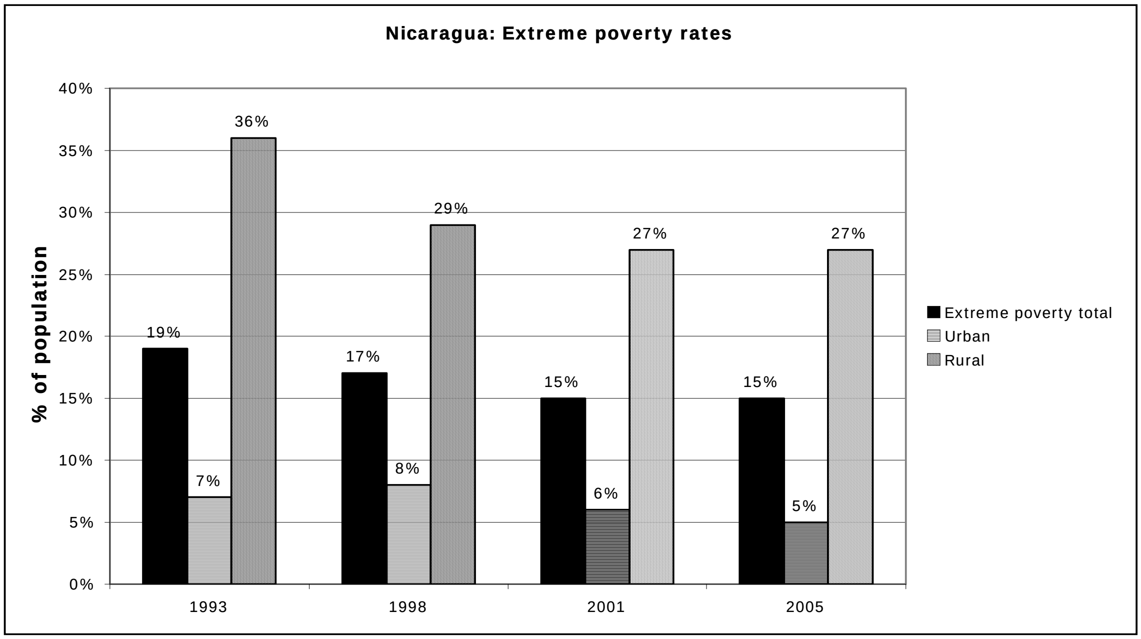
Figure 5: Headcount Poverty Rates



Sources: PRSCs Implementation Completion Report (IEG 2008a, 2008b)

32 In the case of Nicaragua, the data would suggest that poverty would decline only when the rate of growth of the economy is higher than 3 percent. However, as noted, there are many factors at work, and the flattening of poverty reduction of the early 2000s could be the result of other variables, acting simultaneously or with lags.

Figure 6. Extreme Poverty Rates



Source: Nicaragua Poverty Assessment, Main Report, Report No. - 39736 – NI, 2007, Figure 1.1

4.40 A different indicator shows some improvement. The extreme poverty gap (the difference between the average consumption of the extreme poor and the consumption level at the extreme poverty line) did decline slightly, falling from 4.1 percent in 1998 to 3.4 percent in 2005. Yet, even if there is an improvement in this indicator, it is so small that it does not compensate for the stagnation of the headcount indicators. These figures are particularly disappointing because the country has attained them while receiving large volumes of external aid — much in donations and with all lending subsidized — equivalent to 20 percent of GDP on average during the last 15 years. In dollar terms, the country received USD 4.4 billion in the four years going from 2003 to 2006, while the average GDP of these years was USD 4.7 billion per year (IEG 2007). In addition, Nicaragua was the beneficiary of debt reduction that represented over 500 percent of GDP. This suggests that the cash multiplier of external aid and the efficiency of the cash transfer in Nicaragua is extremely low. If such aid were given directly to all the poor (2.4 million people), each would receive USD 400 per year. Given the long list of catastrophic events to befall the country over the past 30 years—from political insurrections and civil wars to Hurricanes—and the persistent lack of infrastructure, it is debatable whether even this form of direct aid would be able to make a dent on poverty. However, these findings suggest that the overall development strategy of Nicaragua deserves revision, including an evaluation of the climate of aid dependence. This problem, however, cannot be attributed to the PRSCs.

5. Bank Performance

5.1 *Assessment of instrument adequacy*. The PRSC is a good instrument for poverty-reduction activities. More than a type of loan, the PRSC is a system for diagnosing poverty problems, designing strategies for their solution, turning such strategies into operational programs, and putting together a joint effort of the government, the Bank and other donors to implement those. By forcing all actors to go through the required steps in a well-ordered fashion and based on technically sound diagnoses of the situation, the PRSC system helps borrowing countries develop some of the resources they lack most: the skills and discipline needed to manage government efficiently. Given the flexibility of the instrument, which allows for financing any aspect of poverty-reduction strategies, it is ideal for its purposes. In the case of Nicaragua, while there is a long way to travel to attain the ultimate objectives of poverty reduction, the process has already produced encouraging results.

5.2 *Capacity assessment*. The Bank correctly assessed the capacity problems present in the different institutions of the Nicaraguan government and has backed up its operations with technical assistance to develop the missing capacity. The Bank has done this not just through the PRSCs, but also through specific projects. One example of this is the Bank's emphasis on the development of public financial management and the incorporation into the civil service regime of people working in government, thus eliminating the problems of parallel units created by donors. The present capacity problems of the government suggest that this will be a long term process. The Bank has concentrated on capacity development in the areas associated with its supported programs, either through specific projects or through the PRSCs. However, the capacity of institutions delivering services to the poor is still low and needs to be improved.

5.3 *Resources and incentives*. As regards resources, Nicaragua suffers from an excess of external aid. The enormous size of external aid relative to the size of the Nicaraguan economy generates an excessive dependence on international contributions. People in all sectors — whether in the government, the opposition, or in the private sector — tend to believe that the possibilities for developing Nicaragua rest in the hands of the donors. There is also a tendency to attribute the country's problems to the outside world and an expectation that donors will resolve them.

