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Nicaragua

**Evaluation of the Poverty Reduction Strategy Paper (PRSP)
Process and Arrangements under the Poverty Reduction and
Growth Facility (PRGF)**

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This case study was prepared jointly by the independent evaluation units of the World Bank and IMF, as background to separate but complementary evaluation reports available at www.worldbank.org/oed/prsp and www.imf.org/ieo. The other country case studies conducted in support of these evaluations are also available on-line at the above addresses.

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Abbreviations and Acronyms

BID	Inter-American Development Bank
BWIs	Bretton Woods Institutions
CAS	Country Assistance Strategy
CG	Consultative Group
CONPES	National Council for Social and Economic Planning
CONADES	National Council for Sustainable Development
DFID	Department for International Development
ENADE	National Development Strategy
ERCERP	Estrategia Reforzada de Crecimiento Economico y Reducción de la
FAD	Fiscal Affairs Department
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Countries
IDB	Inter-American Development Bank
IEO	Independent Evaluation Office
IFC	International Finance Corporation
IFIs	International Financial Institutions
IMF	International Monetary Fund
JSA	Joint Staff Assessment
LSMS	Living Standards Measurement Surveys
MDGs	Millennium Development Goals
MHCP	Ministerio de Hacienda y Credito Publico
NGO	Non-governmental organization
OED	Operations Evaluation Department
PER	Public Expenditure Review
PND	Plan Nacional De Desarrollo
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Planning
PRSP-PR	Poverty Reduction Strategy Paper—Progress Report
PSAC	Programmatic Structural Adjustment Credit
PSIA	Poverty and Social Impact Analysis
ROSC	Reports on Observance of Standards and Codes
SECEP	Secretariat of Coordination and Strategy of the Presidency
SETEC	Technical Secretariat of the Presidency
SINASIP	National System for the Follow-Up on Poverty Indicators
SMP	Staff Monitored Program
UNDP	United Nations Development Program
WEO	World Economic Outlook

EXECUTIVE SUMMARY

Country background

Nicaragua is among the poorest countries in Latin America with a GNI per capita of US\$710 in 2000. Poverty remains largely a rural phenomenon, heavily concentrated in the Eastern and Northern parts of the country. Between 1993 and 2001, the share of the population living below the poverty line declined from 50 to 46 percent and extreme poverty fell from 19 to 15 percent, but poverty reduction has been uneven across regions.

Nicaragua's political context is one of a polarized society and political system, and weak institutional capacity and governance. The nature of Nicaragua's polarized society, a century old phenomenon, and political instability have been a strong obstacle to consensus building, constraining the process of participation and opening the policy debate, and on reaching common grounds for broader ownership. Nicaragua's political characteristics have contributed to a weak institutional framework, blurring the separation of state powers, weakening the rule of law and the protection of property rights, and leading to governance problems. Moreover, the state has limited capacity to implement and control activities, with a highly fragmented structure.

Throughout the 1990s, after the dismal economic situation left by the Sandinista regime, Nicaragua has struggled with major macroeconomic problems, principally unsustainably large fiscal deficits and debt levels. Repeated efforts to consolidate the fiscal situation during successive government proved unsuccessful owing largely to recurrent expenditure overruns. These recurrent failures put Nicaragua several times in extremely vulnerable positions, on the verge of fiscal collapse and balance of payment crises. Hurricane Mitch at the end of 1998 inflicted serious damage to Nicaragua's infrastructure and disrupted the macroeconomic situation and fiscal consolidation efforts. The Bolaños government has made significant efforts to improve macroeconomic stability.

Nicaragua's macroeconomic vulnerability is one of the main challenges to poverty reduction, including external factors (such as terms of trade shocks and foreign aid dependence). Other major obstacles are the challenges in enhancing non-farm rural activities and in sustaining rural income growth, the inefficient health services, high rate of population growth, and chronic malnutrition.

The PRSP process

The timetable for implementing the PRSP process was rapid; in a year the government moved from launching the Interim PRSP to reaching a HIPC decision point and completing the PRSP. The Nicaraguan government embarked on the PRSP process because it was a precondition for entering the enhanced HIPC initiative. This underlying motivation appears to have driven many subsequent processes and decisions, including the depth and scope of policy debate, which affected ownership perception across stakeholders.

The PRSP approach has on balance been relevant for Nicaragua's national strategy process and its poverty reduction efforts. The approach has addressed important gaps found in past experiences, including through a widening participation efforts,

appropriately focusing on a comprehensive vision of poverty, and addressing a sorely lacking results-oriented framework. In this connection, it has represented a more binding commitment than past national strategies.

However, the PRSP process has initially showed modest results, which needs to be viewed realistically in the context of political and institutional realities and very difficult starting conditions. The PRSP did not initially strengthen policy processes, while poor public expenditure management has been a hindrance to implementation. The fragmentation of policy making has generated problems for coordination and overview of public investment, and weak implementation capacity at the municipal level has remained an obstacle.

The consultation process for the PRSP was a step forward, but differences in views about the purpose and legitimacy of such participation have caused assessments of the participatory process to vary widely. This highlights the inherent difficulties of participation in a country with a highly polarized political system. As a result, broad country ownership of the PRSP has remained limited. Nevertheless, most observers agree that it was a helpful attempt to foster a dialogue among the government, donors, and civil society. Survey results highlight, however, that the area where participation was specially lacking was that of the formulation of the macroeconomic framework.

The new government's desire to modify the PRSP, with the introduction of a new development strategy that sought to change the expenditure composition guided by a greater emphasis on directly productive investment, was marked initially by tensions in the process. The government felt constrained in its ability to pursue a revised strategy, while donors were initially surprised by the initiative, expecting the PRSP to bring a more lasting and resilient policy framework. This illustrates some of the potential tensions between different elements of the PRSP process, notably between the provision of greater policy space to the government and other objectives such as partnership. These tensions were increased in Nicaragua by the poor alignment of the PRSP process with the domestic political cycle and the limited policy debate early in the process on the tradeoffs involved in the growth strategy. The potential tensions between normal political processes and the PRSP approach are illustrated by the fact that, despite the emphasis on greater participation, the issues concerning the growth strategy were not a topic of debate during the general elections. However, the approach did eventually contribute to bringing critical issues in the open, including through the Plan Nacional de Desarrollo (PND), thereby facilitating subsequent work to create a more effective approach to poverty reduction. Even with the considerable imperfections in the process, the fact that the debate has started to take place should be welcomed.

World Bank effectiveness

A number of key findings and lessons emerge from the Bank's support to the PRSP process thus far.

The Bank has provided important support to the PRSP process.

- The Bank was closely involved in the PRSP process, providing relevant analytic inputs and advice. These non-financial services have been well aligned to the

needs of Nicaragua through the PRSP process, including two completed Poverty Assessments, a PER, and an agriculture growth study. Key on-going analytical work includes a CFAA, a CPAR, and a PSIA. The quality of the technical assistance and analytical advice provided by the Bank is held in high regard by most informants.

- The Bank's CAS is well-aligned with the PRSP and closely follows the main strategic pillars. The assistance strategy details the specific support to each pillar, in recognition of the main constraints to poverty reduction outlined in the PRSP. The move to programmatic lending through the PSAC and planned PRSCs is the most explicit expression of the alignment of Bank support to the PRSP on the ground.

The Bank is improving its behavior in terms of promoting the PRSP principles.

- According to stakeholders the Bank has become more open to dialogue with the country and is taking steps to increase its responsiveness to civil society, both reported as areas of weakness in terms of country ownership. The Bank is increasing the cohesion of its large country program and is addressing the decentralization of task managers. The agriculture growth study is an example of unprogrammed analytic work being undertaken at the request of the government and demonstrates greater responsiveness on the Bank's part. The study was also produced in very close cooperation with government officials, and represents a more participative approach to the Bank's work.
- While the Bank may contribute to a technically sound strategy, the durability of a strategy requires both the substance and process dimensions. The Bank could do more in focusing on improving processes in Nicaragua and not just working towards preparation and refinement of a strategy. The process management skills and collaborative attitudes of the Bank need strengthening to allow country ownership to grow, to allow negotiation processes to get to better results, and to achieve the vital balance between technical and political quality in advisory services.

The Bank could do more to advance the debate on broad based growth and the trade-offs between growth and poverty-related spending in Nicaragua.

- There is widespread perception that the emphasis on social sector spending has been imposed by the Bank. In reality, there is an inherent incentive and bias towards social sector spending by government given the link with use of HIPC resources and, rather than an imposition of a "social agenda" by the Bank, the key issue is the absence of a frank discussion of growth issues in Nicaragua.
- The growth-social balance is a technically very complex discussion. It is connected to highly contended political issues and to conflictive political processes—but it needs precisely for that reason to become a more public debate in an appropriate forum, based on arguments rather than mutual mistrust. The Bank should promote and participate in this discussion, integrating the process under the PRSP framework. The ongoing Development Policy Review, with its

focus on sources of economic growth, may play a positive role in this regard. Involvement of stakeholders during preparation, for example through feedback on drafts or presentations of preliminary findings, and appropriate dissemination are likely to be important factors in this works value-added to the PRSP process.

The Bank could play a more aggressive role in supporting government led donor coordination.

- The Bank has in the past not played an effective role in coordinating its activities with those of other donors in Nicaragua. There have recently been promising steps taken towards improving the situation on which the Bank can build. These include improved coordination and participation in its analytical work and the emphasis on SWAps in the CAS.
- Improved aid coordination will require continuing efforts to clarify own policies, positions and procedures, willingness to cede donor-side leadership to other donors, and, as a particularly important signal in this area, assistance to the government enabling and motivating it to coordinate the support from the World Bank and the IDB.

The PRGF and IMF support

The Fund's internal policy formulation process for Nicaragua under the PRGF/PRSP approach was initially not very different from previous practices, although there is some evidence of improvement over time. Macroeconomic stabilization efforts took up most of the attention, and while emphasis on growth and poverty issues has occupied a more prominent place in the internal process, they have not received the consideration that would have been expected under the new approach. Fund technical assistance has generally supported the priorities highlighted in the PRSP, including tax reform and banking crisis resolution.

Program negotiations, rather than the PRSP, remained the driving force behind the formulation of the macroeconomic framework because of several factors including: pressing initial conditions and lack of government credibility; a PRSP macroeconomic framework that was quickly superseded by events; and lack of operational guidance on some major policy tradeoffs in the PRSP. Some sensitive but critical issues (i.e., the resolution of the banking crisis and its fiscal consequences) were not part of the broader policy debate, reflecting government choice. The focus of the PRGF-supported program on macroeconomic stability issues diverted efforts from its linkage to the PRSP's growth pillar. Moreover, limited growth analysis prevented the considerations of tradeoffs, including between alternative fiscal consolidation paths and infrastructure investment.

The initial design of the PRGF-supported program did not differ significantly from earlier ESAF-supported programs, with a key element of the macroeconomic framework being the path of fiscal consolidation. This was in part because both the government and the IMF staff considered stabilization a priority and made it the main axis of the program. However, more recently there appears to be greater fiscal flexibility, including with regard to the accommodation of potentially higher aid flows. Structural conditionality in the PRGF-supported program was streamlined, focusing on financial system and public

sector issues that have major macroeconomic relevance in Nicaragua and have been highlighted in the PRSP as key priorities. But the burden of quantitative performance criteria did not diminish.

The policy space for government-led initiatives and flexibility to political considerations in the context of the PRGF-supported program did expand over time—mainly reflecting increased government credibility and a more stabilized macroeconomic environment. This was reflected, for example, in the context of policy choices associated with the approval of the 2003 budget, the passage of tax reform legislation, and the process of asset recovery from liquidated banks.

Key components of the PRGF-supported program—the need of fiscal consolidation and macroeconomic stability—have been government owned, but the program has lacked broader ownership. Despite recognition of increased outreach efforts by the Fund, the formulation of macroeconomic policy is still regarded as not being open to a broader policy debate outside of traditional negotiations between the IMF staff and the authorities. To a large extent, this reflected the choice of the government. Opening program negotiations to non-government actors is not realistic, but efforts by both the government and the IMF to broaden the discussions of macroeconomic policy could contribute to an explanation of various policy choices and a better understanding of trade-offs. So far, the PRSP has had little impact in this area, although the use of technical commissions, akin to the one employed to formulate tax reform proposals, may be one approach worth exploring further.

The case of Nicaragua illustrates that, when macroeconomic stability issues still require significant attention, PRGF arrangements may only be expected to move gradually to cover in-depth growth and poverty aspects, taking into consideration initial country circumstances. But the issues of how to transit from stabilization to growth and enhanced growth analysis—including consideration of key tradeoffs—would eventually require heightened attention to move towards the key features of the initiative.

Bank-Fund cooperation and the JSA

Joint Staff Assessments were insufficiently candid in some key areas, notably the constraints to participation, but nevertheless played a useful role, identifying country-specific risks to the implementation of the strategy as well as areas where further development of specific policies in the PRSP or policy prioritization was needed. However, the Progress Report did not play the central role that would have been expected in the ongoing debate on the growth strategy and modification of the PRSP, and the associated JSA could have signaled the limited use of the Progress Report in this respect.

The World Bank and IMF have collaborated closely since the PRSP, with country offices playing a key role, providing inputs to the respective programs, and participating regularly in meetings with civil society groups in various fora. The area of governance and legal reform, of prominent importance in Nicaragua, is an example where collaboration appears to have been effective, leading to a clearer delineation of responsibilities and conditionality.

I. INTRODUCTION

1. The International Monetary Fund (IMF) and the World Bank introduced the Poverty Reduction Strategy Paper (PRSP) process in 1999 to strengthen the poverty alleviation focus of their assistance to low-income countries. This report reviews Nicaragua's experience with the PRSP process, focusing on the effectiveness of IMF and World Bank support to the process and the extent to which the two institutions' lending and non-lending activities in the country are aligned to the objectives of the PRSP approach.¹

2. The evidence used for the analyses is based on a variety of sources, including: (i) published and unpublished IMF and World Bank documents relevant to the PRSP and PRGF-supported program; (ii) stakeholder documents on the PRSP process; (iii) interviews with IMF and World Bank staff involved in Nicaragua over the period 1999-2003; (iv) interviews with a broad spectrum of stakeholders in the context of a joint IEO/OED mission to Nicaragua,² including the government, civil society, political parties, and international partners; and (v) a quantitative survey of about 90 stakeholders.³

3. The report is structured as follows: Section B provides background on poverty, the political and economic context, and history of national strategies in Nicaragua. Section C analyzes the PRSP process focusing on application of underlying principles, including through formulation and implementation processes. Section D evaluates the support of the IMF through the PRGF. Section E assesses the support of the World Bank to the PRSP process. Section V summarizes the main findings and attempts to draw lessons for the PRSP process and for Bank and Fund operations.

¹ The report, which was finalized and transmitted for comments to the Government of Nicaragua on December 3, 2003, covers the experience of Nicaragua with the PRSP/PRGF process up to mid-2003. Subsequent developments, including the Plan Nacional de Desarrollo (PND) draft and Consultative Group meetings (end-October) and the Second Progress Report (end-November), have been referenced in the text but not made part of the assessment. The choice of time frame reflects in part that IEO's terms of reference preclude interfering with ongoing operations.

² The mission included Mr. Martin Kaufman and Mr. Alex Segura (IEO), and Mr. Nils Boesen and Ms. Desiree Elizondo (OED consultants). The mission to Managua took place on June 2–13, 2003. The mission met with government officials, civil society organizations (including NGOs, business groups, and trade unions), political parties, and donors (see Annex I for a list of interviewees). There was a field visit to Leon Norte and Santa Rosa del Peñón to talk to local leaders, mayors, and local NGOs. The main messages obtained during the mission were presented in an exit workshop attended by key participants in the PRSP/PRGF process.

³ The results of the survey are highlighted in the main text of this report. Full results are presented in survey Annex II.

II. COUNTRY BACKGROUND

A. Poverty

4. This section lays out the poverty profile of Nicaragua, as background to the discussion of the country's PRSP process. Consideration is given to the income and non-income dimensions of poverty, consistent with the underlying principles of the initiative.

5. Nicaragua is among the poorest countries in Latin America with a GNI per capita of US\$710 in 2000.⁴ Poverty remains largely a rural phenomenon; about 68 percent of the rural population was living under the poverty line in 2001 versus 30 percent of the urban population.⁵ Poverty is heavily concentrated in the Eastern and Northern parts of the country. Ethnic minority groups are especially affected (see Table 1).

6. Between 1993 and 2001, the share of Nicaragua's population living below the poverty line declined from 50 to 46 percent, and extreme poverty fell from 19 to 15 percent.⁶ However, because of strong demographic growth, the absolute number of people living in poverty increased by nearly 300,000 in this period, while the number living in extreme poverty decreased by 25,000.

7. Poverty reduction has been uneven in different regions. The growth of agricultural output in the nineties (7 percent growth annually) is seen as the key cause of the decline, while the huge inflow of assistance after the Mitch hurricane in 1998 helped alleviate poverty in the Atlantic and Pacific Region which suffered most damage. On the other hand, the coffee crisis and drought explains the increase of poverty incidence in Central Region between 1998-2001.

8. Poverty is associated with high income and consumption inequality, high unemployment and under-employment rates (especially for women), land tenure insecurity, and poor access to infrastructure and public services. The social dimension of poverty includes high fertility rates—twice the Latin American average; poor educational attainment; poor quality and access to health services; and widespread malnutrition. Moreover, the poor are vulnerable to recurrent natural disasters and the risk of periodic hunger; are marginalized

⁴ The Central Bank of Nicaragua has recently revised national accounts figures, which had been underestimated for a number of years. A factor 1.7 has been applied to previous figures (GNI per capita was previously estimated at US\$420). GDP figures in this report have been adjusted accordingly.

⁵ Government of Nicaragua, 2002.