5.4 The perspective that donors must "buy" reforms still seems prevalent. In this vein, the IEG mission was told several times that the Bank does not provide large enough incentives for the reforms it supports and that it asks too much for the small amounts it lends. The implication, of course, is that the Bank would obtain more results if it increased its lending.

5.5 The finding of this case study, however, is that the Bank does well to maintain a relatively modest level of lending. There are three reasons for this. First, while the amounts lent by the Bank are comparatively modest, they represent a large proportion of the budget support and technical work that underlie policy strategy and design and also support other aid vehicles. Second, as a result of its prominent role in technical support, the Bank is influential in the donor community in Nicaragua and abroad; it commands influence with the government that goes well beyond the volume of resources it transfers every year. Third, the amounts the Bank manages in Nicaragua puts its role in the correct context — it contributes mostly with knowledge and skills, not with money. Moreover, the provision of a modest volume of resources does not reinforce the damaging idea that the responsibility for development is not with the Nicaraguans, but rather with foreigners. Thus, in the opinion of this report, the Bank manages the right incentives in its work with the PRSCs in Nicaragua.

5.6 The Bank's economic and sector work in Nicaragua has been excellent in terms of relevance and technical quality. This is recognized by the government and by the other members of the donor community, who believe that Bank studies form the backbone of development efforts in Nicaragua. One exception to this was when the Bank failed to conduct the appropriate analysis early on to determine the precise fiscal implications of the proposed pension reform. As a result, the government spent substantial resources, some financed by the Bank, to design and prepare a reform package that eventually had to be abandoned. Although it is laudable that the Bank showed the capacity to change direction mid-course in response to new information rather than holding rigidly to a policy that would surely have failed, the abandonment of this reform negatively affected the prestige of both the government and the Bank.

5.7 *Effectiveness in donor harmonization*. The Bank has been quite effective in donor harmonization. The Bank contributed decisively to the creation of the Budget Support Group, provides most of the technical basis for Budget Support Group analysis of policies, and has played a crucial role in keeping the dialogue open between the Budget Support Group and the government. While not perfect, harmonization has been reasonable. As far as the Bank's role in harmonizing support is concerned, its participation has been important in three ways. First, it gave credibility to the proposal of creating the Budget Support Group, so much that some donors believe that the group would not exist had it not been for the Bank's support. Second, the Bank provides the technical support that gives a rationale for Budget Support Group decisions.[33] Third, the Bank led the Budget Support Group and kept dialogue open with the government during a crucial period of adjustment for the donor community with the advent of the new administration.

5.8 The last contribution has been the subject of some controversy, as the donor community split in the aftermath of the 2007 change of government, some believing it would be difficult to work with the new administration and others willing to see if a working relationship could be established. The difference in opinion was particularly marked in mid-2007, when the government, gave priority to its negotiations with the IMF[34] at the expense of its compliance with the Budget Support Group calendar, which had been established with the previous governments to ensure budget support timeliness. At that time, the position of Coordinator of the Budget Support Group became available, and the Bank was elected to fill it. The Bank took over coordination of the group for six months during a period of intense negotiations of the Performance assessment matrix with active input from nearly all the members[35] and used its position to reopen

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33 However, Bank country staff feel that Budget Support Group decisions in 2008 and 2009 were based more on political considerations than technical ones.

34 The government gave the IMF negotiations priority because it knew that this would be a precondition for most other budget support.

35 One of the exceptions was Sweden, who decided not to disburse budget support and to withdraw from most of Latin America. Germany had also decided not to continue with budget support, partly be-

dialogue between the Budget Support Group and the government, keeping the possibility of budget support alive. Dialogue continued throughout 2007, although not at the rhythm expected by the Budget Support Group—the government also became very preoccupied with its response to Hurricane Felix in September that year. However, a major turning point was marked by allegations of fraud in the November 2008 municipal elections, which led to a freezing of 2008 and 2009 disbursements. The Budget Support Group still exists for now, but its future will be decided in the next few months.

6. Conclusions and Lessons Learned

6.1 The PRSCs were a new instrument when applied in Nicaragua. At the time, the focus of Bank operations on PRSPs and PRSCs was also still relatively new, and best practices in this area were not well defined. Thus, both government and Bank staff had to improvise somewhat when designing these operations. There are some lessons that can be extracted from this experience:

- The PRSPs/PRSCs have proven to be valuable instruments to diagnose poverty problems, design strategies for their solution, turn strategies into operational programs, and bring together government, the Bank, and other donors to implement them. Even if the PRSCs were not distinctly different from structural adjustment loans in the case of Nicaragua, they can potentially be effective to spur development and poverty reduction.
- It is necessary to put the Bank operations in a realistic perspective. Poverty is a complex problem that cannot be significantly reduced over a single budgetary period. For this reason, it is essential to break an overall poverty reduction strategy into strategic steps that could be taken within budgetary periods. The multi-year budgetary framework that is slowly developing in Nicaragua is a good instrument to do that.
- It is essential to develop a culture of monitoring and evaluation as well as to build an institutional framework to assess and publicize the results of strategies, policies, and projects. This would help overcome one of the most difficult challenges facing developing countries: the tendency to discuss development problems in ideological terms, without proper attention to facts and previous experiences.
- As part of such an effort, the Bank should give prime attention to the generation of adequate and reliable data on indicators that can be easily linked to policy actions. The design of policies in Nicaragua is negatively affected by lack of trust in the data. In some issues, it is not even known if variables are going up or down. Effective policies cannot be designed on the basis of such data. It is also essential to make sure that a clear linkage

cause of their reading of the Nicaraguan situation and also because of a general lack of support in their Parliament for the instrument.

is established between the policies supported by the PRSCs and the expected results of operations.

- PRSC operations would be more effective if they aimed at achieving a better balance among the dimensions of poverty they address. They should focus on strategic activities that advance the longer-term objectives of all dimensions of poverty-reduction. A balanced approach, with strategic activities in all dimensions, would give the PRSCs more substance and make them more effective.
- The success of operations depends on borrower ownership. However, ensuring ownership requires more than agreeing on a set of objectives. It means involving people in all areas of the government in the design of operational strategies, policies, and projects to embed them into the day-to-day operation of the government through budget management. This is the ultimate objective of the PRSCs.
- Trying to affect several reforms through one operation may be overambitious. Instead, concentrating on only a few sectors with sustainable strategies (that is, sector budget support instead of general budget support) may be more effective in some cases.
- Finally, it should be noted that there is no automatic recipe for meeting the objectives of the PRSCs in Nicaragua. The Bank must tread a narrow path between taking government objectives uncritically, even when they contradict best practice, and intervening excessively in the definition of objectives. The extent to which the Bank will be successful in attaining and maintaining such a delicate balance will depend on the judgment and sense of perspective it brings to the task.

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APPENDIX A: OVERVIEW OF AUTONOMOUS SCHOOLS, HEALTH SERVICE DELIVERY, AND PENSION REFORM

The Autonomous Schools

The Autonomous Schools project aimed at decentralizing the management of the schools to a local board of directors that included parents, teachers, and school directors. Based on experience in many developing and developed countries, the model is widely recognized as a means to improving governance, accountability and decision making autonomy in the education sector. Autonomous schools are run by the community and receive funding in the form of capitation transfers from the government. The international agencies strongly endorsed this model in Nicaragua, which started to be implemented in 1993. By 2002, when the programmatic structural adjustment credit was approved, the autonomous schools already represented 49 percent of all the public schools in Nicaragua and 69 percent of the students in the public schools. The programmatic structural adjustment credit supported the enactment of the Law of Educative Participation, which made it mandatory the transformation of all the public schools into autonomous ones. The PRSCs supported the implementation of this law.

After having been seen as a successful reform by the previous administrations and the donors, the new administration declared the Autonomous School Project a failure and canceled it. Its argument to do so was that it had discovered that schools were exaggerating the number of pupils they had in order to get more resources (the government transferred resources in direct proportion to the number of pupils).

The government's decision to cancel the project was highly controversial for several reasons. First, the reform had been rated as successful and improving in the previous years.[36] Second, while there had been some exaggeration in the statement of the number of pupils, such exaggeration was observed in both the autonomous and non-autonomous schools. No statistical test was carried out to determine whether the exaggeration was larger in the autonomous than in the other schools. Thus, there is no evidence that the problem was caused by autonomy. Third, even if this problem existed, it could have been resolved by improving administrative controls. Independent people interviewed by IEG were of the opinion that the abandonment of this reform was politically, not technically, motivated. According to this opinion, the current administration did not like autonomy because it reduced the administrative and political power of the central government over the schools and the teachers. Further study of why this project was canceled could yield important lessons for future Bank activity.

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36 See Gustavo Arcia, Emilio Porta Pallais and Jose Ramon Laguna, "Otro vistazo a la autonomia escolar de Nicaragua: aceptación y percepción en 2004, Ministerio de Educación, Cultura y Deportes, República de Nicaragua, 2004. This document finds that the autonomy scheme had good results in terms of internal efficiency and modest but still better results than the non-autonomous public schools in terms of academic achievement.

Health Service Delivery

The Nicaraguan government worked for several years in designing, with the help of the Bank, a model for the development of a system for the delivery of health services. The model focused on the delivery of a basic package of health services and contemplated payments for the services in accordance with ability to pay. The expansion of coverage concentrated particularly on primary health care and on women of reproductive age, children and adolescents, and involved the creation, rehabilitation and equipping of health care units in rural areas, together with the development of a cost effective package of basic services, which was to include reproductive health care services. Improving the patient referral system and expanding provision of vaccines at the primary level was also expected to contribute to a more efficient delivery of services.

The new administration criticized this model and the reforms associated with it but, in practice, have built on the model, introducing important changes. One of the major changes is to not charge for public health services; free public health care is in fact established in the Nicaraguan Constitution. The content of the basic package continues to concentrate on primary health care and on women of reproductive age, children and adolescents, but the Ministry of Health is also gradually introducing services for people with special needs (disabled) and for those with chronic illnesses such as diabetes. The new model, which also promotes more community participation in prevention, is now being implemented throughout the country.

Pension Reform

Pension reform aimed at transforming the system from the pay-as-you-go, defined benefits system managed by the public sector that existed before the reform into a system based on defined contributions, which would build reserves owned by the beneficiaries individually in pension funds managed by private agents. The new system would be similar to that existing in Chile as well as in several other countries in Latin America.

As in the case of the Autonomous Schools, the government and the Bank worked on the pension reform for several years before the programmatic structural adjustment credit. In fact, the National Assembly enacted the law that carried out the reform before the programmatic structural adjustment credit was approved, so that the latter contained as triggering events some actions related to the implementation of the law: the appointment of a new Superintendent of Pensions; streamlining the administration of the Superintendency of Pensions; the awarding of licenses to two private fund managers; the restructuring of the Social Security institute (INSS) to adapt it to its reduced role (it would lose the management of the pensions); and the transfer of eligible social security contributions to the new pension system.

The government appointed a (not new) Superintendent. Yet, the award of licenses to two private fund managers was postponed on the Bank’s advice, even though the Nicaraguan authorities were ready to conclude that step by the end of 2003 (IEG 2004). The Bank’s advice was based on a growing preoccupation with the impact of the transition to the new system on the cash flow of the government. According to accounts given to the IEG mission by people who worked on the reform at the time, the Bank’s concerns appeared after the IMF looked into the proposed reform and became alarmed at its fiscal impact. The review of the status of the pension reform and the reassessment of its impact on the fiscal accounts became one of the activities supported by the first PRSC.

The review of the fiscal impact was carried out with the participation of the IMF. It resulted in a consensus between the government, the Bank, and the Fund that the reform should be abandoned because its impact on the government's cash flow would create unmanageable financial problems. Thus, the reform was aborted when all the institutional setting was ready for its implementation—the law, the Superintendency and at least two private pension fund managers were ready to operate. The reversal was a source of substantial economic costs as well as of a deep embarrassment for the government and the Bank. The current government cites this frustrated reform as an example of what it sees as the carelessness displayed by the previous governments and the Bank in the design of reforms before 2007.