⁶ The poverty line corresponds to a consumption of approximately 1 U.S. dollar a day, and the extreme poverty line to half a U.S. dollar a day.

by the lack of information and opportunities; and have high incidence of domestic violence which raises concerns about women's status and lack of social cohesion.⁷

Table 1. Poverty and Extreme Poverty by Region, 1993–1998–2001 1/

Region	Incidence of extreme poverty (percentage)			Incidence of poverty (percentage)		
	1993	1998	2001	1993	1998	2001
National	19.4	17.3	15.1	50.3	47.9	45.8
Urban	7.3	7.6	6.2	31.9	30.5	30.1
Rural	36.3	28.9	27.4	76.1	68.5	67.8
Managua	5.1	3.1	2.5	29.9	18.5	20.2
Pacific						
Urban	6.4	9.8	5.9	28.1	39.6	37.2
Rural	31.6	24.1	16.3	70.7	67.1	56.8
Central						
Urban	15.3	12.2	11.1	49.2	39.4	37.6
Rural	47.6	32.7	38.4	84.7	74.0	75.1
Atlantic				35.		
Urban	7.9	17.0	13.1	5	83.	44.4
Rural	30.3	41.4	26.9	6	79.3	43.0

Source: World Bank (2002). The incidence of poverty includes the incidence of extreme poverty, which is a sub-set of the poverty incidence. The poverty line corresponds to a consumption of approximately 1 U.S. dollar a day, and the extreme poverty line to half a U.S. dollar a day.

1/ The national level figures are identical to the figures reported in the PRSP progress report (Government of Nicaragua, 2002). There are apparent inconsistencies; although the aggregate national fall in extreme poverty incidence from 1998-2001 was 2.2 percent, neither the urban nor rural reductions exceeded 1.5 percent. A draft and still unpublished updated Poverty Assessment prepared by the World Bank has different figures.

9. Social indicators and the coverage of social services have improved in the period 1993-2001, but progress has been uneven. Primary enrollment accelerated and secondary enrollment improved considerably, but internal efficiency for primary education has not improved. Infant and child mortality rates decreased significantly in this period, including an impressive reduction of the infant mortality rate from 40 to 31 per thousand from 1998 to 2001. Maternal health has improved, but both prenatal care and institutional birth rates have only improved modestly.

⁷ Government of Nicaragua, 2001, and World Bank, 2001.

10. The poor perceive that they lack economic and political power to influence decisions and policies that affect their lives. The PRSP found that in general, poor people have little confidence in public institutions, which are perceived as bureaucratic and prone to corruption. Although statistics indicate progress, a perception of access inequality to health and education services still persists, and a perception of a decline of wellbeing is associated with the 1990s.⁸

11. Poverty in Nicaragua is associated with high vulnerability of the economy to external shocks including sharp reductions in prices on a few key agricultural products—and drastic increases in prices on staples such as corn. At the same time, neither publicly provided safety nets, nor the coping strategies of the poor, are highly effective in protecting vulnerable families against the effects of crises.

12. Nicaragua has a good foundation for measuring changes in poverty incidence. The main source of quantitative data on poverty in Nicaragua is from the Living Standards Measurement Surveys (LSMS) of 1993, 1998 and 2001, enabling the establishment of comparable time-series. A census and a health survey have also been conducted in 1995 and 1998, respectively. Unfortunately, comparable data prior to 1993 is not available.

B. Political Context

13. Nicaragua's political context—notably a polarized society and political system, and weak institutional capacity and governance—has affected the PRSP process and must be taken into account in judging the speed and extent to which the new approach could be expected to bring about change. In particular, the political context highlights the limits that could be expected on the breadth and depth of country ownership, and the importance of political and institutional factors in formulating and implementing policies and national strategies.

14. The nature of Nicaragua's *polarized society*—which is a century old phenomenon that has continued after the transition to democracy in the early 1990s from the Sandinista regime (see Box 1)—and political instability have been a strong obstacle to consensus building. This has been a constraint on the process of participation and opening the policy debate, and on reaching common grounds for broader ownership. With very different political or ideological positions, agreement on policies would tend to be at best at very general levels. This need to reduce policies to their lowest common denominator, in order to broaden an otherwise elusive consensus, has impaired the role of consultation institutions (such as CONPES, the National Council for Social and Economic Planning).

15. Moreover, as a result of the strong bi-partisan division of power and the absence of other party alternatives, many people have sought platforms in civil society organizations, notably NGOs. This has contributed to the view among many in the political establishment

⁸ Ibid.

and in various civil society organizations that some NGOs use participation to acquire political strength, despite having limited representation. This phenomenon has also affected participation and the effectiveness of policy dialogue. Moreover, the government's weak parliamentary backing, partly as a result of its anticorruption efforts, has forced it to seek support on a case-by-case basis for the passage of key legislation, including reforms necessary to reach the completion point under the HIPC initiative.

Box 1. Chronology of Nicaragua's Recent Political Events

After overthrowing the Somoza dictatorship, the Sandinista revolution took power in 1979, moving away from the market economy to a more centrally planned organization of economic activity. By the second half of the 1980s, the economic and political situation degenerated rapidly, with the exodus of 10 to 15 percent of the population.

Following a peace agreement in 1989, the Sandinistas were defeated in the 1990 elections by a centre-right coalition led by Violeta Chamorro. The new government undertook the task of national reconciliation and economic stabilization. However, the collapse of the ruling coalition in 1992 halted most reform efforts by the government.

At the end of 1996, Arnoldo Alemán of the Liberal Party was elected president. His election led initially to high political polarization, but in 2000 Liberals and Sandinistas entered into a pact, dividing key institutions along party lines, including the judiciary and Electoral Council.

In November 2001, Mr. Bolaños was elected president and pressed on with an anticorruption agenda against the previous administration, which led to the removal of Mr. Alemán as president of the National Assembly. As a result, the government lost the support of most members of the ruling Liberal Party, and was left without significant parliamentary support.

16. The characteristics of Nicaragua's society have also contributed to *weak institutional*ity, blurring the separation of state powers,⁹ weakening the rule of law and the protection of property rights, and leading to governance problems including patronage and widespread corruption. In this context, the process of designing and implementing economic and social policies has been difficult, even in areas where some consensus could be reached. The PRSP took considerable note of these problems and devoted a full pillar to governance. However, division of power in key institutions such, as the supreme court and the electoral council, between the two dominant parties continues to represent a threat to good governance (see Box 2).

17. Moreover, the state in Nicaraguan has limited capacity to implement and control activities, with a tendency to "institutional feudalism," whereby leading positions in institutions are considered a reward. The institutional framework of the public sector is

⁹ For example, despite the new government's intentions, progress in improving the judicial system have been limited. Supreme Court judges have been recently elected based on party affiliation and excluding candidates promoted by the executive, with direct implications for the independence of the judicial systems since the Supreme Court appoints lower-court judges.

highly fragmented, with overlap of competencies and duplication of programs. Such deep rooted factors explain why a long series of initiatives and recommendations have had limited success, and why public sector reform would be a long term endeavor.

Box 2. Governance in Nicaragua

Nicaragua scores relatively low on most indicators of governance such as government effectiveness, the rule of law, and political stability according to the World Bank Governance Indicators (see Table).

The combat of corruption and the rule of law have improved in recent years, but progress in this area has been modest, starting from a low base, in part because of political division in the ruling party and profound politicization of key institutions (see main text). Moreover, the indicators of regulatory quality, political stability, and government effectiveness have all continued to deteriorate since the late 1990s.

Overall changes have been insufficient to have a significant impact on the investment climate as the country continues to face institutional challenges to guarantee the enforceability of contracts and attract foreign investment. The Economist Intelligence Unit recently assigned Nicaragua a score of D for Legal and Regulatory risk—on a scale from A (low risk) to E (high risk).

Evolution of Governance Indicators in Nicaragua

	1996	1998	2000	2002
Voice and Accountability	-0.21	0.07	-0.08	0.09
Political Stability	0.15	0.16	-0.15	-0.57
Government Effectiveness	-0.47	-0.57	-0.74	-0.87
Regulatory Quality	-0.24	0.45	0.31	-0.41
Rule of Law	-0.66	-0.81	-0.90	-0.63
Control of Corruption	-0.14	-0.70	-0.91	-0.44

Source: World Bank Governance Indicators (2003). The governance indicator is normally distributed with a mean of zero and a standard deviation of 1, with virtually all scores in the range of -2.5 and 2.5, with higher scores corresponding to better outcomes.

C. Economic Policy and Performance

18. This section presents a brief overview of Nicaragua’s recent economic history and identifies the main challenges and constraints to growth and poverty reduction. It provides a background to understand the context in which the PRSP process was introduced.

Recent economic developments

19. Throughout the 1990s, after the dismal economic situation left by the Sandinista regime, Nicaragua has struggled with major macroeconomic problems, principally *unsustainably large fiscal deficits and debt levels*. The very high debt hangover made Nicaragua eligible for the HIPC initiative, which has been a key driver of the PRSP

process.¹⁰ Repeated efforts to consolidate the fiscal situation during the Chamorro and Aleman administrations proved unsuccessful owing largely to recurrent expenditure overruns. These recurrent failures put Nicaragua several times in extremely vulnerable positions, on the verge of fiscal collapse and balance of payment crises. In this context, the Bolaños government made significant efforts to improve the fiscal situation and shore up macroeconomic stability, and earn a track record of economic management.

20. After the hyperinflation of 1990, inflation in Nicaragua has remained relatively contained. The government of Ms. Chamorro successfully stabilized inflation to one-digit levels. Subsequent administrations, despite unsettled economic conditions, managed to avoid a recurrence of inflation spirals.

21. Nicaragua also suffered a major natural disaster in the late 1990s, *hurricane Mitch* that disrupted the macroeconomic situation and fiscal consolidation efforts. Mitch hit Central America at the end of 1998 and produced serious damage to Nicaragua's infrastructure. The hurricane killed over 3,000 people and displaced close to one million. The international community responded swiftly and aid flows to Nicaragua tripled, which translated in public investment nearly doubling as percent of GDP in 1999.

Challenges and constraints to growth and poverty reduction

22. Nicaragua's economy is highly dependent on agriculture, which accounted for 50-70 percent of exports and a third of Nicaragua's GDP in 2001, a larger share than that of any other Central American country. Growth rates of agriculture in the 1990s averaged over 6 percent but the coffee sector in particular has been vulnerable to recent sharp declines in world prices. Growth in manufacturing has been slow in spite of government incentives, except in the maquila sector which has expanded rapidly since 1997.

23. Nicaragua's vulnerability to macroeconomic crises is perhaps the main challenge to poverty reduction, according to the World Bank's 2001 Poverty Assessment. While the report highlights external factors such as terms of trade shocks and foreign aid dependence, it also attributes vulnerability to the country's nascent and weak financial sector which sorely lacks oversight capacity. Resolution of a major banking crisis in 2000–2001 resulted in a significant increase in public debt.

24. Other obstacles to poverty reduction are Nicaragua's inefficient health services, a high population growth rate, chronic malnutrition, gender bias which manifests itself in high rates of domestic violence, challenges in enhancing non-farm rural activities and in sustaining rural income growth. On the latter, a recent World Bank report singles out the

¹⁰ The projected fiscal impact of the HIPC initiative was substantial; the burden of debt service was projected to decline from 20 percent of government revenues in 2000 to less than 9 percent by 2007. Under the plan laid out in the Interim PRSP, the government was committed to use HIPC-released funds to finance poverty-reducing expenditures.

contribution of broad-based growth in the agricultural sector to the significant poverty reduction that occurred in Nicaragua between 1993 and 2001.¹¹ The report cautions, however, that the causes of growth and the corresponding poverty reduction between 1993 and 2001 were temporary—high export commodity prices, the availability of unoccupied land and a return to peace—and cannot be sustained; it goes on to argue that Nicaragua’s best hope for sustained growth and poverty reduction probably lies with agricultural exports.

25. However, Nicaraguan agricultural exports are not only hampered by their vulnerability to external shocks but have been constrained by various factors including marketing constraints, poorly performing goods markets, a lack of sufficient infrastructure, incentives biased towards production of products for the domestic market, inefficient public spending in rural areas and low productivity in all factor markets.

D. National Strategies and their Formulation

26. This section outlines national strategies formulated over the past decade, as a basis for understanding the starting point for the launch of the PRSP process and assessing the relevance of the PRSP approach to the Nicaraguan case. Review of these past strategies point to limited participation, strong donor involvement in defining development priorities, and the lack of follow-through including a lack of a real effect on resource allocations.

27. When President Chamorro assumed power in 1990, the agenda was concentrated on restoring peace, reestablishing macroeconomic stability, and restructuring the public sector. To support and expand these efforts, Nicaragua produced in 1993 a “Medium Term Development Policy” in close collaboration with the Bank and the IMF. At the same time, the government prepared a Social Agenda for 1993-96 with three objectives: (i) to provide support for the poorest and most vulnerable groups of the population; (ii) to increase the effectiveness and efficiency of services delivered to the poor; and (iii) to assist some excluded productive sectors. FISE, the Emergency Social Investment Fund, became a primary vehicle for donor-funded investments in social infrastructure within this vision of social protection and assistance.

28. One of the first attempts to use a participatory approach to policy-making strategies was the formulation of the Environmental Action Plan for Nicaragua in 1994–95, when there were extensive consultations involving multiple stakeholders in municipalities, as well as sector-level consultations. This was one of the first times that municipalities started to assume a more prominent role as political units since the first municipal elections in 1990.

29. The Liberal government that took office in 1997 did not present a comprehensive development plan, but focused on strengthening a private sector-led approach to development, with a strong emphasis on agriculture and rural development. When political

¹¹ World Bank, “Promoting Competitiveness and Stimulating Broad-based Growth in Agriculture,” October (2002).

negotiations with the opposition Sandinista party proved unsuccessful in mid-1997, and social unrest threatened, the Government launched a “National Dialogue” process to broaden stakeholder involvement, notably without including international partners. A number of agreements were entered through work in different sub-commissions, including fiscal and monetary policy, employment, production, and governance issues. However, the agreements reached in this broader, participatory process were never honored. Rather, the power-sharing “pact” in 2000 between the Liberal and Sandinista parties shifted back preeminence to the formal democratic, political-party system.

30. Following hurricane Mitch in late 1998, a reconstruction plan was presented to the donor community at the Consultative Group meeting in Stockholm in May 1999. The “Stockholm Declaration” was agreed upon with the donor community; and identified six priorities for Central American countries: (i) reduction of social and ecological vulnerability; (ii) reconstruction and transformation on the basis on an integrated approach of transparency and good governance; (iii) consolidation of democracy and good governance, with active civil society participation; (iv) respect for human rights, and equality between men and women; (v) coordination of donor efforts, guided by recipient country priorities; and (vi) intensified efforts to reduce the external debt burden.

31. In the Policy Framework Paper (PFP) prepared in collaboration with the Bank and the Fund in August 1999, a “poverty alleviation and social development strategy” was outlined. It focused on four pillars: promoting economic growth with equity, investing in human capital, strengthening the social safety net, and promoting rural development. The government promised to increase overall social spending to more than 15 percent of GDP in 2000–2001.

32. The launching of the enhanced HIPC initiative in late 1999 prompted the Nicaraguan government to prepare two preliminary documents for the May 2000 Consultative Group (CG) meeting in Washington: a more backward looking and general document (“One Nation, Many Voices”), and a “Progress Report on the Fight Against Poverty” which contained the foundations of the later I-PRSP and the PRSP strategies and goals. This document concluded that the government needed to follow three steps to reduce poverty: “(i) generate broad-based economic growth galvanized by the modernization of the countryside; (ii) improve the human capital of all, but particularly of the rural poor; and (iii) try to ensure an adequate safety net so those at the bottom do not slip further down.”¹² These three pillars later became the foundation of the PRSP, with the addition of governance as the fourth pillar (owing to the insistence of the donor community given that governance had been a key issue in the Stockholm Declaration).

33. For both documents, a limited consultation process took place with civil society representatives and donors. The consultations with civil society representatives took place in

¹² Government of Nicaragua (2000b), p. 12.

CONPES, the National Council for Economic and Social Planning, set up to provide advice to the President on economic and social issues. The creation of CONPES was enshrined in the 1996 Constitution, and the council was brought to life in August 1999, mainly to ensure a follow-up on the Stockholm agreement.

34. There have been two additional strategy documents, parallel to the PRSP process, that are worthy of mention. First, the *Plan Puebla-Panamá* was launched in early 2001, and envisaged major infrastructure investments in Nicaragua as part of efforts to improve transportation between Mexico and Central American countries. Some observers found a clash between this process and the PRSP process.¹³ Second, the UNDP (in the context of the Capacity 21-initiative) and the OEA promoted and funded another participatory process to shape a “Vision of the Nation” in 2001. This process was supported both by CONPES and CONADES (the National Council for Sustainable Development). CONADES, which had been formed after the Rio 92 conference, was the key instrument to develop the “Vision of the Nation”—a strategy to focus on environmental and poverty issues organized according to a territorial approach.

35. *None of the above visions, strategies or plans were linked to the budgeting process or to specific allocation of resources that are co-managed by the government and donors.* References to earlier documents have been symbolic or virtually non-existent in later strategies and plans. Informants interviewed were also silent about the virtues and defects of earlier strategies, and there is a general perception among interviewees that actual resource allocations, policy developments, and legal initiatives have been determined by other political processes (i.e., pacts and negotiations among political parties, negotiations with IFIs, etc.) rather than by the existence of these plans and strategies.

36. Except for the National Dialogue in 1997, and to a lesser extent the Plan Puebla-Panama, the *different documents and strategies have largely responded to donor or international events, rather than to domestically driven processes.* They mostly lacked continuity in the public policy agenda and had generally a short life. In fact, their appearances have often taken place without the participation of the main political parties and the National Assembly. They were often developed as a mechanism on the part of the Executive to deflate pressure in other parts of the political system. The extent to which the PRSP has changed or improved upon some of these dynamics in the formulation of development strategies in Nicaragua will be discussed in the following sections of this report.

¹³ The question of the relation between the PRSP and the Plan Puebla-Panamá (PPP) was raised again in a follow-up meeting with civil society on the PPP arranged by the IDB in June 2002.

III. THE PRSP PROCESS

37. A new framework for poverty reduction was proposed by the staffs of the World Bank and IMF, and endorsed in 1999 by the Interim and Development Committees. The framework's key objective is to assist countries in developing and implementing more effective strategies to fight poverty, embodied in Poverty Reduction Strategy Papers (PRSPs). The PRSP approach draws on key underlying principles (see Box 3). This section assesses the PRSP process in Nicaragua, including key evaluation issues such as relevance (first section) and the application of underlying principles (second section). The third section reviews the preliminary results from the process including links to budget processes and achievement of targets.

Box 3. Underlying Principles of the PRSP Process

1. *Country-driven* involving broad-based participation.
2. *Results-oriented* and focused on outcomes that benefit the poor.
3. *Comprehensive* in recognizing the multi-dimensional nature of poverty.
4. *Partnership-oriented* involving coordinated participation of development partners.
5. Based on a *long-term perspective* for poverty reduction.

Source: Poverty Reduction Strategy Papers: Operational Issues (1999).

38. The timetable for implementing the PRSP process was rapid; in a year the government moved from launching the Interim PRSP to reaching a HIPC decision point and completing the PRSP (see Table 2).¹⁴ The Interim PRSP was completed in August 2000, and by December the decision point under the enhanced HIPC initiative had been reached. A year later, in August 2001, the PRSP was successfully completed and presented to the executive boards of the World Bank and the IMF. In November 2001, a new government was elected, and in November 2002 the first PRSP Progress Report was completed.

39. The principles guiding the PRSP process included a continued modernization of the state, greater equity by empowering the poor (in particular the most disadvantaged groups), increased transparency and accountability, and broader participation. Poverty was recognized as a multidimensional problem, with economic, human capital, vulnerability, and marginality

¹⁴ The PRSP is known in Nicaragua as the ERCERP: Estrategia Reforzada de Crecimiento Económico y Reducción de la Pobreza (Strengthened Growth and Poverty Reduction Strategy).

dimensions. The four key pillars and the cross-cutting themes of the PRSP are set out in Box 4.

Table 2. Key PRSP, IMF, and World Bank Events

Year	IMF	PRSP	HIPC	World Bank
1998	ESAF 98-00			CAS 99-01
Aug 1999	Modified ESAF			
Sep 1999			HIPC Qualification	
Aug 2000		I-PRSP finalized JSA of I-PRSP		
Dec 2000			Decision Point	
July 2001		PRSP finalized		
Aug 2001		JSA of PRSP		
2001		CONADES/CONP ES consultations		
Nov 2002		PRSP Progress Report		
Dec 2002	PRGF	JSA of Progress Report		CAS 03-2005; PSAC
End 2003			Completion Point expected	

CONADES/CONPES: Consultative process
JSA: Joint Staff Assessment

CAS: Country Assistance Strategy
PSAC: Programmatic Structural Adjustment Lending

Box 4. Key Features of Nicaragua's PRSP

Nicaragua's PRSP contains four pillars and three cross-cutting topics.

Pillars:

- a. *Broad-based, labor intensive economic growth and structural reform*: This requires high growth rates as well as price stability. Growth 2001-2005 is projected to be 4.2 percent annually, but to accelerate later. Expansion of agriculture, directly targeting rural poverty, is emphasized.
- b. *Investment in human capital*: Increased coverage, quality and integration of public education, health, nutrition, and reproductive health services, especially in rural areas.
- c. *Improved protection of vulnerable groups*: A short-term increase in access to public services and protection for the most vulnerable groups.

A. Relevance

40. Assessing the relevance of the PRSP process in Nicaragua involves assessing the “fit” between the PRSP approach—principles and process—and the key development challenges facing Nicaragua at the time of its introduction. In this regard, the key assessment question is did the PRSP approach address key gaps in the country’s strategic approach to long-term poverty reduction?

41. As described in the previous sections, policy formulation and implementation in Nicaragua had taken place in a context of extreme political instability, aid dependence, fiscal vulnerability, improving but weak governance, and highly fragmented policies and institutions. The scope of prior national strategies had broadened from a narrow focus on alleviation measures (such as the Social Investment Fund), but the policies were closely related to donor-related processes rather than domestic policy processes. They were not a significant part of a public policy agenda nor were they consistently subject to consultative processes. Further, their links to the budget process were non-existent, and the policies were rarely implemented due to recurrent political and fiscal crises and weak implementation capacity.

42. Compared to prior processes for policy formulation, informants agreed, with few exceptions, that the PRSP approach, in principle, was substantially relevant to Nicaragua’s situation. Survey respondents also rated the relevance of the approach highly,¹⁵ which is consistent with the assessment of the evaluation team, with the following points worth emphasizing:

- In a context of a fragmented and largely donor-driven policy-making arena, the PRSP approach—which requires leadership and commitment of the government and a broad-based consultative process (which, ideally, broadens country ownership and durability of policies)—offered a minimum standard for the inclusion of a wider polity in national strategy formulation. Most informants saw the PRSP as providing a framework for broadening the policy formulation processes in the country—with opposition parties being notable exceptions, for reasons that are discussed further below.

¹⁵ Questions 8, 9 and 10 on the relevance of the approach ranked among the 5 most positive responses to the survey. Forty-five percent of respondents agreed that “The concept of a PRSP is a good model for addressing poverty reduction”, and that “The PRSP process has added value to the country’s response to the challenges of poverty reduction, compared to previous strategies/policy frameworks.” And 45 percent agreed that “The PRSP framework improves on past modalities for donor assistance.” See Annex II for more details on the survey results.

- With its attention to the multiple dimensions of poverty and the need for balanced economic and social policies in a context of public sector reform, the PRSP had the potential to focus government, donors and civil society on a comprehensive view of poverty reduction and its challenges.
- The PRSP initiative was designed to have direct and important implications for resource allocations, prioritization, and explicit results and indicators—elements that in practice had been missing from previous strategies. It was thus relevant in establishing a comprehensive and transparent agenda for further work to develop more precise, better focused and more efficient actions to reduce poverty.
- However, expectations of what the approach could deliver in the short-term needed to be tempered by the poor starting conditions—including political polarization and an economic crisis. Discussions with many informants suggest that expectations of what the new approach could deliver in the near-term were raised unduly high, which can be regarded as one of the potential costs of the new approach.

43. The initial effect of the PRSP process as a device for broadening the policy dialogue was influenced by its close link to HIPC debt relief. While there were reasons for this linkage that go well beyond the case of Nicaragua, in this particular case the result was that the PRSP became closely aligned to the timetable for HIPC debt relief and markedly unaligned to the domestic political situation. As a result, the preparation of the PRSP ended up taking place when both the government and the macro-economic situation were in crisis and elections were unfolding. While the PRSP timing was, of course, ultimately the government's decision, there is no doubt that it was heavily influenced by the HIPC process.

44. After the new government took over, debates over the framework and process for modifying the PRSP, in a context where there was a strong focus of donors on the PRSP and donor support, initially complicated rather than facilitated discussions of alternative development strategies. In effect, as the discussion below will elaborate, tensions emerged between the emphasis on a government-driven process and other aspects of the process, notably the broad-based, participatory and partnership aspects. However, more recently, these tensions do seem to have resulted in a substantive debate on the development strategy, which can be viewed as a benefit of the evolving PRSP approach. Ultimately, whether the benefits exceed the costs will depend to a large extent on whether the approach succeeds or fails in building broader country ownership and better and more sustained policies over time, despite the inevitable tensions with externally-driven process requirements. All such judgments need to be calibrated against the poor initial starting conditions.

45. To summarize, the PRSP approach is judged on balance to be relevant for Nicaragua's national strategy process and its poverty reduction efforts. The approach addresses important gaps found in past experiences. It offered (i) an opportunity for widening the inclusion of all stakeholders in strategy-making with the potential for greater government commitment; (ii) an appropriate focus on a comprehensive vision of poverty; and (iii) a sorely lacking results-oriented framework. While the PRSP approach puts focus on addressing

problems, expectations must remain realistic in what can be accomplished in the near term, especially in light of the timing of the PRSP launch during a period of political and macroeconomic crisis, and the strong link to critical support from donors which, given the past experience of donor-driven national strategies, is at tension with the approach's support for country ownership of the strategy. The continued relevance of the PRSP is thus not guaranteed and will depend crucially on how sensibly and flexibly the many actors use it in the near future, and how well they bring the lessons learnt from the process to bear on future actions.

B. Application of the Underlying Principles and Assessment of What Has Changed

a) Country-driven with broad-based participation

46. Interviews by the evaluation team and background documents support the view that the Nicaraguan government embarked on the PRSP process because it was a precondition for entering the enhanced HIPC initiative. This underlying motivation appears to have driven many subsequent decisions. While this is perhaps not especially surprising, the key assessment questions are how country-driven and broadly-based the process was despite these tensions and whether the process is continuing to evolve in a positive direction. Reflecting the particular evolution of the PRSP in Nicaragua, we discuss first the initial formulation of the PRSP and then the problems that arose during later attempts to modify the objectives of the strategy.

(i) Formulation of the I-PRSP and PRSP

47. The preparation of the PRSP was led by a specially created unit—the Technical Secretariat of the Presidency (SETEC)—consisting of a small group of Nicaraguan professionals.¹⁶ This group commanded the selection of goals, priorities and strategies and coordinated the consultation process with other government sectors. Observers interviewed in Nicaragua stressed that the PRSP document was prepared by SETEC in a highly centralized manner. Although key social ministries (education and health) participated in the design of the PRSP, there was limited diffusion to other strata of government. Moreover, there was limited diffusion and knowledge of the PRSP outside Managua. However, the group had unhindered access to and active support from the highest levels of government, its head has minister rank and a seat in the Cabinet. SETEC had a clear and strong mandate to prepare, as quickly as possible, an I-PRSP and a PRSP which would be acceptable to the Bretton Woods Institution and other donors.¹⁷ As a demonstration of this focus, the first version of the I-PRSP was produced in English rather than Spanish.

¹⁶ Subsequently, the unit's name was changed to the Strategy and Coordination Secretariat, SECEP.

¹⁷ The government invited a Nicaraguan staff member of the FMI to lead the work of SETEC, thus ensuring intimate familiarity with the thinking and operations of the Fund.

(continued)

48. *The participatory process was initially limited, but was subsequently broadened as a result of pressure from stakeholders, including donors.* In May 2000 the government envisaged that the full PRSP would be ready by the end of 2000, just four months after completing the I-PRSP in August 2000. A short consultation process was planned for late 2000, including events in three departments. Based on this strategy, the government proposed to present the full PRSP to the BWIs in March 2001. Donors and civil society groups felt that this timetable was unduly rushing the process.¹⁸ In this context, four rural municipalities north of León conducted their own participatory process in the fall of 2000 with assistance from an international NGO, and forwarded the results of their consultation to the World Bank,¹⁹ complaining about the lack of participation of municipal representatives in the formal consultations for the PRSP.

49. As a result of pressures from donors and civil society, the government undertook a broader consultation process, which took place in March-April 2001. UNDP and DFID provided funding for this new consultation process that came to be known as PROCONSULTA. The consultations centered on Pillars 2 and 3—human capital development (health and education) and social protection, with less focus on growth strategies and macroeconomic policies. Observers, including IMF and World Bank staff, generally agreed that there had, in particular, been little public debate on the macroeconomic framework and alternative policy options for such a framework, and that such discussions had still been undertaken within the context of negotiations on the IMF-supported program (see Section D).

50. The process made efforts to extend participation to some of the poorest areas of the country, and included focal group sessions with the poor, and community and municipal events, as well as consultations with civil society organizations. Nevertheless, reflecting the dissatisfaction of some civil society groups with the official consultation process, parallel consultation efforts were organized, including that of the Civil Emergency and Reconstruction Coordinator—an umbrella NGO formed with donor support after the hurricane Mitch—that organized its own process and presented its own document (“La Nicaragua que Queremos”). Political parties and representatives from the National Assembly were little involved in the consultation process.

SETEC staff was partly funded as consultants by a World Bank credit (EMTA-I), and other donors funded other parts of the PRSP process (including UNDP, BID and DFID).

¹⁸ The Joint Staff Assessment of the I-PRSP also “expressed caution against rushing the process of finalizing the full PRSP” (IDA and IMF (2000a)).

¹⁹ As a result of this participatory process they prepared a document that they called “PRSPicito” (or little PRSP in Spanish), which was a reflection of their dissatisfaction with the processes associated with the official PRSP.

51. Assessments of the participatory process vary widely, driven in large part by differences in views about the purpose and legitimacy of such participation. Leading officials involved in the process who were interviewed by the evaluation team generally regarded participation as a process of information provision and consultation. In their view, the government had the democratic mandate to do what it saw best, and consultation in CONPES with representatives of various groups and umbrella organizations would basically be sufficient to ensure national acceptance and co-responsibility. Consultation was thus not seen as a means to create opening for significant direct influence on policy formulation. They also argued that CONPES, since it is composed of members with very different political or ideological positions, cannot agree except on the lowest common denominator, which in practice reduces the operational usefulness of CONPES agreements.

52. Information from political parties conveyed the impression that they chose not to get involved for fear of losing bargaining power in the Assembly. More fundamentally, the two dominant parties perceive the focus on participation as part of a political game, intending to weaken their influence. They see in particular that the present government, because it has limited support in the Assembly, uses CONPES and participation as a means to create support for its policy platform which can serve in the political battles in the Assembly.

53. Private sector representatives interviewed by the evaluation team found the consultation processes in CONPES ineffective and time-consuming, and leading to few results. Nevertheless, they have remained committed to the process. They also claimed that some members of CONPES do not represent any significant groups.

54. Civil society groups (NGO and labor union representatives) generally saw the PRSP consultations as a first, positive step, but many expressed frustration that the process had not moved from consultation to greater participation and influence on the ultimate policy decisions, which they regarded as the goal of a participatory process. They generally found that viewpoints raised in this consultation process were not taken into account in any significant manner in the final version of the PRSP. In this regard, various informants also said that a “participation fatigue” was building up in Nicaragua. At the community level, externally induced participation processes create considerable expectations which in many cases—justified or not—led to frustrations when the expected delivery of benefits from the process do not materialize soon. At the national level, the fact that the process so far has had little impact on the debate on broader macro goals (including tradeoffs involved in the choice of growth strategy, discussed below) was leading some stakeholders to question the cost benefits from participation in consultative processes. Results of a survey of stakeholders also suggest a similar picture; they indicate that civil society has been less involved than other stakeholders in the PRSP process (see Survey Annex).²⁰

²⁰ In turn, external evaluations of the PRSP process in Nicaragua show a general perception that the government’s efforts to foster participation have been insufficient, especially for the macroeconomic framework of the PRSP (see Review of External Evaluation annex).

55. *Thus, the country ownership of the PRSP was limited in several important respects.* First, although its preparation was government-driven, the circle involved was relatively narrow. Several of those closely involved in assembling the strategy said they viewed themselves as having “intellectual property rights” to the PRSP, even if they also stressed that donors (not least the World Bank and the IMF) influenced the content strongly and that the timetable was HIPC-driven. A number of observers also acknowledged that there was limited ownership of the strategy in the government, beyond the SETEC/SECEP and the Ministry of Finance.

56. Second, given the general perception among very different civil society actors that the consultation process had been insufficient and that the government did not take the points raised into account, it is clear that there is little civil society ownership. There have been only limited efforts to disseminate the strategy and the PRSP is, according to some informants, virtually unknown in municipalities which have not participated directly in the consultation process or been chosen as pilot areas for implementation.

57. Third, the nature and depth of the policy debate varied substantially between different elements of the PRSP. In particular, pillars 2 and 3 (human capital development and social protection) were the main focus of the consultation process and social sector line ministries were more strongly involved so that, for example, health and education policies built upon strategies already developed at the sector level. In contrast, the policy debate on pillar 1—how to achieve broad-based labor-intensive economic growth—has been incomplete and some of the central issues and policy alternatives were not fully developed as part of the original PRSP process, a weakness recognized in the strategy. As discussed below, this also affected the current government’s attempts to shift the focus of the strategy.

(ii) Modifications/implementation of the PRSP

58. How country-driven and participatory has the process been since finalization of the original PRSP? A number of developments suggest important messages.

59. First, the new (Bolaños) government has sought to modify substantially the growth pillar of the PRSP. At the same time as a new PRGF and a new CAS were agreed with clear references to the PRSP, the government introduced a new draft “National Development Strategy” (ENADE), initially to the surprise and consternation of donors (see Box 5). While the document mentions the PRSP (and PRGF-supported program), it clearly sets out to define a strategy with the mark of the present government. Though still an unfinished story, this episode provides several lessons:

- Interviews with senior officials at the time of the evaluation mission made clear that the new government felt constrained in its ability to pursue the revised strategy set out in the ENADE. For some, this is precisely the idea of PRSPs: they aim at introducing a measure of resilience and permanence in poverty reduction policies, also beyond changes of governments and emphasize the importance of a participatory debate before changes are made. For others, the story demonstrates that the donors continue

to call the shots and that they decide if, when and how an aid-dependent government may change course.

- The fact that the growth strategy, and the tradeoffs involved were not fully developed during the initial preparation of the PRSP probably contributed to later events. Pressures arising from the HIPC timing contributed to the new government's desire not to "rock the boat" initially, even though it had different views on the development strategy, including the balance between growth-enhancing expenditures and more direct poverty alleviation.
- The timing of final agreement on the PRSP—with an outgoing government with seriously compromised authority—was poor. Better alignment with the domestic political cycle would undoubtedly have been preferable and might have alleviated some of the tensions referred to above.

60. Viewed from the perspective of the PRSP as a dynamic process, the events related to the ENADE can be seen as steps in a continuing negotiation between the government and the international community. They also highlight the potential tensions that can arise between the "country driven" aspect and other PRSP objectives. In this perspective, the key points under assessment would be whether this interaction can foster a more inclusive debate on fundamental policy choices, leading to broader ownership, and whether this process leads to better policies (in substance and in durability), including better coordination between governments and donors. In this regard, recent developments at the CG meeting in late October 2003 appear to indicate a change in processes relative to those associated with the ENADE (see Box 5). Importantly, although initially the process could not be said to have enhanced mutual trust between the government and the donors, the fact that the key growth strategy and poverty alleviation tradeoffs are being debated should be welcomed.