In fact, it is difficult to understand why the fiscal implications of the reform emerged as a crucial issue only at the end of the process, when the reform was about to be implemented. Such implications are easy to work out and are well known through the experience of all the countries that have carried out reforms under the Chilean model. These implications are rooted in one problem. At the moment of the conversion from one model to the other, the government retains the obligation to fund the pensions being paid as well as to fund those that will become payable on account of contributions already given to the old pension system — these are the resources that the private funds must invest to pay for the future pensions. This creates a cash flow deficit. Thus, during the transition, the government not only loses its cash inflows but also must have substantial outflows to go over the transition to the new system. This is well known, and the magnitude of the transfers is so large that even substantial changes in the assumptions about the evolution of the system do not change the basic fact that a reform of this kind imposes enormous cash flow pressures on the reforming government.

Of course, the transition only leads to negative cash flows if the reserves of the existing pay-as-you-go system are not sufficient to cover all its obligations — which was the case in Nicaragua and in most other countries. In this case, avoiding the reform does not eliminate the cash flow problem, which will come about even if no reform is carried out when the reserves are exhausted and the current contributions are not enough to cover the cash outflows. The abandonment of the reform only delayed the cash flow problem.[37] However, the government, the IMF, and the Bank believed that this delay was a crucial benefit in a country with the fiscal problems of Nicaragua. Thus, abandoning the reform could be rationally justified. What is not easy to understand is why all the considerations that led to it were not made before valuable resources were invested in carrying out the reform. This was a major mistake in the PRSC design and implementation.

To be fair, considering the adverse fiscal consequences that going through with the pension reform would have had, it is laudable that the Bank country team supported the decision to eventually abandon the reform. While the Bank has often been criticizing for adhering too rigidly to its recommendations or policies, this was an instance of an appropriate—and commenda-

37 The 2007-08 Public Sector Expenditure Review estimated that the government would have to generate a primary surplus of 6 percent of gross domestic product in the long term to cover the current pension system's obligations.

ble—change of course. Ideally, of course, this change should have occurred *before* resources were spent.

APPENDIX B: KEY PFM INDICATORS

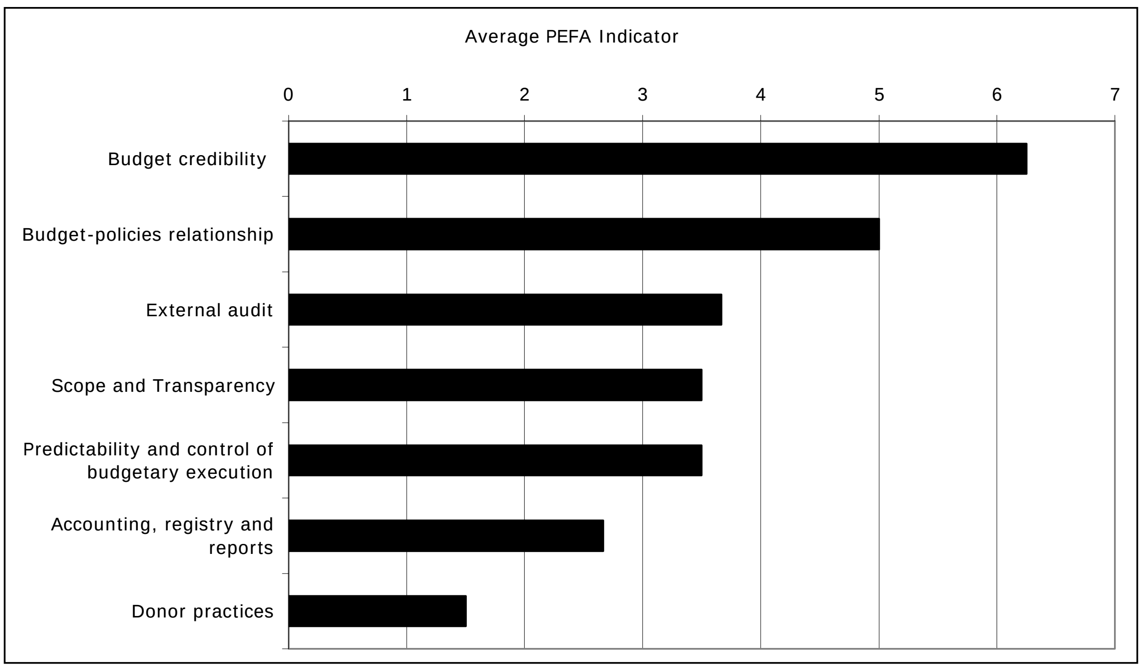
PEFA Indicators

The most recent report on the performance of public financial management (PFM) in Nicaragua was dated December 31, 2006.[38] It was drafted by the Government, the IDB, the Bank, the European Union and the British Ministry of International Development. This section summarizes the indicators provided by such report regarding several aspects of public financial management. The report ranked them in terms of seven categories, going from D and D+, C and C+… to A. In this section, the categories were changed to numbers, so that A corresponds to 7 and D to 1. This allowed the estimation of an overall average of the indicators, which was calculated as 3.7 (or somewhere between C and C+).

Summary

The 2006 report rates 31 public financial management activities organized in the 7 categories shown in Appendix Table 1, ordered from the best to the worst performed.