61. Second, in the preparation of the recent tax reform, the government opted for an alternative approach to participation, forming a group of qualified professionals who were invited to participate in the preparatory work. Apart from being technically qualified to enter into the design of tax reform, the individuals had strong links to important stakeholder groups, thus helping to ensure that the inevitable political negotiation aspects could also be dealt with as part of the process. The new approach was generally recognized as a positive step to broaden the policy dialogue and a possible model to be used in other areas. (see also Section D).

**Box 5. The Introduction of the National Development Strategy (ENADE)—
Implications for the PRSP Process**

In autumn 2002, a first draft of what was titled a “National Development Strategy” (ENADE) circulated among donors in Nicaragua, prepared by SECEP, initially with very limited reference to the PRSP. The ENADE document was intended to serve as basis for the Consultative Group meeting, at that point planned for February 2003. The key thinking in the draft document was included in the PRSP progress report of November 2002, and a revised draft was circulated in December 2002. This happened at the same time as the government and the IMF agreed on the PRGF, and the government and the World Bank agreed on the Country Assistance Strategy (CAS) for 2003-2005, as well as a Programmatic Structural Adjustment Credit (PSAC). The supporting documents for the CAS and PSAC focus strongly on the PRSP, although there is acknowledgement that a new growth approach has been presented.

The approach underlying the ENADE was a significant modification of some of the key propositions of the PRSP. In particular, they would imply substantial modifications of the (largely donor-funded) public investment program, with less emphasis on social infrastructure and more emphasis on productive infrastructure, including in selected areas judged to be of high growth potential.

Donors reacted with some consternation, having expected that the PRSP would still be the foundation of future dialogue. Representatives of the World Bank and IMF expressed concern about the fact that the links between the draft ENADE and the PRSP were unclear and that parts of the ENADE appeared to be in contradiction to the PRSP. It was also noted that it was not clear whether the ENADE would replace or supplement the PRSP; the costs of the ENADE went beyond the PRGF; and the ENADE was presented without consultations with domestic stakeholders.

As a result of the mixed reception, the government indicated at the time that it would strengthen the original draft and consult interested parties. The CG meeting was postponed, and a consultative process of a shorter, revised document (“Foundations for a Prosperous Nicaragua”) was set-up and announced to the Assembly by the President in January 2003. The authorities presented a modified growth strategy document, Plan Nacional de Desarrollo (PND), during the CG meeting in October 2003. The government presented the plan as an elaboration on the PRSP, specifically on Pillar I, clarifying previous concerns about the relationship of these documents. The PND was being consulted both in Managua and regional departments and with various civil society organizations, including political parties and NGOs. This has sought to address shortcomings in the previous participation processes. Moreover, the government was planning to hold a workshop in early 2004 with stakeholders to discuss how to modify the PRSP based on the PND.²¹

62. Third, there has been no significant movement toward opening up the debate on the macroeconomic framework and alternative policy tradeoffs to a broader group of participants.²² IMF staff argued that this was the choice of the government and not one they

²¹ The Second Progress Report of November 2003 became available only after the finalization of this case study report. The Progress Report notes that the Government expects the PND to provide the basis for the development of an enhanced SGPRS or a Second Generation PRSP.

²² Indeed, recent changes to CONPES have weakened its role in the process of dialogue and consultation with civil society. After the conclusion of the PRSP process, the new government that took office changed the composition of CONPES making it a “pure” civil society body through the withdrawal of senior government officials as members. Most civil society organizations interviewed by the evaluation team found that CONPES has been

(continued)

could realistically have challenged. Indeed, many senior officials and IMF staff interviewed argued that the urgency of the economic circumstances at the time the PRSP was being formulated—most notably the massive public sector deficits, the fragility of the financial sector, and the lack of government credibility stemming from poor macroeconomic management and earlier governance problems—limited the public exploration of alternative macroeconomic policies.²³ In contrast, officials involved in program negotiations with the IMF do report some broadening of the policy space and a willingness of the IMF to consider alternative policy options that took into account political economy factors—albeit within the context of a traditional negotiating framework. As economic conditions improved and government credibility increased, the IMF gradually became more receptive to government initiatives on alternative policy settings and timing. (Specific examples are discussed in Section D.) This represents progress and perhaps is all that could realistically be expected given the very difficult starting conditions. However, macroeconomic policy formulation is undoubtedly one area where (possibly unrealistic) expectations of a markedly different, and broader-based, process under the PRSP have not yet been met.

b) Comprehensive in recognizing the multi-dimensional nature of poverty and based on long-term perspective

63. The PRSP has good quantitative and qualitative diagnoses of poverty. The quantitative analysis built on the Living Standards Measurement surveys conducted in 1993, 1998, and 1999 (post-Mitch); and the Demographic and Health surveys. The diagnosis was based on poverty lines constructed on the basis of consumption.²⁴ In addition, the PRSP also

weakened considerably by this change since it eliminated the possibility for civil society to have direct dialogue with senior government officials and hence greater potential to influence the policy-making process.

²³ Clearly, even in a severe macroeconomic crisis, alternative policy options could be considered and, in principle, be subject to a broad-based policy debate. One example of particular relevance to Nicaragua is the distribution of “burden-sharing” (between depositors, existing debt holders, and future taxpayers) of the costs of a banking crisis. Some observers, including representatives of civil society, have questioned the choice that was made at the time. (In essence, the government reimbursed fully deposits in failed banks at the cost of a higher public debt. Some—see, for example, Avendaño (2002)—have argued that this was an inappropriate choice, leading to higher domestic debt burden at the same time HIPC debt relief was being sought.) Whatever the merits of this argument, it is hard to see how the PRSP process could have handled such a debate in practice. While there clearly were important tradeoffs involved, to have debated publicly at the time alternative scenarios for imposing the costs on different groups of depositors and debt holders would have made the crisis worse.

²⁴ The poverty line corresponds to a consumption of approximately \$1 dollar a day, and the extreme poverty line to \$0.5 dollar a day.

built on a Qualitative Poverty and Exclusion study that analyzed the perceptions of the poor, placing vulnerability at the center of attention, and was useful to better understand the multidimensional implications of poverty

64. *The PRSP strategy was comprehensive and went beyond a simple social sector development approach.* The PRSP had four pillars, including a macroeconomic policy framework, a growth strategy, a strategy for social service delivery and protection, and an agenda for improving governance.

65. However, the growth strategy in Pillar I of the PRSP was perceived as weak. The general perception within the current government was that the PRSP was too welfare-oriented, which risked creating a culture of state dependency. Survey respondents were also critical that the PRSP did not put enough emphasis on growth.²⁵ The focus on the social sectors was partly the result of the strong initial focus on the MDGs, where 5 of 7 targets concentrated on health and education. Some observers attributed this focus to the preferences of the World Bank and the IDB. Box 6 sets out the main issues involved in the renewed growth debate.

66. Pillar II focused on investment in human capital and was the most developed of the PRSP. It built on an advanced strategy that was already in place in the education and, to a lesser extent, health sectors. Pillar III, protection of vulnerable groups, was mainly defining a work agenda for getting to a specific and operational strategy. This has none the less proven to be very useful for the subsequent work in the responsible institutions, and has served for discussing how to improve the targeting and avoid negative effects of existing social programs

67. The PRSP included intermediate targets and indicators, a policy matrix, and a list of costed programs in each pillar, but it did not detail the territorial distribution of investment and special programs. The relative priority given to extremely poor areas versus poor and less poor areas was not clearly spelled out. Although the PRSP included a detailed poverty map, ranking each municipality in terms of poverty incidence, the strategy adopted a sector rather than territorial approach. Actions regarding decentralization, which was a cross-cutting issue in the strategy, were not significantly detailed. Less than 5 percent of total expenditures in the PRSP were assigned to municipal strengthening.

²⁵ Question 23, on whether the PRSP document strikes an appropriate balance between the promotion of growth and poverty alleviation, received the most negative response in the survey with 55 percent of respondents disagreeing. Of those that disagreed, 70 percent felt that the PRSP puts too much emphasis on poverty alleviation. See Annex II for more details on the survey.

Box 6: The Debate on Nicaragua's Growth Strategy

At the heart of renewed debate about a growth/poverty reduction strategy in Nicaragua is the question of whether there is sufficient growth potential in rural areas where the poor live—or whether a growth/poverty reduction strategy should create incentives to foster migration from what are perceived as poor, low growth-potential areas to assumed high-potential areas where most of public infrastructure and social investments should consequently be concentrated. Or, put very simply: should the money go where the poor are, or should the poor go where the money are?

The PRSP is not very specific on this point, but affirms in general that rural areas have “high growth potential and factor availability.” It underlines that the growth strategy needs considerable strengthening through specific policies and implementation mechanisms. Migration is not discussed.

The current government, on the other hand, is now promoting a “micro-economic vision” of cluster development, explicitly targeting zones which are assessed to have economic potential, with the hope that conditions could be created to influence migration towards these zones, thereby substantially reducing the “burden of subsidies caused by providing public services to zones with little potential.” For the population that does not want to relocate, the government would implement programs to buffer the negative effects of this strategy. (First Progress Report on the PRSP, November 2002).

The JSA of the First Progress Report expressed several concerns: it was noted that “zones with high growth potential may not necessarily be the ones with a high concentration of poor and extremely poor population,” and a discussion of the tradeoffs was requested without taking an explicit view. The JSA also found that “...government should refrain from picking winners in the private sector and from distorting incentives for the financial system.” The staffs of the Bank and the IMF “would therefore urge the authorities to focus the next report on a strengthened analysis of the source and growth and related policy actions.”

The debate touches key issues about the relative advantages of broad-based or more concentrated growth, direct and indirect benefits of growth, the different outcomes for different groups, and the relative importance of complementary social protection measures for those not getting the direct benefits of growth. These issues are fundamental political questions that deserve the informed debate among all involved actors. They also touch fundamental value questions: what are the appropriate balance and political feasibility between: (i) an approach to public investments and service delivery that focuses on achieving the highest economic return and employment creation, with a consequent greater emphasis on resources for infrastructure development; and (ii) a rights-based or equity approach, which emphasizes a more equal distribution of public goods and services to citizens, no matter where they reside, along with a greater emphasis on direct poverty alleviation. In Nicaragua, this tradeoff has to be decided in a context where a parallel resource allocation decision system exists, related to strong and pervasive client-patron relations.

Neither the PRSP process, nor its analytical underpinnings, addressed these issues in a comprehensive manner or answered these questions in such detail that specific resource allocation proposals emerged. The discussion of the government's PND in the CG meeting held in October 2003 and the associated consultation process appear to have been a step in this direction by opening the debate to a broad range of stakeholders and moving to make the new strategy operational. In addition, the Bank is currently preparing a Development Policy Review focusing on the sources of economic growth in Nicaragua.

68. PRSP programs consisted to a large extent of already existing projects funded by donors. This raised the issue of whether donors and relevant government agencies would be willing to modify their projects to align them with the general thrust of the strategy.

69. The overall goals of the PRSP extend to 2015, the horizon for the MDGs, but operationally the strategy covered four years (2002-2005), ending just one year before the current government's term expires.

70. In terms of the *relation to the MDGs*, the 10 objectives of the PRSP met the 7 MDGs, except in school enrollment (where Nicaragua set the target at 90 percent enrollment instead of 100 percent) and in gender equality (where it claimed to have already achieved the goal). There was some variance with the MDGs in the choice of indicators for education (where the country has not chosen as an indicator the literacy rates among 15-24 year old people) and in relation to environmental sustainability and regeneration (where it has chosen the approval of laws as an indicator, but not measurable indices of impact as proposed in the MDGs).

71. *The PRSP has provided a useful longer-term perspective on economic and social objectives.* At the same time, however, some stakeholders noted that the strategy was still too focused on the short-term (a three-year period) and wished the PRSP had taken an even longer-term perspective.

c) Results-oriented and focused on outcomes that benefit the poor

Targets

72. The PRSP included a comprehensive series of targets and indicators to monitor the impact of policies on the poor. These included: (i) national objectives of poverty reduction and social development indicators; (ii) intermediate indicators, some measuring impact and others public service quantitative delivery; (iii) policy matrix targets (some at the service output level, and others at the process level such as the preparation of laws); and (iv) resource input targets, fixing, for example, expenditure levels for certain areas and programs, and including the resource available through HIPC debt relief.

73. However, as noted by the JSA, while the link between goals and intermediate indicators was clearly set out in the social area, there were no intermediate indicators for the productive area. This would make it difficult to trace the effects of public policies on the growth and the impact of growth on the poor.

Monitoring

74. The government, with IDB assistance, has established SINASIP—a specific mechanism to monitor the evolution of the different poverty indicators of the PRSP.

SINASIP²⁶ (National System for the Follow-Up on Poverty Indicators) was designed specifically to monitor the indicators of the PRSP and provide information to facilitate, where necessary, the introduction of corrective actions. It is also a mechanism to inform stakeholders.

75. However, the execution of SINASIP has been delayed due to inclusion of additional indicators and the ambitious attempt to trace these indicators in 151 municipalities. A website and a first presentation of collected data are expected to be ready by mid-2003. The collection of consolidated sector data has proven particularly difficult—according to SINASIP the Ministry of Health has no less than 18 systems crossing information about child health. In this connection, the JSA of the First PRSP Progress Report is particular attentive to the weaknesses of SINASIP.

76. SINASIP is now being perceived as one more element in a much more comprehensive system to support the monitoring and evaluation of the PRSP. The government has established the National Coordination System for the Participatory Implementation, Monitoring and Evaluation of the PRSP (referred to as “the System”).²⁷ The design of this much more ambitious System grew out of initially more modest efforts promoted and funded by UNDP and DFID. The objective was to design a project that would support the monitoring and evaluation of the PRSP.

77. The system aims at strengthening the territorial presence of the state, which currently has a limited presence in Nicaragua’s 16 departments. As regards participatory processes, the System reintroduces CONADES as the key organizer of territorial participatory mechanisms. The implications of the System have not yet been consolidated with current plans for the deepening of other aspects of public sector reforms, which are overseen by other institutions that have not been involved in or consulted regarding the design System. There is some risk that a process initially aiming at monitoring the PRSP unintentionally becomes a public sector reform strategy in itself—something that was not initially anticipated. In the narrower relation to PRSP, SINASIP will still perform the shorter term monitoring of the specific indicators.

Tracking of poverty related expenditures

78. The PRSP includes, as required under the HIPC initiative, a mechanism for tracking the flow of debt relief. An action plan to make the mechanism operative was designed with technical assistance by the IMF and the World Bank. As noted in the JSA of the PRSP, the

²⁶ SINASIP has four objectives: (i) Inter-institutional coordination, where it is also discussed whether new indicators should be included; (ii) improvement of quality of underlying statistics and data collection procedures; (iii) communication through a website and other means; and (iv) follow-up on donor poverty spending.

²⁷ SECEP (2003). Previously, this was referred to as PASE.

transparency in budget preparation, executing and reporting is still inadequate. In addition, the coverage of the integrated financial management system and the budget coding would have to be modified to allow for tracking of poverty related expenditures.

79. The methodology associated with the classification of certain outlays as poverty-reducing expenditures is still in question. The PER observes that there has been a tendency to include all programs in some rural development sub-sectors classified as important for poverty reduction, and to include virtually the entire social sector investment program, including many programs that are not especially targeted to the poor. Conversely, only very few road investment projects were included. The classification of projects as included or excluded from the PRSP, which is included as an annex to the PER provides immediate evidence of the difficulties of the tagging process, and the apparent level of discretionary assessments included.²⁸ The overly broad classification of pro-poor social spending was also underscored by some stakeholders interviewed by the evaluation team, who linked it to the incentives created by HIPC conditionality.

80. According to the PRSP, poverty reduction expenditures will increase from 54 percent to 62 percent of total public expenditures from 2002-2005, reaching 50 percent of recurrent costs and 83 percent of investment costs. However, if pillar 1 of the strategy is modified as suggested in the draft development strategy of the new government (ENADE), then this picture could be drastically changed. Primary infrastructure investments (highway, ports and airports) would take a more prominent role and would probably be classified as poverty reducing investments. This suggests that significant caution should be applied when focusing on indicators of expenditure composition as targets in PRSP. The definition of pro-poor expenditures is still work in progress.

81. The monitoring of the poverty related expenditures is the responsibility of the Supplementary Social Fund (FSS). The board is composed of government officials and CONPES representatives. The donor community has an observer (the World Bank is presently representing the donors).

82. However, taking into account that Nicaragua has received interim HIPC relief since January 2001, the process of implementing of the tracking mechanism has been slow. The first report was presented in April 2003. Unfortunately, it does not compare the actual figures

²⁸ The most significant classification issues pertain to the fact that—unlike health, education and agriculture—social protection is generally not defined as a sector, but rather as a “sub-sector” or “strategy” within the traditional sectors. Due to the large variety of programs and projects within each ministry, it is often difficult to identify with precision what part of the budget is specific to social protection. Another important problem is the fact that only 35 percent of the budget for social protection is classified as recurrent expenditures. This is due to the fact that almost 50 percent of the budget for social protection comes from external resources (which are not designed to finance current spending).

with the targets of the PRSP. Hence, it is not very useful as an instrument to evaluate whether the levels and distribution of social expenditure are in accordance with the plan.

d) Partnership-oriented involving coordinated participation of development partners

Aid dependency and effectiveness

83. Nicaragua is highly aid-dependent, and is among the top five recipients of official development assistance in the world. In 1998, Nicaragua received US\$117 per capita in aid, and annual inflows have oscillated around US\$400–500 million, with a decline after the extraordinary assistance associated with hurricane Mitch.

84. Virtually all aid is classified as investment and it finances around 70 percent of the public investment budget or around 45 percent of the total budget. The IDB is the largest multilateral donor with annual disbursements of US\$88 million on average in 1997–2001. IDA provided slightly less in the same period of time (US\$85 million). Among the bilateral donors, Japan and the United States are the largest donors with an annual disbursement of about US\$50 million each year during 1997–2001, followed by Sweden and Denmark. The UN Agencies as a whole provide US\$30 million on average per year and the EU \$27 million. Consolidated figures of aid flows are not available.²⁹

85. *The impact of aid has generally been below expectations*, and there is a general sense of frustration due to the low levels of aid effectiveness—a view expressed both by the government, donors and civil society representatives. Though there is no economy-wide systematic evidence confirming this broad perception, some sector studies do provide specific evidence of the severe deficiencies in the coherence of donor funded projects and programs, poor targeting, and lack of a result-oriented approach that permits an assessment of outcomes.³⁰ The recent PER concluded that a calculation of recurrent cost implications of investment projects is generally absent. The PER also included extensive recommendations to enhance decision making processes related to investments—an issue in which donors play a key role (see section on preliminary results for discussion on budget processes).³¹

²⁹ Annex E to the PER explains the differences between the results obtained in the three registers of external aid (Central Bank, MHCP and Ministry of Foreign Relations).

³⁰ Gillespie et. al. (2001). The World Bank (2002) finds, regarding donor contributions to the rural sector, that “there is a wide recognition that lack of focus, variability over time and space, and ever-changing agendas strongly affected the effectiveness of these investments in the last decade.”

³¹ The thrust of these recommendations referred to the development of a better classification of current and capital expenditures, the importance of putting in place mechanisms to strengthen the government’s medium-term planning capacity, and the need to review the public investment program proposed in the PRSP.

86. The considerable recurrent costs classified as investment are almost exclusively linked to donor funded projects or programs. Donor funding is routinely classified as pure investment. This is because most donors are reluctant to openly acknowledge that they are providing funding to recurrent costs. Donors also fund a large number of technical assistance projects with mostly Nicaraguan staff. These staff in practice assume core functions in ministries, but are paid much higher salaries than ordinary civil servants. This has the negative effect of creating two layers of public administration. Donor funded projects are in many ministries also a key source for covering recurrent non-salary costs, such as transportation and office equipment for the entire institutions. In addition to donor funds, national counterpart funds associated with foreign grants are also classified as investment. In reality, they are effectively used to pay a considerable part of the payroll costs of some ministries. This provides a strong incentives to seek donor funded projects not necessarily to advance specific institutional objectives, but because they are a means to basic institutional survival.

Support to the PRSP process

87. Within a context of high indebtedness, high aid dependency, low aid effectiveness and broadly recognized problems of donor coordination, donors have in general enthusiastically supported the advent of the PRSP process. From the beginning, a considerable number of donors offered financial assistance, either through separate new projects or as part of ongoing assistance. UNDP, DFID and the IDB have provided funding for CONPES, the consultative processes, and the subsequent monitoring and evaluation efforts. The World Bank has provided several key analytical inputs, and the Economic Management Technical Assistance Credit (EMTA) has partially funded SETEC/SECEP. Other multilateral and bilateral donors have also contributed with their analytical inputs.

88. According to various stakeholders, the fine line between “support” and “imposition” has in several cases been overstepped by donors. The value of many of the analytical inputs is recognized, but there is a perception that the social sector emphasis of the PRSP reflected pressures from donors, including the IFIs, that could not be easily questioned. For some, the strong donor backing of the PRSP is precisely a manifestation that the strategy reflects a “Washington-consensus” on how poverty reduction is best achieved, and they see the skeptical reaction to the ENADE as evidence of this. The strong political backing of and hands-on donor support to the process also raises the issue of the capacity of the government to carry the PRSP forward to effective implementation. The JSA of the PRSP found that “implementation of the PRSP will require significant technical assistance support,” and informants perceived that some of this donor assistance was driving the implementation process, rather than the government.

Alignment of donor assistance to the PRSP, progress in donor coordination

89. Both donors and the government agree that a key role of the PRSP is to serve as a reference point for the alignment of donor support. Four key modalities for this alignment are materializing: (i) enhanced, government-led donor coordination mechanisms; (ii) a revision

of the ongoing projects and programs in a number of sectors; (iii) a move towards Sector Wide Approaches (SWAs); and iv) increased use of budget support conditioned on PRSP and PRGF indicators.

90. A first general donor-government encounter was held in July 2002 and a Presidential Decree from January 2003 obliges all sectors to form sector coordination round tables. The purpose of these tables is to diagnose ongoing activities in the sector and facilitate the preparation of clear sector policies and strategies. Although in some sectors such mechanisms have already been in existence for some time, in many sectors they represent a new approach. The sector coordination mechanisms are linked to a strengthening of the National System for Public Investment (SNIP). It is expected that the SNIP will play a direct supervision function, effectively approving investment proposals generated in the sectors.

91. Progress in revising and reorienting ongoing projects and programs in key sectors of the PRSP is advancing very slowly. The urge to engage in this revision is not new, but was already clearly stated in the World Bank's 2001 Public Expenditure Review, and in the JSA of the First Progress Report. The limited progress in this area can partially be ascribed to limited capacity in government sector agencies and to the unwillingness or inability of donors to reconsider projects that have already been approved. Neither the formal rules of donors nor the incentives applying to their staff appear conducive to effective reallocation processes. And donors confirmed that their favored approach is rather to wait for old projects to expire.

92. No major SWAs are functioning in Nicaragua, but positive moves towards this aid modality are underway in education, health and agriculture. A programmatic approach is also being discussed in relation to public sector reform. If they include donors accepting to fund recurrent costs, the adoption of SWAs could address the serious issue of balancing current and capital expenditures. The move could also increase transparency in the use of donors' current funding. This could significantly reduce distortions in performance incentives in the current project-oriented system. In addition a limited group of donors (including the World Bank) is discussing the possibility of creating a joint framework for budget support linked to the Supplementary Social Fund and the PRSP. A key issue is how to use the government treasury system for this support and still maintain acceptable fiduciary safeguards.

Obstacles to progress

93. For many observers, the fragmentation of donor support in Nicaragua is regarded as one of the most important hurdles in the country's fight against poverty. A recent World Bank study of the rural sector concludes that one of the government's top priorities is to strategically coordinate the use of donor resources.³² This will require concerted efforts on both the government and the donor side. This will pose a significant challenge: donors tend

³² World Bank (2002), p. iv.

to claim that the government is not taking action, while government representatives tend to blame donors for continuing to pursue their own agendas. An analysis of why many previous attempts to improve coordination have come short of expectations might also be very useful. There seems to be a very narrow knowledge base about the strengths and weaknesses of different approaches to inter-institutional coordination.³³

C. Preliminary Evidence on the Results

94. The PRSP process brought poverty issues to the fore of Nicaragua's public policy agenda. Although this was not the first time that a concerted effort to fight poverty had been attempted, most observers view the PRSP as the most comprehensive attempt to date to link poverty issues with a strategy for economic development. Government officials (including a number of ministers), donors, and the World Bank argued that the PRSP represented a more binding commitment for all parties toward poverty reduction.

95. Most observers agreed that the PRSP process was a helpful first attempt to foster a dialogue among the government, donors, and civil society about the country's main priorities. In a country historically characterized by a great deal of economic and political volatility, the PRSP offered a framework that in principle promised some degree of policy continuity along some broadly-shared objectives. Even the most critical observers from civil society recognized that the PRSP process facilitated an exchange of ideas among the government, donors, and civil society, and among civil society organizations themselves.

96. However, Nicaragua's commitment to and ownership of the PRSP and its principles have been questioned.³⁴ First, as mentioned earlier, the design of the PRSP itself, with its firm links to debt relief under HIPC and continued support from the BWIs, limited the legitimacy of the PRSP process in Nicaragua. Civil society organizations argued that the government was not really convinced of the utility of the process other than as a mechanism to obtain debt relief. The donor community expressed a similar view and senior government officials acknowledged that this was the main reason why they went along with the PRSP model. Some ministers argued that Nicaragua's economic problems, including the debt problem, were so severe that the government had to play a donor-game: as one key informant pointed out, the feeling was that [donors should] "tell us what we need to do to get aid, and

³³ The forthcoming Country Financial Accountability Assessment contains an annex presenting a methodology for assessing levels of external aid coordination, as well as a brief presentation of basic organisational coordination mechanisms.

³⁴ External observers generally agree that the PRSP has led to an expansion of participatory processes in Nicaragua, but they also note a number of significant problems and shortcomings (see Review of External Evaluation annex).

we will do it.”³⁵ There is, however, a degree to which debt relief has been a catalyst for gradual building of domestic consensus on basic elements of a sustainable stabilization program, and for concentrating efforts to tackle pressing macroeconomic issues.

97. Second, the main political parties did not participate in the process, which has made it difficult for the PRSP to gain broader support from the leading members of the political elite.

98. Third, the circulation of the draft of a new strategy of development (ENADE) in December 2002 and the launching of another broad consultative process around it did not contribute initially to improve relations between the government and civil society. The consultation process on the government’s Plan Nacional de Desarrollo (PND) is still ongoing, and it is yet too early to say whether this has changed the rapport between the government and civil society, and the latter’s perception of consultation efforts as a formality without impact on the policy-making process.

99. Although progress is yet far from an ideal benchmark, expectations of what can be rapidly achieved in an initial PRSP cycle need to take into account initial country circumstances. From a standpoint of whether processes and content have started to move in the expected direction, several indications, including recent developments with the ENADE/PND and bringing critical issues in the open, seem to constitute steps in the right direction.

100. The weight of HIPC debt reduction on the process, and the continued relevance of the PRSP in time for poverty reduction, including through the government’s intended modification of the PRSP early next year based on the PND, will only fully emerge after the HIPC completion point is reached in January 2004.

101. Even if the government and the donor community commit to the PRSP as the guiding framework for their programs and projects, there still remain severe challenges to the government’s implementation capacity. The public sector has undergone a process of modernization and restructuring, but serious problems and capacity constraints make implementation a challenge. Implementation capacity at the municipal level, in particular, is very weak due to the lack of qualified staff, centralized decision making practices, and limited resources (although the government has recently approved a block grant transfer to municipalities equal to four percent of tax revenues). The size of the public sector has been drastically reduced (from 218,000 persons in 1990 to 78,000 in 1999³⁶). Efforts to implement public sector reforms have been ongoing since 1994, initially focusing on (i) civil service

³⁵ At end-1999, the net present value (NPV) of the external debt was US\$5.5 billion—660 percent of exports and over 200 percent of GDP. Once it reaches completion point, Nicaragua can expect to receive debt relief of about US\$4.3 billion. This would reduce external debt to 150 percent of exports (about 50 percent of GDP)

³⁶ World Bank (2001a), Annex C.

reform; (ii) public expenditure management; and (iii) individual institutional reforms. Decentralization, governance/anti-corruption and overall reform of the institutional structure are more recent initiatives. Important progress has been achieved in various areas, but the continued weaknesses of the public sector are widely recognized, and the reform initiatives have not been as effective as expected.

102. *Nicaragua's poor system of public expenditure management is a particular hindrance to PRSP implementation.* The latest Public Expenditure Review (PER) from 2001 recognizes important areas of improvement in recent years, but concludes that the country's public expenditure management still displayed many problems affecting the government's ability to implement the PRSP. Three key parameters are assessed in the PER—aggregate fiscal discipline, allocative efficiency and operational efficiency; improving the capacity of the last two was found to be the most important. Some of the problems include: the fragmentation of policy making (e.g., the incrementalism of budgeting processes and the effective separation of recurrent and investment budgeting), the widespread practice of earmarking budget funds (notably for universities), and the government's inability to determine whether funds are being used efficiently or for the purposes intended which places the public sector in a weak position to address governance issues.

103. The fragmentation of policy making has generated problems for the coordination and overview of the combined public sector finances. The SNIP (National System of Public Investment), has been nominally in charge of collecting information and supervising public investment. In practice, however, it has also supervised the use of a considerable share of recurrent expenditures. This is an area of particular importance given that a recent study has shown that 46 percent of outlays that are classified as investment are actually recurrent costs. The Ministry of Finance deals with the remaining recurrent expenditures and is in charge of relations with the World Bank—the second largest provider of funds to Nicaragua. Other donors, including the IDB (which is Nicaragua's largest provider of funding), are coordinated by the Ministry of Foreign Relations. Finally, the Central Bank is also involved in the registration of foreign currency transactions. This has resulted in four different and often not compatible data bases.

104. A 2002 joint study by the IMF and the World Bank³⁷ also concludes that despite recent improvements, Nicaragua still has a relatively weak system of budget formulation, budget execution, and budget reporting. In this study, Nicaragua only met 5 out of 15 benchmarks for expenditure management (see Box 7 for details).³⁸ Assessment of

³⁷ *Actions to Strengthen the Tracking of Poverty-Reducing Public Spending in Heavily Indebted Poor Countries—Background Paper (SM/02/03)*

³⁸ These problems are well-documented in the World Bank's 2001 Public Expenditure Review of Nicaragua.

subsequent changes under the ‘action plan’ is under way and expected to be completed during 2004.

105. With respect to the linkage of the PRSP to the budget, the PRSP document addressed the issue of tracking expenditures funded by HIPC debt relief, but it had little discussion of broader links with budgetary processes. In practice, this has been an area of weakness in the PRSP process that many observers have noted, including the JSA, and which highlights the need to link the mechanisms for monitoring implementation of the PRSP to the government's financial management system. This, however, requires improvements in public expenditure management as mentioned above.

Box 7. Problems in Nicaragua's Public Expenditure Management

Nicaragua has met only 5 of 15 benchmarks for expenditure management: 3 out of 7 benchmarks in budget formulation; none in budget execution; and 2 of 4 benchmarks in budget reporting. This box describes the shortcomings found in these three areas of public expenditure management.

Budget Formulation is made difficult by three inter-related problems: (i) the extensive existence of extra-budgetary funds, which are not integrated into the budget³⁹; (ii) the lack of a clear definitional separation between current and capital expenditures, and (iii) the absence of a medium-term expenditure framework in the preparation of the budget.⁴⁰ With the PRSP, Nicaragua has been trying to improve the budget classification to make it more compatible with the Government Finance Statistics (GFS) Methodology. There has also been some progress in the incorporation of all central government activities in the budget account, and in the definition of poverty-reducing expenditures.

Budget Execution is the weakest area of public expenditure management in Nicaragua. The system of internal control is weak and unable to determine the total amount of outstanding obligations. Similarly, no crosschecks of monetary and fiscal transaction are performed. The World Bank has been providing training in this area through an Economic Management and Technical Assistance (EMTA) project to develop auditing programs.

Budget Reporting, line ministries submit detailed accounts of their operations on a timely manner. However, the amount of functional detail provided in quarterly reports is very limited. And the final budget settlement account submitted to the national assembly and the Comptroller's office is not audited. In this area, the World Bank and the IDB have provided technical assistance to the general comptroller's office on developing an external audit. But it is still too early to assess what has been the impact of these initiatives.

Source: Actions to Strengthen the Tracking of Poverty-Reducing Public Spending in Heavily Indebted Poor Countries—Background Paper (SM/02/03).

³⁹ A related problem is that the operations of local governments are not integrated into the budget. However, given the fact that local governments only execute a very small percentage of poverty-reducing expenditures, this problem is less important than the existence of extra-budgetary funds.

⁴⁰ One exception is the existence of multiyear public investment forecasts.

106. Although limitations in budget reporting need to be taken into account in interpreting budget data, early evidence on expenditures from the 2002 PRSP Progress Report offers some promise.⁴¹ In 2002, Nicaragua spent \$211 million on PRSP outlays which was just under the planned amount of \$217 million. As a percent of GDP, PRSP expenditures were actually higher than planned although domestic financing was on target at 9.2 percent of GDP. Expenditures of 15.6 percent of GDP represent an increase relative to 1997 levels, in which expenditures on PRSP outlays were estimated to be 14.7 percent of GDP. The composition of expenditures in 2002 was biased towards social protection, environment and decentralization, at the expense of human capital investment and in particular, education (see Table 3). (Actual 2002 expenditures on education were \$39.1 against the \$52.2 million that was planned in the SGPRS.)

Table 3. PRSP Expenditures, 2000–2002

	2000	2001		2002		Plan vs. Actual (In percent)
	Actual	Actual	Revised	Plan	Actual	
SGPRS Outlays (percent of GDP)	17.3	14.9	14.1	14.4	15.6	8.3
Internally financed (including HIPC)	10.2	9.2	8.4	9.2	9.2	0.0
Externally financed	7.1	5.7	5.7	5.2	6.4	23.1
SGPRS Outlays (US\$ millions)		218.5	268.4	217	211.8	-2.4
				(In Percent)		
Economic growth (percent of total)		37	35	44	43	-1.9
Human capital investment		33	29	35	27	-22.1
Social protection		14	13	9	13	43.0
Governance		1	0	1	2	17.1
Cross-cutting themes		15	23	11	15	43.1
		100	100	100	100	

Source: 2001 PRSP; and 2002 PRSP Progress Report.

107. Ultimately the PRSP will be measured against its record of poverty reduction. At this point, it is still too early to assess whether expenditures have translated into results, but progress has been made on some fronts. Data for 2002 is not yet available but of the 29 intermediate targets specified for 2001 in the PRSP, 20 have been achieved according to

⁴¹ This case study was finalized before the Second Progress Report of November 2003 was available, and therefore this paragraph and the next do not take into account the results reported in the Progress Report.

the PRSP Progress Report (see Table 4).⁴² The 9 that are lagging behind are clustered in primary schooling, infant, child and maternal mortality—the rates of students finishing primary school in 6 years, percentage of multi-grade rural schools with 6 grades, percentage of institutional births, polio vaccine rates, net pre-school enrollment rates, coverage of pre-natal and early pre-natal care and the incidence of diarrhea in children. The Progress Report notes that the last 4 are of particular concern as they have been static or slightly below the base year of 1999.