Appendix Table 1. Summary of PEFA Indicators



Source: PEFA, 2006, World Bank

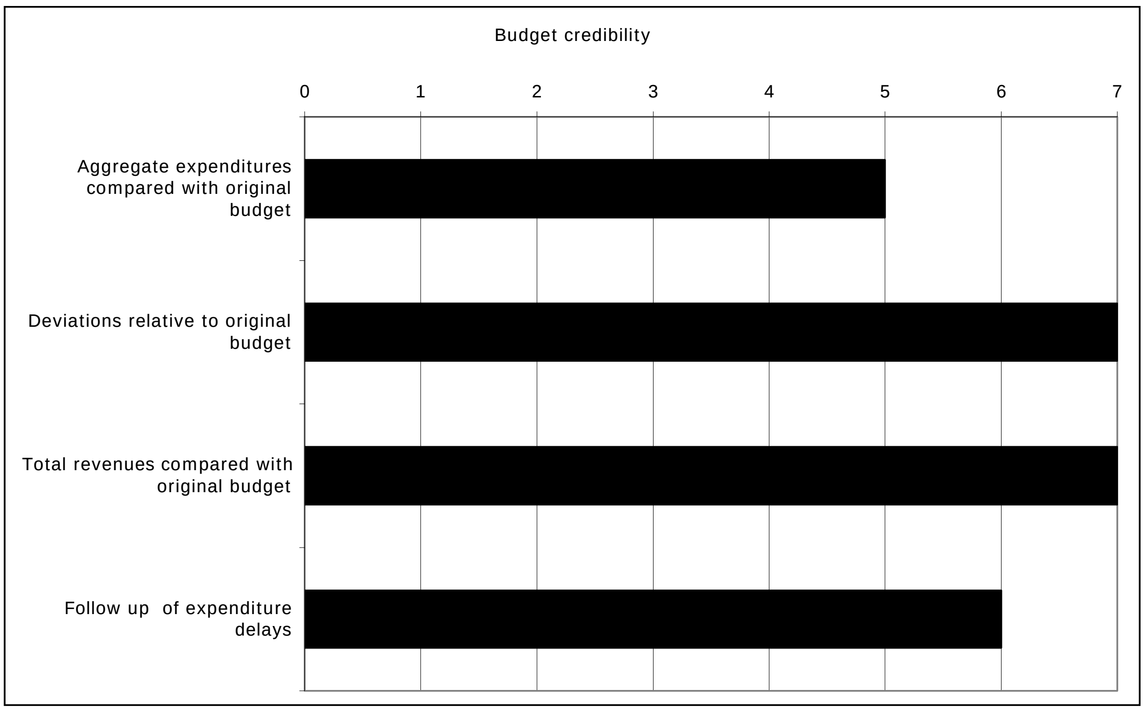
38 At the time of this writing, the Bank and the IDB were in the process of beginning to negotiate a new PEFA with the GON.

It should be noted that the rating of the public financial management report refers to the inputs of each of the activities, not of the outputs. This is important to note because the second-worst activity is the quality and punctuality of accounting, registry and reports, which being deficient, negatively affects the rest of the outcomes. It is important to note that the worst rated activities were the donor practices, which have poor predictability in their budgetary support and produce scant data on the projects they support. The following sub-sections show the ratings of the activities included in each of the categories of Appendix Table 1.

Budget credibility. Average rating: 6.25

This category was rated the best one. The budget is credible in Nicaragua. The weakest area in this respect is the comparison between the aggregate expenditures with the original budget, which, even if rated below the rest of the activities in this category, it is still rated acceptably.

Appendix Table 2. Ratings on Budget Credibility

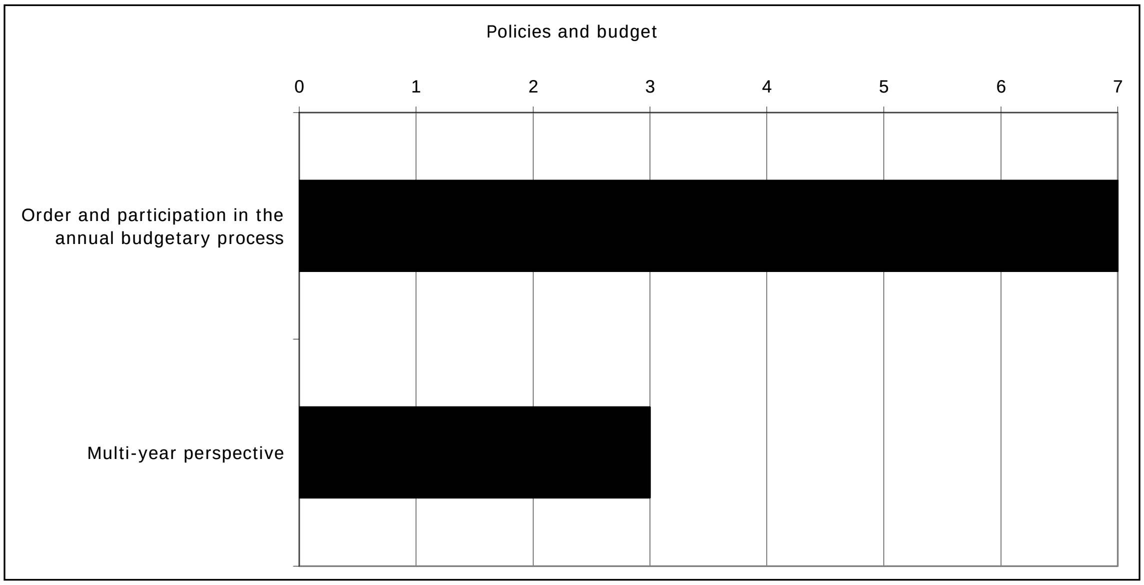


Source: PEFA, 2006, World Bank

Budget-policies relationship. Average rating: 5

According to the public financial management report, the budget is well aligned with policies. The report also notes the progress that Nicaragua is making in terms of developing a multiyear approach to the budget, although it still rates it with a low 3 (C).