Table 4. Progress in Meeting PRSP Targets for 2001

2005 Targets	Number of intermediate indicators in 2001	Number of 2001 targets not achieved
Reduce extreme poverty by 17.5 percent	2	0
Increase net primary enrolment rate to 83.4 percent from 75 percent in 1999	7	4
Reduce maternal mortality rate to 129 from 148/100,000 born alive in 1999	3	3
Reduce infant mortality rate to 32/1000 live births from 40/1000 live births in 1998	4	1
Reduce mortality in children less than 5 to 37 from 50/1000 live births in 1998	2	1
Reduce to 24.8 percent the unsatisfied demand for family planning among women with partners in the 15-19 age group from 27.1 percent in 1998	3	0
Reduce to 18 percent the unsatisfied demand for family planning among women with partners in the 20-24 age group from 19.7 percent in 1998		
Have the National Strategy for Sustainable Development implemented by 2003	1	0
Reduce chronic malnutrition in children under 5 to 16 percent in 2004 from 19.9 percent in 1998	1	0
Increase national coverage of water to 75.4 percent from 66.5 percent in 1999	1	0
Increase access to safe water and sanitation in rural dispersed areas to 53.5 percent from 39 percent in 1999	1	0
Increase national access to sanitation to 88 percent in 2004 from 84.1 percent in 1998	1	0
Increase access to sewerage in urban areas from 44.1 percent from 33.6 percent in 1999	1	0
Reduce illiteracy rate to 16 percent by 2004 from 19 percent from 1998	2	0
Total	29	9

Source: 2001 PRSP, 2002 PRSP Progress Report.

⁴² The PRSP Progress Report counts a goal as having been achieved if the 2001 figure meets 97 percent of the target.

IV. THE PRGF AND IMF SUPPORT

108. This section discusses changes in the role of the IMF in Nicaragua following the introduction of the PRSP and PRGF initiatives, and analyzes how these changes have affected program design and country ownership. We look into how the PRGF in Nicaragua has adapted to the key features of the new approach,⁴³ and pay special attention to questions of policy formulation, linkage to the PRSP, and program design.

109. In the first section we analyze IMF inputs into the policy formulation processes by reviewing evidence from internal briefing papers and comments from review departments, and assessing technical assistance support. In Section II, we analyze the links between the PRGF-supported program and the PRSP, and assess the question of ‘alignment’ between the two in its temporal and policy dimensions. Finally, we examine in depth several key aspects of content and design of the PRGF-supported program to assess what has changed from previous arrangements, paying special attention to issues of policy space and structural conditionality.

A. Inputs into the Policy Formulation Processes

(a) Review of internal IMF procedures

110. The review of internal briefing papers and comments from review departments suggests that *the Fund’s internal policy formulation processes for Nicaragua in the early stages of the PRSP/PRGF approach were not initially very different from previous practices.*⁴⁴ Although poverty and social sector issues received more attention in these

⁴³ The key features of the PRGF include (1) broad participation and greater ownership, (2) embedding the PRGF in the overall strategy for growth and poverty reduction, (3) budgets that are more pro-poor and pro-growth, (4) appropriate flexibility of fiscal targets ensured, (5) more selective structural conditionality, (6) emphasis on measures to improve public resource management/accountability, and (7) social impact analysis of major macroeconomic adjustments and structural reforms. Given the nature of the evidence and the varying degrees of importance of these features in the case of Nicaragua, our analysis does not necessarily cover all these area with the same depth. For a review of the key features of the PRGF, see Gupta et al. (2002).

⁴⁴ To assess the extent to which internal IMF processes have adapted to the PRSP and PRGF, we analyzed briefing papers and review department comments against a series of specific criteria derived from the objectives and key features of the PRSP and PRGF. For each criterion, the processes were ranked according to a four-rating scale: highly consistent, consistent, inconsistent, and highly inconsistent. While such judgments inevitably involve a subjective element, the division of the broad question of how well internal briefing paper processes have adapted into a series of sub-criteria, with a broad indication of what we would expect to see to warrant a particular classification, should provide some degree of uniformity

(continued)

documents, growth and poverty considerations still do not constitute the backbone of the internal process. Emphasis on stabilization efforts has taken up most of the attention, and treatment of program alignment to the PRSP has been peripherally addressed. Most briefing papers did not discuss the links between the PRSP and the PRGF in a direct manner and contained very few direct references to the PRSP. Similarly, comments from review departments generally did not ask the staff to explain how specific policies of the PRGF were linked to the medium-term strategy of the PRSP. Briefing papers did not present any substantial discussion of policy tradeoffs, and the only discussion of alternative courses of action has been at the level of fall back positions that the Fund would take in case their main policy positions were initially rejected by the government.⁴⁵

111. *Internal discussions within the Fund indicate that the strategy to negotiate programs with Nicaragua offered initially limited flexibility but that the policy space increased over time.* The initial PRGF-supported program negotiation mission in March 2002 left Washington with a clear blueprint that left little margin for maneuver. The briefing paper explained that the country was facing a serious problem of governance and credibility, and Fund staff felt that a track record needed to be established.⁴⁶ In addition, there was a sense of urgency given that Nicaragua was facing the consequences of a full-blown banking crisis in 2000-2001, and the government wanted a rapid program negotiation to unlock aid flows interrupted by the derailment of the previous program. However, it should be emphasized that interviews with those directly involved in program negotiations on the Nicaraguan side suggest that this assessment of priorities was shared by key government officials.

112. The degree of Fund flexibility varied across policy areas, and tended to broaden over time. The following discussion identifies four key policy areas under the PRGF-supported program, and analyzes the extent to which the Fund had a clearly defined position and whether it was open to accommodate ‘homegrown’ alternative policy options. In addition it tracks whether progress was made over time.

to the judgments. See Annex IV for a summary table presenting the assessments. Further details of the methodology underlying the classifications will be provided in the main evaluation report.

⁴⁵ We discuss some examples in the next section, including the adoption of the tax reform in two stages if the authorities did not favor the Fund’s preferred one-stage approach.

⁴⁶ The most recent program had been a Staff-Monitored program that went off-track at the end of 2001 with a fiscal deficit exceeding by over 6 percentage points of GDP the initial target.

Emphasis on poverty reduction

113. Changes in briefing papers suggest that IMF staff became increasingly concerned about poverty and social sector issues. All briefing papers for program negotiations emphasized the importance of protecting poverty-reducing expenditures in the process of fiscal consolidation. This represented a clear change from previous programs.⁴⁷

114. The attention given to social expenditures has increased over time. The briefing paper of March 2002 argued that one of the main challenges of the program was to reduce expenditures significantly, while allowing for an increase in poverty-reducing outlays. It also pointed out that Nicaragua was expected to strengthen its tracking mechanism for poverty-reducing expenditures, with support from the World Bank and the IDB. A subsequent mission in June 2002 provided more information on the evolution of social expenditures during 2002 and explained that, under the program, poverty-reducing spending would be maintained at a level of 1.5-2 percentage points of GDP higher than in 1998.⁴⁸ The briefing took a strong position that primary current expenditures had to be reduced drastically by about 6 percent of GDP. However, it also stressed that the authorities should target increases in real terms for both capital and current poverty-reducing spending. In addition, the June briefing paper explained that the mission would encourage the authorities to undertake a Poverty and Social Impact Analysis (PSIA) in close collaboration with the World Bank. However, no mention was made of the areas where a PSIA would be useful and there are no signs that the IMF staff viewed PSIA as a means of entering into a broader public policy debate on key issues.⁴⁹

Fiscal adjustment

115. Briefing papers made clear that a large fiscal adjustment was a key element of the program. The overall fiscal deficit after grants in 2001 had exceeded 14 percent of GDP—twice the envisaged magnitude in the 2001 Staff-monitored program. The briefing papers argued that Nicaragua's high debt levels and financing constraints made the *magnitude* of

⁴⁷ We have examined briefing papers for the 1998-2000 period and found that in most cases there was virtually no reference to poverty-reducing expenditures or social policies. The increasing importance of poverty issues began toward the end of 1999 when the Deputy Managing Director asked staff whether an antipoverty strategy was being developed. However, during most of 2000 briefing papers made practically no reference to poverty-reducing expenditures. During 2001, within the context of the Staff-monitored program discussions of social sector issues were absent.

⁴⁸ IMF documents do not define precisely poverty-reducing expenditures, but indicate that they comprise outlays “on programs identified in the PRSP aiming to increase access to education, health, housing, and water and sewage.”

⁴⁹ See also the discussion of PSIA in Section F.II on Bank-Fund collaboration.

fiscal adjustment hardly negotiable. This view was also corroborated in interviews with the Fund staff. Briefing papers argued that the sustainability of the fiscal position in Nicaragua depended on the expected net flows of grants and concessional loans over the medium term. The staff estimated that given the projected level of grants and commercial lending (see section III), Nicaragua could sustain an overall fiscal deficit after grants of about 3 percent of GDP over the medium term. The composition of the adjustment between revenues and expenditures was also clearly defined, and the initial negotiation missions did not seem to leave much space for changing the initial position laid out in the briefing papers.⁵⁰ As noted earlier, the macroeconomic framework in the PRSP provided little guide to these discussions, since it had been quickly overtaken by events.

116. Although neither initial briefing papers (March and June 2002) nor the December 2002 Staff Report for the PRGF-supported program analyzed whether it would be appropriate for the fiscal stance to be relaxed if aid flows were higher than expected, the briefing paper for the first review of the PRGF-supported program (March 2003) did consider the issue and indicated that higher expenditures would be possible if it could be demonstrated that the size, composition, and financing of additional expenditures in future years would be sustainable given Nicaragua's absorption capacity and expectations of future external flows. (The actual program targets and outcomes are discussed in Section III below.)

117. On the other hand, internal policy formulation processes do appear to have shown increasing sensitivity to political economy factors over time. Briefing papers contained an increasingly more detailed assessment of the political situation in Nicaragua and how governance problems and public support for certain policies were an effective risk to the program.⁵¹ This increased sensitivity to political economy factors translated into more flexibility on the part of the Fund, as discussed below.

Tax reform

118. Tax reform was a critical element of the PRSP and became a key area of focus in the PRGF-supported program.⁵² Briefing papers showed increasing flexibility with respect to the *timing* of the tax reform. The government wanted a two-stage approach to tax reform—with a first stage in 2002 and a second stage in 2003. The initial position of the Fund was to press

⁵⁰ Although, most of the adjustment was envisaged to come from the expenditure side (with primary spending declining from 44 percent of GDP in 2001 to 37.5 percent in 2002 and 35.5 percent in 2003), important tax measures were also considered.

⁵¹ The March 2003 briefing paper included a box with a relatively comprehensive discussion of Nicaragua's political situation.

⁵² It included two elements: (i) the reduction of exemptions and special regimes for indirect taxes, and (ii) changes in direct taxation aimed at increasing efficiency, equity and buoyancy. The second element was to be based on technical assistance from FAD.

for the implementation of the tax reform measures in one stage. The Fund argued that there were very high risks in adopting a two-stage approach. For example, the June 2002 briefing paper argued that it was uncertain whether the authorities would be in a better position than at that time to pass the second part of the reform in 2003, and pressed for the comprehensive tax reform to be completed and implemented in 2002. However, the paper added that despite the risks, the mission would be prepared to accept, if necessary, a two-stage approach to provide a politically viable option for the authorities. This is what happened in practice. In terms of content of the reform, the Fund proved willing to broaden the policy space, although the targeted revenue yield remained largely unchanged. In the event, a country-driven approach in the design of the tax reform, including a form of participatory process using technical commissions, yielded positive results, although the participation was less broad based than that preceding the PRSP.

Exchange rate policy

119. The IMF showed significant openness in accepting Nicaragua's choice of exchange rate regime. Although it indicated its preference for a more flexible exchange rate system, briefing papers explained that the Fund was willing to accept the government's view that the crawling peg had been a useful instrument for price stabilization and would support the decision to continue with the crawl. Flexibility in this area, however, cannot be attributed to the PRSP/PRGF framework.⁵³ The IMF's position was already flexible before the PRGF arrangement. Already in 2000, briefing papers for the ESAF/PRGF discussed this issue at some length. Despite the fact that the Fund had a preference for a flexible exchange rate, it acknowledged that economic theory and experience in the case of Nicaragua did not provide sufficiently strong evidence to support one type of regime over another.⁵⁴

⁵³ The PRSP did not address exchange rate policy issues.

⁵⁴ Different missions made the point that Nicaragua was a small open economy, highly vulnerable to exogenous shocks such as sharp changes in the terms of trade, aid flows, worker remittances or private flows. In this context, a flexible exchange rate would provide a better mechanism to deal with asymmetrical shocks. However, under a relatively free floating system with a high degree of capital mobility, Nicaragua's exchange rate might become excessively volatile, with a risk of overshooting the equilibrium real exchange rate. This would increase transaction costs, limit the expansion of trade, and introduce distortions in the allocation of resources in the economy. In addition, given the substantial degree of dollarization in the banking system, a large depreciation of the national currency could also have serious consequences for an already weak banking system. These considerations led Fund staff to be prepared to go along with Nicaragua's view on the exchange rate regime. The IMF Board endorsed this position, noting the desirability of an eventual move to a more flexible arrangement.

120. On the issue of aid inflows and “Dutch Disease,” IMF briefing papers and review documents did not address the issue. The PRGF-supported program did not deal with the issue but just noted that the Staff agreed with the authorities’ view that the exchange rate did not appear to be overvalued.

(b) IMF technical assistance

121. *Fund technical assistance has generally supported the priorities highlighted in the PRSP.* The PRSP and the Progress Report identified the key macroeconomic problems facing the country and the need for corrective actions, including a tax reform and the resolution of the banking crisis and also emphasized the importance of strengthened governance. Provision of IMF technical assistance generally matched these priorities, with most activities over the last three years in the fiscal sector (transparency and tax reform) and financial system (bank restructuring and supervision) (see Table 5).

Table 5. Technical Assistance in Nicaragua, 2000–2002

	Date
Tax Reform	January 2000
Assessing the Central Bank’s Debt Sustainability	July 2001
ROSC Fiscal Transparency Module	November 2001
Bank Restructuring	November 2001
National Accounts	December 2001
Monetary and Finance Statistics	Sept. and November 2001
Bank Supervision	

Source: Program documents.

122. On the *fiscal sector*, technical assistance had two objectives: to support the government’s tax reform initiatives (identified in the PRSP) and to increase transparency of public finances. On tax reform, FAD provided technical advice during the preparation stage by a group of local tax experts, before the tax reform was sent to the Legislature for discussion. Senior officials interviewed indicated that technical assistance in this area was useful and helped in the consideration of alternatives. On fiscal transparency, a Report on the Observance of Standards and Codes (ROSC) was undertaken, which highlighted a number of areas where significantly greater fiscal transparency was needed.

123. Technical assistance has also played a prominent role on *financial sector* issues (another critical area identified in the PRSP and Progress Report), as noted by senior officials at the Central Bank. TA missions have provided assistance on bank restructuring and bank supervision that have supported government efforts to first resolve the banking problem and then shore up the oversight of the financial sector. Moreover, technical assistance has advised

on the sale of assets of liquidated banks, in the process of containing the fiscal consequences of the banking problem.⁵⁵

B. The PRGF-Supported Program and its Link to the PRSP

Temporal and policy alignment

124. Following the approach of recent IMF policy papers,⁵⁶ the concept of “alignment” can be disaggregated into a temporal and a policy dimension. The temporal dimension refers to the timing and different phases of the program formulation process vis-à-vis the PRSP cycle (and domestic budgetary process), while the policy dimension of alignment refers to the extent to which the IMF-supported program, especially in its macroeconomic component, incorporates and is consistent with the strategy set out in the PRSP (see Box 8).

125. Regarding *temporal alignment*, the sequence of the PRSP and the PRGF-supported program created a number of problems. The PRSP was completed in July-August 2001 at about the same time negotiations for a third-year tranche under the ESAF/PRGF arrangement had collapsed. As a result, Nicaragua and the Fund only agreed on a staff-monitored program (SMP) for the second half of 2001. The SMP had limited references to the PRSP, with a focus on restoration of macroeconomic stability. The SMP failed to achieve its objectives mainly due to fiscal expenditure overruns associated with the November 2001 general election. The new government that took office early in 2002 had as a key objective reaching an agreement with the Fund for a PRGF arrangement. Program negotiations took most of 2002 by which time the macroeconomic framework of the PRSP had become largely outdated owing to the larger costs of the banking crisis—which started to unfold in late 2000—and to the 2001 fiscal deficit that exceeded projections in the PRSP by over 10 percentage points of GDP. Thus, the PRSP and PRGF were not well aligned in a temporal sense. However, the PRGF-supported program was timely vis-à-vis the domestic budget cycle; the program had as prior action the submission to the National Assembly of the 2003 budget—with a combined public sector deficit consistent with program targets.

⁵⁵ Technical assistance from the Statistics department has also provided advice on national account statistics, to update Nicaragua’s GDP series which had been consistently underestimated by over 70 percent.

⁵⁶ See, for example, “Defining the Concept of Alignment” in *Aligning the Poverty Reduction and Growth Facility (PRGF) and the Poverty Reduction Strategy Paper (PRSP) Approach – Issues and Options* (SM/03/94, March 13, 2003).

Box 8. Key Elements of Recent IMF-supported Programs in Nicaragua

1994 ESAF-supported Program. The program placed particular emphasis on developing conditions for private sector investment and employment, and required a significant degree of fiscal consolidation—of nearly 6 percent of GDP in the end. Other objectives included reduction of the size of the public sector (including through privatizations), financial system development, and trade liberalization. The program also emphasized the need to expand poverty alleviation programs and acknowledged the government's efforts to provide a social safety net. The program went off track during its first year, mainly due to fiscal deviations.

1998 ESAF/PRGF Arrangement. The program had a strong fiscal component, aiming at reducing the size of the public sector and increasing public savings by 6 percent of GDP during its 3-year horizon. The program also sought an improvement in governance and transparency, and the strengthening of prudential regulations and supervision in the banking sector. At the time of the second annual review, the ESAF-supported arrangement was transformed into a PRGF-supported program, coinciding with the completion of the I-PRSP. In 2000, public sector finances experienced significant expenditure overruns—with the combined public sector deficit exceeding 8 percent of GDP. As a result, a third annual arrangement for 2001 could not be agreed and the program went off-track.