Appendix Table 3. Ratings on the Relationship between Policies and Budget

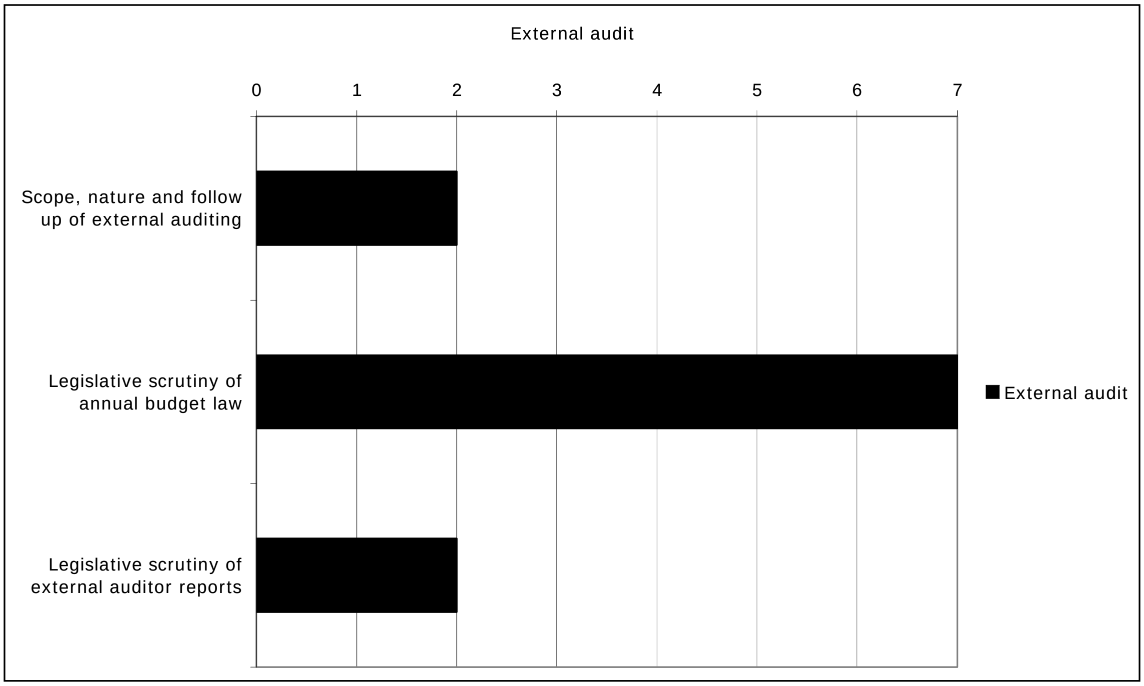


Source: PEFA, 2006, World Bank

External audit. Average rating: 3.7

The rating in this category is an average of widely dispersedly rated components. The public financial management report reckoned that the legislative scrutiny of annual budget laws was excellent (A = 7); yet, it gave the second lowest rating (D+ = 2) to the scope, nature and follow up of external auditing and the legislative scrutiny of such auditing. This means that although the political discussion of the budget is thorough, external audits are very weak.

Appendix Table 4. Ratings on External Audit and Scrutiny

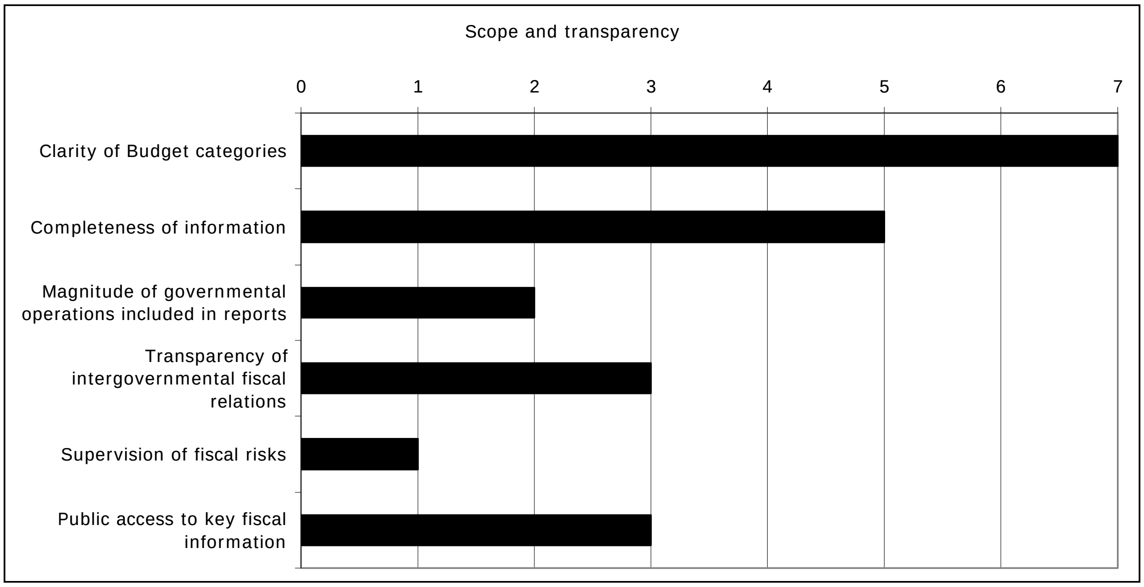


Source: PEFA, 2006, World Bank

Scope and transparency. Average rating: 3.5

The budgetary process received good ratings in terms of clarity of budget categories and the completeness of the information included with the budget itself. However, it received low and very low marks in all activities related to transparency, public access to key information and supervision of fiscal risks.