2001 Staff-monitored Program. Fiscal problems continued during the first half of 2001, and a Staff-monitored program (SMP) was put in place in August 2001 to help stabilize the economic situation in the run-up of presidential election and build up a track record. The SMP sought some reduction in the public sector deficit, and emphasized the need to implement a comprehensive tax reform package. The Staff Monitored program went off track due to fiscal excesses—the combined public sector deficit in 2001 was over 14 percent of GDP. Moreover, the real fallout of the banking crisis had begun to unfold.

2002 PRGF-supported Program. After protracted negotiations, a new three-year PRGF arrangement was signed in December 2002 with the new government, coinciding with the first PRSP Progress Report in November. The program aimed at improving the fiscal position (by a reducing primary expenditures and increasing tax revenues), reducing domestic public debt (using resources from asset recovery, privatizations, and balance of payment support), and strengthening the financial system (by enforcing prudential regulations and revamping the regulatory framework).

126. Even if the sequencing of the PRSP and the PRGF-supported program created problems, it would still have been possible, in principle, for the PRSP to establish the broad policy objectives and *indicate* the nature of priorities/trade-offs to be accepted in the event of unexpected shocks; the PRGF-supported program would then have keyed off those elements. This is the *policy alignment* challenge, but in practice it also encountered significant difficulties, including on the macroeconomic framework and the link to the growth pillar.

127. *PRGF/SMP program negotiations, rather than the PRSP, remained the driving force behind the formulation of the macroeconomic framework.* In practice, there appears to have been relatively little public debate, as part of the PRSP process, on alternative macroeconomic policy options. Several factors can be identified to have contributed to this situation:

- *Original macroeconomic framework quickly superseded by events.* Policy alignment was made difficult because the macroeconomic framework in the PRSP was rapidly superseded by events, including the full unfolding of the banking crisis and major fiscal overruns. The PRSP proved to be overly optimistic in the assessment of the cost of the banking crisis—which in the end proved to be seven times higher. Moreover,

the PRSP greatly underestimated the magnitude of the fiscal deficit for 2001. This meant that, for example, the need to reduce the much larger deficit would make it more difficult to accommodate the level of poverty-reducing expenditure anticipated in the PRSP.⁵⁷

- *Pressing initial conditions and initial lack of government credibility limited the “policy space” early in the PRSP process.* Senior officials and IMF staff interviewed by the evaluation team saw the influence of program negotiations on the design of the macroeconomic framework in the PRSP as a consequence of the dire economic conditions prevailing at the time and the lack of government credibility—due to repeated fiscal excesses and program failures, and past governance problems. The Joint Staff Assessment highlights the risks posed by banking sector vulnerabilities and lack of fiscal discipline in the run-up to the presidential elections.⁵⁸ Civil society organizations interviewed also perceived a strong direct influence of Fund program negotiations in the design of the macroeconomic framework of the PRSP, and questioned the rushing of the process amid unsettled circumstances and the impending change of government.
- *Lack of operational guidance in the PRSP.* The policy alignment process was also complicated by the lack of operational guidance in the PRSP on some key macroeconomic issues in Nicaragua, including the banking crisis and its fiscal consequences. The PRSP stated that the strategy envisaged “decisive actions to recover assets,” but was mute about policy options on how the cost of the resolution of the banking problem would be covered.
- *Sensitive nature of some of the key policy tradeoffs limited public debate.* As discussed in section III, the nature of some policy issues—especially with respect to the “burden-sharing” of the cost of the banking crisis—was such that an open debate at the time might have exacerbated the crisis. This is despite the fact that, as some NGOs and other observers have emphasized, alternative burden-sharing strategies could have been considered in principle (see for example Avendaño (2002)).

128. Taking account of these factors, would a broader policy debate on alternative macroeconomic policy frameworks have been possible under these circumstances and would it have lead to a better outcome? It is not possible to test such a counterfactual, but three points can be made. First, it was the Nicaragua government’s choice not to open up the key

⁵⁷ In this regard, The PRSP did provide some guidance on the *composition* of the fiscal adjustment, emphasizing that poverty-reducing expenditure would be protected to achieve key social targets.

⁵⁸ It also noted the need to reassess the macroeconomic framework when the new government had taken office.

macroeconomic policy alternatives to a broader dialogue during the crises, although Fund staff readily went along with the decision. Indeed, exchanges with Fund staff during the evaluation indicated that they did not see any significant change in their role in such a dialogue, unless the government first took the initiative. Second, the key elements of the strategy were government-owned, albeit within a relatively narrow circle of senior officials as far as the crisis management elements were concerned. Third, as will be discussed further below, there was a gradual opening up of the policy dialogue and policy space as the crisis conditions passed, although the limited progress has to be judged against the very difficult starting conditions.

129. The focus of the PRGF-supported program on macroeconomic stability issues also diverted attention from its *linkage to the PRSP's growth pillar*. The program did acknowledge structural and institutional impediments to growth and the importance of macroeconomic stability to foster economic development. Moreover, the context of fragile economic circumstances and hence the importance of restoration of stability was broadly acknowledged by the government and donors. However, senior officials interviewed by the evaluation team regarded as insufficient the efforts to address the issue of how to transit from stabilization to growth, a key pillar of the PRSP to reduce poverty and achieve its targets. Moreover, they noted that limited growth analysis in the PRGF-supported program would prevent the considerations of tradeoffs, including what the authorities considered to be critical going forward for their new development strategy: the analysis of tradeoffs between alternative fiscal consolidation paths and infrastructure investment.

130. Civil society organizations interviewed complained that the PRGF-supported program was a traditional stabilization program, that it was not aligned with the longer term objectives under the PRSP, and that it did not pay attention to growth-related issues, including access to credit and the support of medium and small enterprises. IMF staff acknowledged that the program was largely centered on macroeconomic stabilization, and noted that senior government officials also recognized that pressing initial conditions made it imperative to focus efforts on addressing an economic situation that was critical.

131. Survey results suggest that most stakeholders were generally unaware of the IMF involvement in the PRSP process. Among those that were aware of Fund involvement, civil society had less favorable views than other stakeholders about its helpfulness. Moreover, all non-government stakeholders expressed that the formulation of the macroeconomic framework was insufficiently participatory (see Survey Annex). Other external evaluations of the PRSP/PRGF process have also found that the government's efforts to foster participation have been insufficient, and that discussions of the macroeconomic framework of the PRSP were virtually absent (see Annex III on External Evaluation).

132. *Poverty concerns* under the PRGF-supported program translated into the inclusion of poverty expenditure targets⁵⁹ to preserve those outlays in a fiscal consolidation program, and in efforts to cover poverty and social issues and tracking and monitoring mechanisms. The inclusion of a target on poverty-reducing expenditures in the program was welcomed by civil society and the donor community as a positive step in line with PRSP objectives and to maintain and improve those expenditures. However, the target on poverty expenditures under the PRGF-supported program was identified by senior officials that the evaluation team interviewed as a constraint on their ability to reallocate outlays towards infrastructure investment consistent with the government's new development strategy. IMF staff noted that the definition of poverty-reducing expenditures was consistent with the priorities established under the HIPC initiative.

C. Content of the PRGF-Supported Program

(a) The PRGF-supported programs vis-à-vis previous arrangements

133. This section assesses how the content of the PRGF-supported program has fared against key features of the initiative, including whether it has afforded greater fiscal flexibility, increased emphasis on growth and poverty issues, and contained more streamlined conditionality.

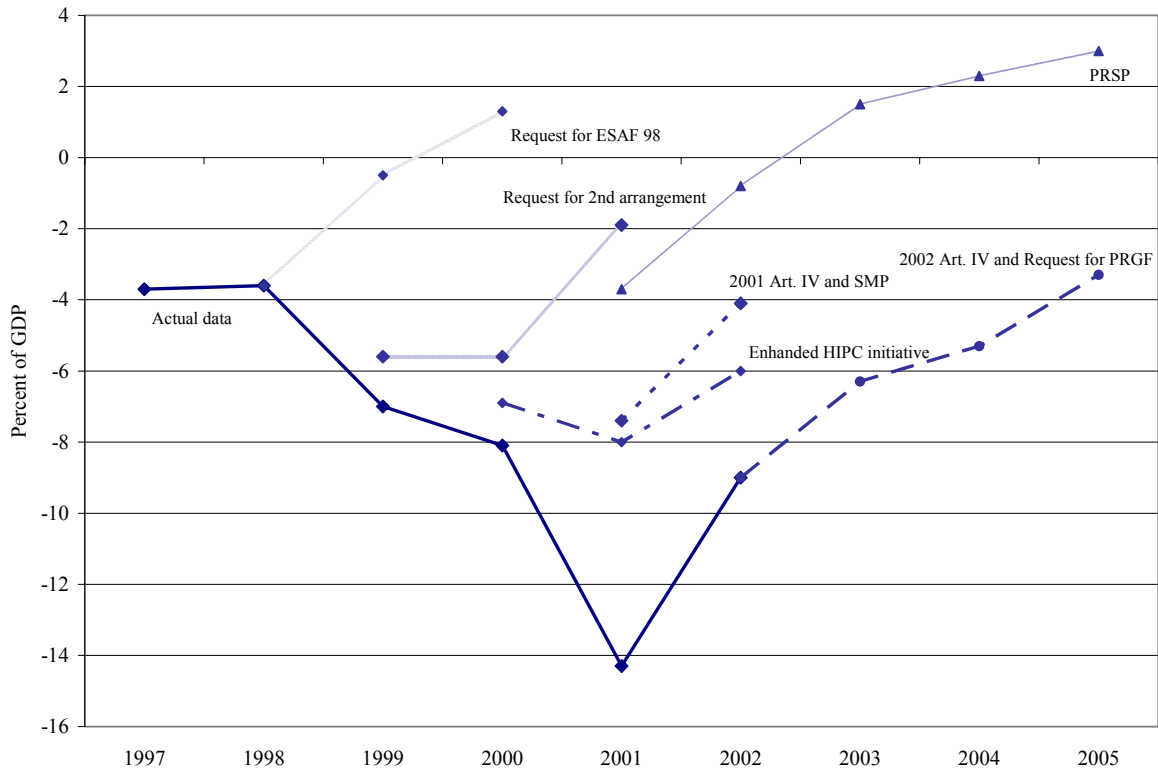
134. For the reasons mentioned in the previous section, the *design of the PRGF-supported program* in Nicaragua did not differ significantly from earlier ESAF-supported programs. In interviews held with senior officials, they emphasized that with or without a Fund-supported program, major fiscal consolidation efforts had to be made. In these circumstances, fiscal flexibility options were constrained, in part because of the authorities' lack of credibility to undertake major initiatives. Donors and IMF staff interviewed stressed that the burden of proof was on the new government to build a track record of fiscal and governance probity before the policy space could effectively be opened and greater flexibility could be productive. In this context, there was also limited attention to poverty and growth issues.

135. A key element of the macroeconomic framework in the PRGF-supported program and previous arrangements has been the *path of fiscal consolidation*. The design of programs aimed repeatedly at shoring up public sector finances, albeit each time from a significantly deteriorated position. Figure 1 illustrates the deviation between the programmed path of fiscal consolidation as projected in each IMF-supported program and program review, in the PRSP and progress report, as well as the actual outcome. The contrast in fiscal performance is particularly dramatic in 2001—the year prior to the negotiations of the PRGF-supported program—when the overall public sector deficit after grants was about 7 percentage points of

⁵⁹ Poverty-reducing expenditure targets were not included in the program as quantitative performance criteria, but senior government official interviewed expressed that, nonetheless, they effectively carried significant weight in the assessment of program results.

GDP higher than envisaged. The size of the fiscal adjustment sought under the PRGF-supported program was not different from that under the ESAF arrangement. However, given the pressing circumstances at the time of the PRGF-supported program, it would be difficult to envisage room to pursue significantly different fiscal consolidation efforts.

Figure 1. Combined Public Sector Balance (after grants)

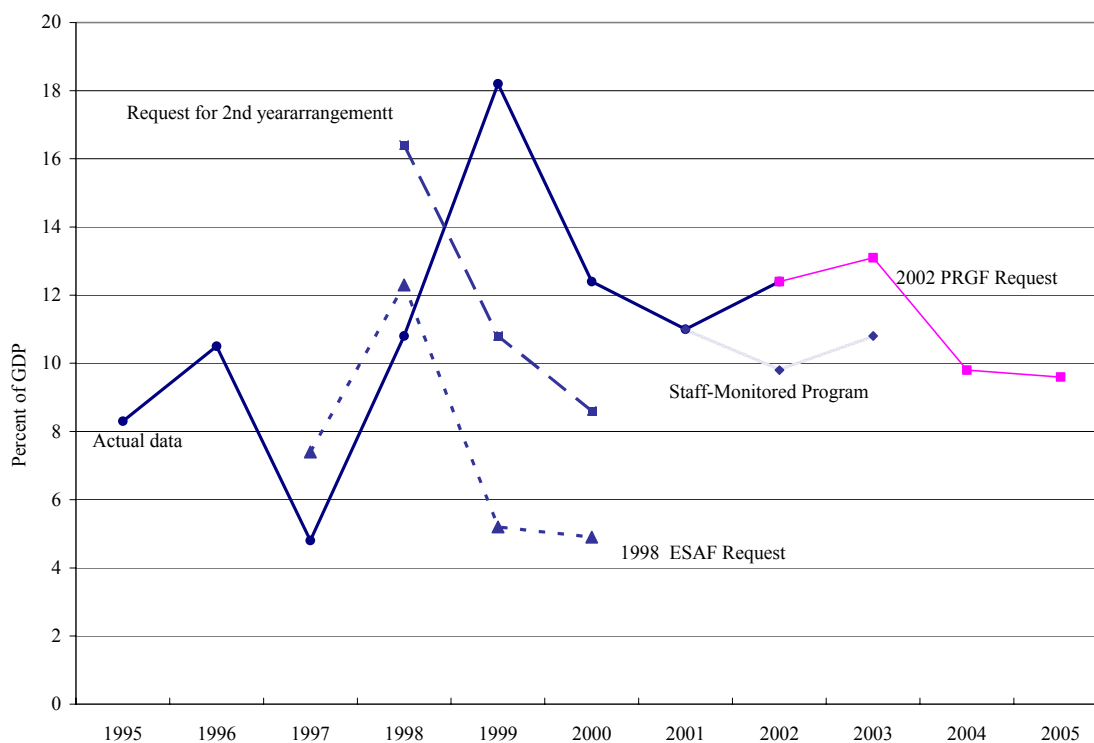


Source: WEO data base and Program documents.

136. On the projected availability of *external financial support* underpinning the fiscal paths, the PRGF-supported program has assumed larger access to financing compared to ESAF-supported programs (Figure 2). However, there has been generally little discussion of the basis behind projected resources.⁶⁰ A more explicit assessment of resources available, and its implication for the path of fiscal consolidation needed, could potentially help future discussions with the donor community on the required resources to implement a successful poverty reduction strategy in Nicaragua, including the government's new development strategy.

⁶⁰ In interviews with Fund staff it was indicated that projected resources have taken into account expected donor support, and that, in turn, expected financing gaps have fed back to donors.

Figure 2. Grants Plus Net External Finance



Source: WEO database and program documents.

137. The overall conclusion, therefore, is that the initial design of the PRGF-supported program did not change significantly from previous ESAF-supported arrangements in part because both the government and the IMF staff considered stabilization a priority and made it the main axis of the program.⁶¹ To be sure, unsettled and vulnerable macroeconomic conditions are not conducive to the promotion of growth and development. To the extent that macroeconomic stability constitutes a precondition and a degree of sequencing is required, the issue of transition into PRGF arrangements becomes relevant—i.e., gradualism versus big

⁶¹ Other external evaluations have also noted that the PRGF-supported program design has not changed much from previous ESAF-supported programs. They concluded that the program did not afford greater flexibility to the authorities, and the focus was on stabilization rather than growth (see Box on External Evaluation). The view of civil society organizations interviewed was also that little had changed in the PRGF-supported program compared to previous ESAF programs. They generally emphasized that alternative macroeconomic policy options were not considered, including one that several organizations had been calling for: the restructuring of domestic debt which they considered to be, at least in part, illegitimate and with a heavy service cost that absorbed a significant share of budget resources and, indirectly, HIPC debt relief, and crowded out poverty-reducing expenditures.

bang in the application of key features—taking into consideration initial country circumstances and the effective speed limits that the process of aligning Fund support may encounter. However, going forward the issues of how to transit from stabilization to growth and enhanced growth analysis—including consideration of key tradeoffs—would require heightened attention to move towards the key features of the initiative.

138. *Structural conditionality in the PRGF-supported program was streamlined—in the sense of a lower number of specific conditions—but the burden of quantitative performance criteria did not diminish.* The PRGF-supported program reduced the number of structural targets with respect to previous ESAF arrangements as documented in Table 6. The total number of structural benchmarks and structural performance criteria has declined by half to 17. Moreover, structural conditionality became greatly focused on financial system and public sector issues. Both areas of concentration were of major macroeconomic relevance in Nicaragua, and had been highlighted in the PRSP as key priorities.

Table 6. Structural Performance Criteria and Structural Benchmarks in Nicaragua’s IMF-Supported Programs, 1998–2002

	ESAF/98		PRGF/2002
	First annual arrangement	Second annual arrangement	
Public Sector	6	4	5
Privatization	9	10	1
Social Security Reform	2	5	0
Legal Reform/Governance	2	9	3
Financial System Reform	5	5	8
Trade Policy	2	4	0
TOTAL	26	37	17
Prior Actions	8	3	3
Performance Criteria	5	3	5
Structural Benchmarks	13	31	9

Source: Program documents.