Appendix Table 5. Scope and Transparency

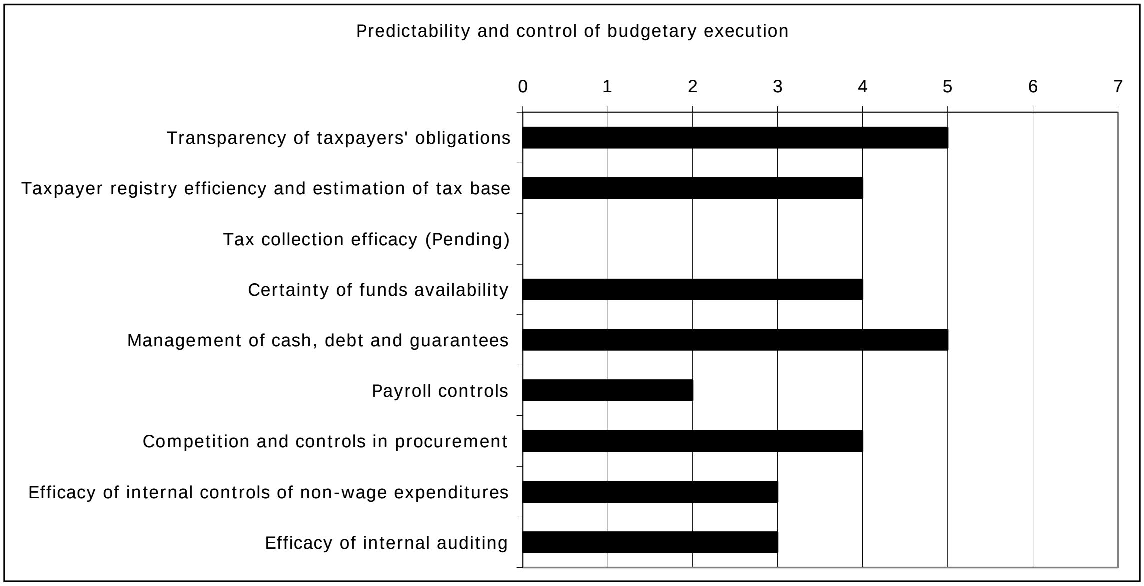


Source: PEFA, 2006, World Bank

Predictability and control of budgetary execution. Average rating: 3.5

This category, which comprises the ability of the fiscal system to work predictably, got a relatively low rating, particularly in internal expenditure controls and auditing.

Appendix Table 6. Predictability and Control of Budgetary Execution

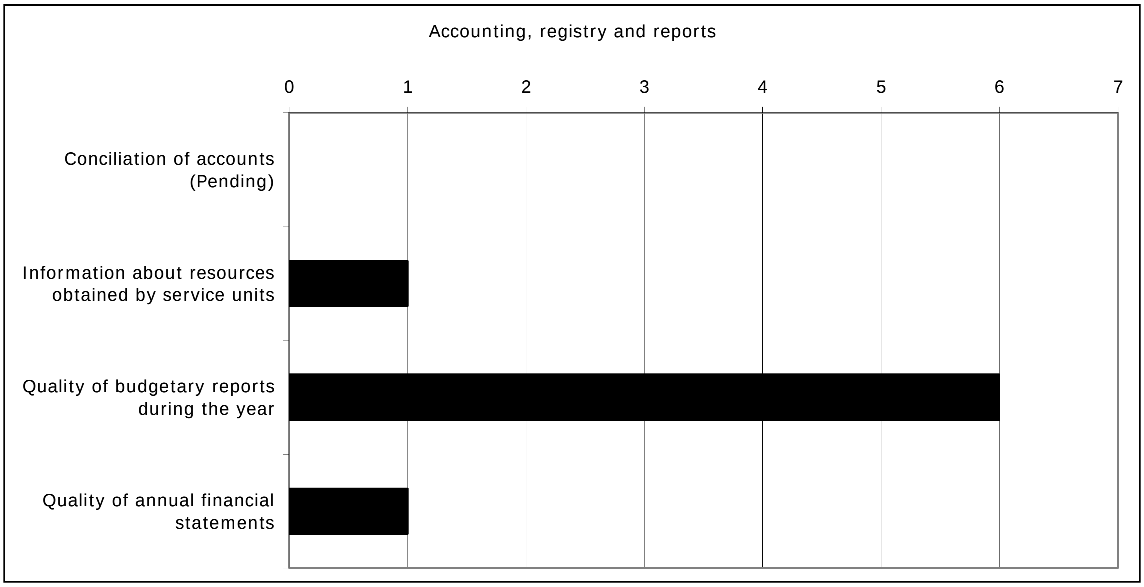


Source: PEFA, 2006, World Bank

Accounting, registry and reports. Average rating: 2.7

The public financial management report gave a relatively high mark to the quality of budgetary reports during the current year. It, however, gave the lowest marks to the quality and punctuality of annual finance statements and the information about resources obtained by service units.

Appendix Table 7. Accounting, Registry, and Reports

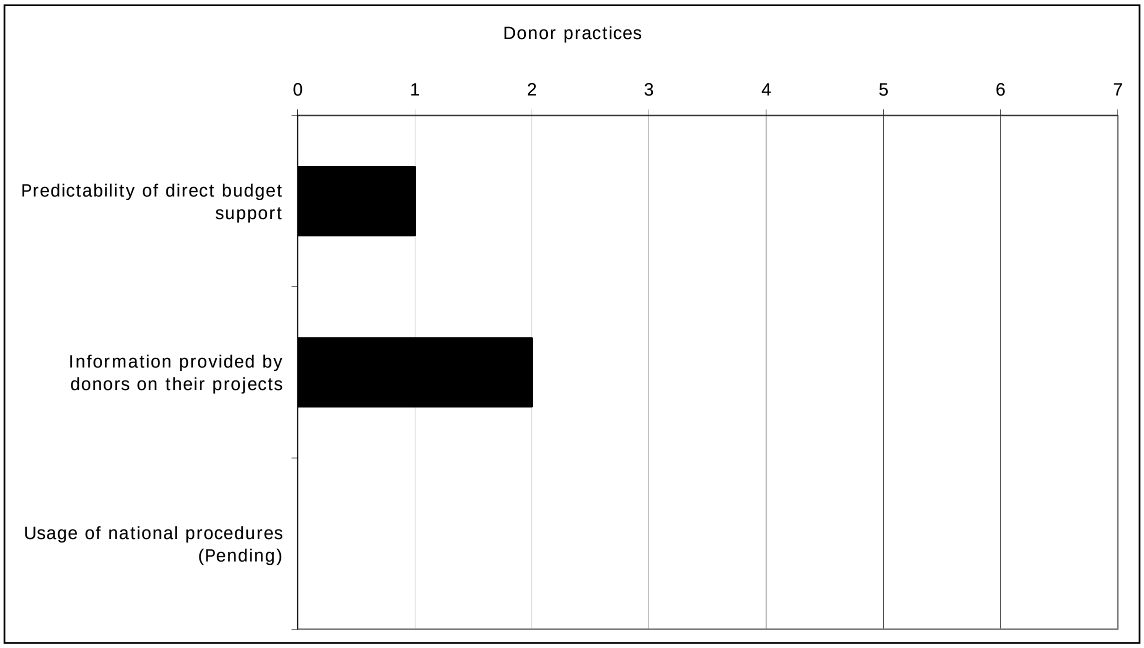


Source: PEFA, 2006, World Bank*:*

Donor practices. Average rating: 2.7

The report rates very low the predictability of direct budget support and the information provided by the donors on their projects. The report left pending the usage of national procedures. On average, the donors got the lowest rating of all categories.

Appendix Table 8. Donor Practices



Source: PEFA, 2006, World Bank

APPENDIX C: PUBLIC EXPENDITURES AND BUDGET

Appendix Table 9. Total Public Expenditure by Sector (percent of GDP)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Social Services	6.5	6.5	5.9	9	9.6	7.4	8.1	9.5	9.9	10.8	9.8
Infrastructure and production	3.5	4.2	4.7	6.8	5.4	4.8	3.6	3.8	4.3	4	4.2
Defense and security	2.1	1.7	1.6	1.6	1.4	1.7	2	2.1	1.8	1.8	1.8
General Services	3.5	2.3	2.5	2.9	2.6	3.6	2.6	2.5	2.7	3.3	3.2
Other	0	0.3	0.2	0.6	0	1	1.2	1.6	1.5	1.3	1.6
Interests	1.7	2.8	2.8	1.9	2.9	2.1	2.9	4.6	2	1.2	1.8
TOTAL	17.4	17.8	17.8	22.9	21.9	20.5	20.4	24.1	22.3	22.3	22.4

Sources: Government of Nicaragua, World Bank

Appendix Table 10. Total Expenditures by Functional Allocation (percent of total)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
National Assembly	1.9	2.1	1.6	1.7	1.9	2	2	1.7	1.7	1.6
Supreme Court	3.2	4	2.8	3.2	3.7	3.8	4	3.4	3.7	4.4
Supreme Electoral Council	1.1	1.3	0.7	0.8	6.7	2.1	0.8	2.2	1.4	4.8
Comptroller General	0.6	0.7	0.4	0.4	0.6	0.7	0.6	0.6	0.6	0.6
Office of the Presidency	3.7	2.3	4.7	3.1	2.2	2.4	1.8	1.4	1.3	1.4
Ministry of Governance	5.5	5.8	4.4	4.1	5.3	6.4	6.2	5.4	5.4	5.4
Ministry of Foreign Affairs	2.8	2.6	1.9	2.2	2.5	2.6	2.2	1.9	1.8	1.8
Ministry of Defense	6	4.9	3.4	3.4	3.7	4.9	4.4	3.6	3.3	3.4
Ministry of Finance	2.9	3.6	2.4	2.3	0.9	0.9	0.7	0.6	0.6	0.6
Ministry of Economy	0.7	1.6	0.7	0.8	0.9	1.1	1.4	1.4	1.4	1.8
Ministry of Education	14.8	13.4	13.8	15.2	13.6	15.1	15	14.2	14.9	15.2
Ministry of Agriculture & Forestry	4.7	4.4	4.9	3.7	3.4	3.4	3.3	2.9	2.6	2.8
Ministry of Transport & Infrastructure	9.7	13.1	15.9	14.3	12.1	9.3	8.7	9.2	8.2	4.6
Ministry of Health	16	14.6	15.3	18.5	15.3	16.5	16.8	14.7	15.3	16.1
Ministry of Labor	0.5	0.5	0.6	0.9	0.6	0.5	0.4	0.4	0.5	0.5
Ministry of the Environment	2.5	2.6	1.7	2.4	1.9	1.7	1.8	2.3	1.6	1.5
Ministry of the Family	0.4	0.6	1.5	2.2	1.2	1.3	2.5	2.9	2.2	1.6
Municipal Development Institute	1.1	1.3	3.7	3.3	1.4	1.1	1	1.1	0.9	0
Attorney General	0.3	0.3	0.2	0.2	0.2	0.1	0.2	0.1	0.1	0.2
Other Institutions	21.8	20.2	19.2	17.3	22	23.9	26.2	29.9	32.6	31.7
o/w IDR (PNDR)	4	4.5	5.6	5.6	4.6	3.1	2.9	2.7	3	2.6
FISE	0.8	0.8	--	0.9	0.6	2.6	4.9	5.8	4.7	1.7
Transfers to Universities	5.9	6.2	4.5	4.9	5.8	6.7	6.6	5.2	5.4	6.5
Transfers to Municipalities	0	0	0.3	0.7	1	1.5	1.2	2.8	4.9	5.4
Total	100	100	100	100	100	100	100	100	100	100

Sources: Government of Nicaragua, World Bank

Appendix Table 11. Financial Structure of the National Public Sector Budget, 2007

			Domestic resources			External resources	
	Budget	% of total	Treasury	Own revenues	Credits	Grants	Credits
Central Government	24,156	64.3	19,915	--	-3,125	4,017	3,349
Decentralized Institutions	7,845	20.9	2,970	6,560	-1685	--	--
o/w INSS	3,961	10.5	--	5,544	-1,584	--	--
Regional Governments	161	0.4	161	--	--	--	--
Public Enterprises	4,415	11.7	137	3,514	-256	297	723
o/w ENEL	1,621	4.3	--	1,793	-455	--	283
ENACAL	1,687	4.5	98	744	175	288	383
Public Financial Institutions	847	2.3	--	865	-134	--	116
Other Autonomous Entities	169	0.4	169	--	--	--	--
Total	100%	23,352	10,939	-5,200	4,314	4,188	4,072
% of projected GDP 2007	35.70%	22.2	10.40%	-4.90%	4.10%	4.00%	3.89%

Sources: Government of Nicaragua, World Bank