139. The Bank and Fund (as well as donors) also required structural measures to improve governance and transparency. The fight against corruption was a key policy in the government’s agenda—and a requirement for reaching HIPC completion point. Thus, governance-related conditionality also reflected priorities set in the PRSP. The IMF-supported program included three structural benchmarks on governance.⁶² However, it

⁶² These included the submission to the national assembly of the law on domestic and external indebtedness of the public sector, the approval of prudential norms to limit risks

(continued)

was the World Bank who took most of the formal responsibilities on conditionality in this area.⁶³

140. In the area of privatization there was also substantial streamlining; the PRGF-supported program included one structural benchmark (divesting the remaining government stake in ENITEL) whereas the previous ESAF-supported arrangement had included ten measures.

141. However, despite this significant reduction in structural conditionality, senior government officials interviewed stressed that the burden of quantitative performance criteria in the PRGF-supported program did not diminish. They argued that the burden of this conditionality was very strong despite the fact that in their view a sufficient track record had already been established. Moreover, they stressed that the inclusion of targets on direct poverty-reducing expenditure—which was welcomed by civil society and donors—represented an added constraint on policy room, including to the authorities' ability to reassign expenditures. The issue of expenditure reassignment was critical to the authorities' new development strategy, which has called for increased infrastructure investment. For IMF staff the conditionality framework in the PRGF-supported program was consistent with the difficult initial conditions and past macroeconomic mismanagement, and the focus on targets for poverty-reducing expenditures also reflected the priorities established in the HIPC initiative. Hence, the lack of change in non-structural program conditionality reflected the same reasons underlying the lack of modification in program design. But, as noted earlier, there can clearly be tensions between a government-driven emphasis and other objectives of the PRSP/HIPC approach.

Has there been learning/change over time?

142. *The Fund has gradually become more flexible to political considerations and more inclined to opening the policy space to government-led initiatives.* However, it is not possible to discern whether this is due to the PRSP/PRGF process per se or to a more stabilized macroeconomic environment and greater government credibility—based on its economic track record and commitment to better governance. Senior officials interviewed acknowledged that since the PRGF-supported program the IMF staff have become more cognizant of political constraints, agreeing to modify initial plans provided that the spirit of

derived from maturity mismatches, and the publication and official adoption by the Central Bank of revised national accounts for 1994-2000. Fund documents also present the conditionality on the plan for asset recovery as a governance measure. However, this would fall more naturally in the financial sector reform category (as previous Fund documents had done).

⁶³ The World Bank CAS included 11 progress indicators in the areas of governance, transparency, and judicial reform.

policies and reforms was preserved. Several cases illustrate the recent shift by Fund staff towards greater openness to government initiatives and increased flexibility to political economy matters, including the 2003 budget approval process, the tax reform, and the sale of assets from liquidated banks. These cases shed light on a few distinctive issues of process change.

- The *approval of a 2003 budget* complying with the agreed target for the combined public sector deficit was a condition of the program. However, changes introduced to the budget proposal in the Legislature, including higher expenditures and fiscal deficit, did not meet the program's performance criteria and a Presidential veto was used to disallow the modifications. A compromise position with legislators was later reached, which included higher expenditures and raising some taxes to preserve the deficit target under the program.⁶⁴ Senior officials recognized that the Fund exercised flexibility to accommodate tax and expenditure modifications needed to obtain political support for the passage of the budget, while maintaining the agreed target on the combined public sector deficit.
- The *passage of tax reform* legislation was also a benchmark under the program. However, it required changes to the initial proposal in the National Assembly to secure political backing. The changes involved higher expenditures and the increase in some direct taxes, which Fund staff consented to given that the agreed net-revenue gains were preserved. Senior officials interviewed acknowledged the IMF's flexibility in the tax reform process.
- The process of *asset recovery* from liquidated banks was also a performance criterion in the program. A technical assistance mission from MAE contributed to the design of an asset recovery plan, including the use of an international firm to arrange the auctioning of the asset portfolios. The sale of bank assets became a politically charged subject, however, and senior officials indicated that the initial asset-sale plan did not provide flexibility in the preparation of asset groups. To gain legislative approval of the process, modifications to the initial plan were needed and the Fund proved willing to accommodate the changes to assets portfolios in order to carry out the auctions.

⁶⁴ The Budget Law contained higher public expenditures of near 1 percent of GDP. The Fund urged the President to veto the law and argued (including through a letter from the Deputy Managing Director to President Bolaños) that the target for the fiscal deficit could not be loosened. President Bolaños vetoed the Budget Law and negotiated with the Assembly a modified budget whereby total public expenditures would be slightly higher than envisaged under the PRGF (by 0.3 percent of GDP). This deviation from the initial program, however, was compensated by offsetting measures to raise additional revenues, including excise taxes on tobacco and alcohol.

143. Various civil society organizations interviewed acknowledged that Fund staff had become more open to government-led initiatives, and more understanding of political considerations. However, many organizations complained that there still was little opening of discussion of alternative macroeconomic policy options to other interested parties, which they favored doing through the consultative council CONPES or a special commission akin to the one used for the tax reform. For example, domestic debt issues were raised by various organizations but did not permeate official discussions,⁶⁵ and civil society has also complained of being excluded from negotiations of the Central America Free Trade Agreement. As noted earlier, the tax reform was a notable exception, and despite some complaints that the authorities and the Legislature left some recommendation aside, civil society organizations interviewed recognized that this was a positive step and called for the use of technical commissions in future policy discussions, including program negotiations and the budgetary process.

144. *Thus, the indications of gradual opening of the policy space by the Fund, as well as greater willingness of the authorities to engage civil society, are in step with PRSP objectives, but it still unclear at this point how these will affect program design and the perception of broader ownership.* Opening the policy space and increasing participation have aimed to increase policy sustainability and continuity—which has been an issue in Nicaragua—for economic development and poverty reduction. But the links from broadening the policy space and participation to the objectives of policy sustainability and continuity are yet to be determined.

(b) Participation and ownership

145. This section supplements previous discussions of participation and ownership for the PRSP, to address several additional messages specific to the Fund's involvement in the participatory process.

146. *Key components of the PRGF-supported program—the need for fiscal consolidation and macroeconomic stability—have been government owned, but the program has lacked broader ownership.* Senior officials have emphasized that it has been a government priority to consolidate and strengthen public finances and maintain macroeconomic stability in line with the PRGF-supported program. However, many civil society organizations have not been fully cognizant that key aspects of the PRGF-supported program were government-owned, and insisted that the Fund has exerted excessive influence on the design of macroeconomic policy. This view was reinforced by comments of IMF Executive Directors to the press on the budget approval process during their visit to Nicaragua in early 2003, which civil society, political parties, and donors saw as adversely affecting the perception of local ownership of the program.

⁶⁵ See for example Avendaño (2002).

147. There is a perception among most civil society organizations and donors interviewed that the Fund, mostly through its resident representative, has been making greater outreach efforts in the past few years to explain its positions and the content of the program. This has been done through regular participation in meetings where civil society and donors were present and through press articles. They thought, however, that greater efforts in this direction would be helpful.

148. Nevertheless, civil society broadly expressed frustration with the lack of impact of their views on program design, despite that they have been vocal in different fora and on a variety of issues, including on exchange rate overvaluation, the resolution of the banking crisis and the burden of domestic debt, and financial sector issues and access to credit. They thought that the PRGF-supported program was not different from ESAF-supported programs in most aspects, including the exclusion of interested parties from discussions and program design.

149. Legislators that were interviewed noted also that the National Assembly has not participated or been consulted in the process of program negotiations, and they saw also the program as being imposed on the country. In contrast, senior officials interviewed acknowledged that program negotiations have been conducted in private between the Fund and the Central Bank and Finance, but considered that opening program negotiations to other actors would be unrealistic.

150. In the view of the evaluation team, some of the expectations raised among civil society and other stakeholders that the new PRSP/PRGF approach would lead to more direct involvement in program formulation were unrealistic. Nevertheless, the contrast between the broadening of the debate on the development strategy and social priorities—although highly imperfect—and the more limited changes from the “traditional” way of doing business in the macroeconomic policy area are noticeable. Clearly, this reflected to a considerable extent the government’s own preferences. But, broadening the discussions of macroeconomic policy, possibly using technical commissions similar to the tax reform, could contribute to fostering a better understanding of trade-offs and policy choices.

V. WORLD BANK EFFECTIVENESS

151. This section discusses the role and effectiveness of the World Bank in supporting the PRSP process in Nicaragua. The analysis focuses on two areas: (i) *support during PRSP formulation*; and (ii) *alignment during implementation*. Discussion in both areas cover the way the Bank carried out its support with respect to the “country-driven” principle, while the discussion of the alignment during implementation highlights the Bank’s performance in donor coordination and promoting the partnership principle.

152. Specifically, the first section discusses the importance and quality of key analytical inputs from the Bank in the diagnosis and formulation process of the PRSP and includes an assessment of Bank behavior during PRSP preparation and addresses whether Bank support gave sufficient room for a country-led formulation process. The second section looks at

alignment of the institution's support following the PRSP by reviewing four areas covering both behavioral alignment with the principles of country ownership and partnership and the match between Bank's assistance and the pillars of the PRSP. The recent CAS covering 2003-05 provides the basis for the Bank's planned lending and non-lending program, and the overlap between CAS and PRSP priorities is examined. The section concludes with an assessment of the Bank's role in promoting donor coordination and working with other donors under sector wide approaches.

A. World Bank Support During PRSP Formulation

Analytical support to diagnosis and strategy formulation of the PRSP

153. Bank work on poverty issues in Nicaragua predates the launch of the HIPC. IDA supported the first poverty profile and analysis carried out in 1993-1994, and had a close dialogue with the government on its earlier poverty alleviation and social development strategy, which was based on the 1993-1994 diagnosis, via the Bank's 1995 Poverty Assessment.⁶⁶ The Policy Framework Paper (PFP) of 1999-2001, prepared by the government in 1999 with assistance from the Bank and the IMF, included elements which were carried over to the PRSP, as the poverty alleviation strategy focused on: (i) promoting economic growth with equity; (ii) investing in human capital; (iii) strengthening the social safety net; and iv) promoting rural development. The PFP also focused strongly on structural and governance reforms, and macroeconomic stability.

154. The Bank was closely engaged in the preparation of the PRSP. Other donors have been active supporting process aspects, particularly related to the consultative process, but in terms of analytical and strategic advice the Bank played the leading role. The quality of the technical assistance and analytical advice provided by the Bank is held in high regard by most informants.

155. The key diagnostic input to the PRSP formulation process was the Poverty Assessment prepared under Bank leadership in 1999-2000 and published in early 2001.⁶⁷ The report built on the Living Standard Measurement Survey of 1998 and involved 25 staff and consultants as contributors on the Bank side, 20 in the government's task team and a similar number from the National Institute of Statistics. Funding was provided by the Government, the World Bank, IDB, UNDP and three bilateral donors. In addition to the main report, 28 annexes detailed statistics, methodologies applied as well as sector studies, an extreme poverty map (extensively reproduced in the PRSP), and a qualitative poverty and exclusion study.

⁶⁶ World Bank (1995), Report No. 14038-NI.

⁶⁷ World Bank (2001), Report No. 20488-NI.

156. The Poverty Assessment was the centerpiece to the poverty diagnosis included in the PRSP, but the report also included a very comprehensive chapter proposing key elements of a poverty reduction strategy, in many respect with considerably higher specificity than what later appeared in the PRSP. Comparing the thrust of the recommendations in the study with the strategy eventually included in the PRSP, however, yields no direct relation. Bank staff point to the difficult balance of providing technical support while at the same time respecting government's leadership role in drafting the PRSP.⁶⁸

157. Other inputs to the PRSP formulation included a study prepared by World Bank contracted consultants for the SETEC that reviewed the effectiveness of selected social programs which were later included in the PRSP⁶⁹ and observed widespread problems of targeting, operational efficiency and pro-poor impact with several programs. In addition, a Bank-credit (EMTA-I) partially funded the consultants of the SETEC in charge of preparing the PRSP. Lastly, the Bank offered to fund a national PRSP workshop through its World Bank Institute, but in the end offered training which from participants interviewed was not felt to be very relevant at that point in time.

World Bank behavior during preparation

158. Nicaraguan stakeholders and donors perceive that the Bank's agenda has changed during the last five years towards a stronger poverty orientation, and to the promotion of civil society participation, as embodied in the PRSP. The Bank is perceived as more open to dialogue, and it is becoming more open to coordination with other donors. Still, there is a widespread perception that even if changed in a positive direction, the Bank continues to impose its agenda without giving sufficient space for national stakeholders to decide their preferred course. Even in light of the positive changes noted above, informants sense the Bank continues to dominate policy discussion similar to the situation before PRSP/HIPC was introduced, and that more change is needed. However, though more change is needed, and though the Bank continues to be a dominant stakeholder, the evaluation found little evidence that it had actually successfully imposed specific policy positions on the authorities. Features of the PRSP strategy perceived by some as imposed by the Bank during its preparation include insistence on a poverty safety net strategy, emphasis on programs supporting the social sectors (Pillar II and 3 of the PRSP), and an insufficient emphasis on growth. However, government officials recognize that though there were tensions in the dialogue on the necessity of a broader social protection strategy, the Bank eventually respected the

⁶⁸ Ibid. Paragraph 7 of this document's executive summary states: "The Government is in the process of defining a poverty reduction strategy. The purpose of this Poverty Assessment is to provide background material and analysis that will assist the Government in designing this strategy, but it is not itself designed to formulate the strategy. However, some key priorities emerge from the analysis that should be considered in any strategy for Nicaragua."

⁶⁹ Gillespie (2001).

position of the government. Since PRSP preparation, the government is moving towards accepting that such a strategy needs to be prepared. Similarly, the Bank is perceived to have accepted, albeit reluctantly, the targeting of youth in the social sector policies.

159. Rather than imposition of a social sector emphasis by the Bank—which did not happen—the key problem seems to be the absence of a frank technical and political discussion of growth issues and tradeoffs, involving government, qualified Nicaraguan economists, Bank/Fund analysts and other development partners. The emphasis on social sector issues in the PRSP is consistent with the key incentives behind the PRSP approach, in particular as a framework for spending HIPC relief for targeted poverty reduction purposes. The Nicaraguan PRSP is in that sense perceived by some stakeholders to reflect the dominating thinking in Washington at the time it was prepared. Another contributing factor to the continuation of this perception is that the new government’s alternative vision on spending priorities has been reluctantly received by the Bank and the IMF, as discussed in section B above. Interestingly, for most of the Bank staff consulted for this evaluation, it has clearly been a surprise that perceptions of imposition are quite widespread.

160. Many of the informants seeing a Bank-driven agenda during the PRSP formulation also stressed that Bank staff, when overstepping the fine line between assistance and imposition, have been motivated by the best of intentions. They claim that factors relating to the asymmetrical relation between the Bank and the country exacerbate the perception of imposition: the Bank is perceived as powerful not only in terms of influence on flows of concessional assistance or debt relief, but also in terms of analytical capacity and ability to diagnose and formulate recommendations for policies and strategies quite quickly, and in considerably shorter time than the government would need for a similar process. These asymmetries make it difficult to construct national ownership (and, by implication, political quality of proposed strategies).

161. As promoters of the PRSP approach, the BWIs have an important role in ensuring its success. As the more powerful partner, the Bank is obliged to adapt behavior and attitudes to minimize the negative effects of the asymmetry and could improve the process of its engagement in Nicaragua, continuing with recent improvements in the openness of dialogue. While the Bank may contribute to a technically sound strategy, the durability of a strategy requires both the substance and process dimensions. More must be done by the Bank to ensure that the PRSP results in enduring policy processes and not just creation of a strategy.

B. World Bank Alignment During PRSP Implementation

162. The assessment of World Bank alignment during PRSP implementation is based on a review of four areas covering both behavioral alignment with the principles of country ownership and partnership and the match between Bank’s assistance and the pillars of the PRSP. The areas are: (i) the process of managing the Bank’s recent lending operations, (ii) the alignment of the areas covered and manner of conducting recent analytical work, (iii) the Bank’s assistance strategy for the next several years outlined in the recently approved

Country Assistance Strategy (CAS) for 2003-2005, and (iv) the Bank's role in donor coordination.

Task management of lending operations

163. During consultations with donors and government authorities, the prevalence of Washington-based task managers was viewed as a constraint to a cohesive and timely dialogue with the Bank at an operational level, and dampening prospects for country-led aid management and more coordinated relations with donors on the ground. The World Bank office in Nicaragua has been strengthened over the last 3-4 years. Most recently, an agricultural sector specialist has been relocated from Washington to Managua. This strengthening is greatly appreciated by other donors and by government representatives. With a portfolio of 17 active credits (see Box 9) covering as many sectors or sub-sectors, and institutions, the vast majority of task managers continues to be based in Washington. A recent Nordic study of the role of the IFIs in Nicaragua in relation to the PRSP recognized the increased presence, but still concluded that "the World Bank continues to be perceived as a distant organization with little direct presence in Nicaragua."⁷⁰

Box 9. A Snapshot of World Bank Lending in Nicaragua

The Bank's portfolio in Nicaragua, as of May 19, 2003, consists of 17 credits totaling US\$488.1 million of which US\$247.8 million has been disbursed, and US\$75.5 million is planned for disbursement in FY03. It is the largest active portfolio in Central America.

The largest credits in the current portfolio, in terms of commitments yet to be disbursed, are:

- (i) Poverty Reduction and Local Development (FISE) (US\$52.9 million undisbursed);
- (ii) Road Rehabilitation and Maintenance III credit (US\$47.7 million);
- (iii) Land Administration Project (US\$34.7 million);
- (iv) Rural Municipal Development Project (US\$18.3 million); and
- (v) Basic Education Project (US\$16.9 million)

Bank lending to Nicaragua has grown steadily from US\$120.3 million net commitments in FY92. The composition of the portfolio has evolved from a single economic management credit in FY92 to FY97, in which 4/5 of the portfolio was in environmental, social or human development. Currently, about 47 percent of the portfolio is in environmental, human development or social protection operations, 40 percent in private sector and infrastructure development, and 13 percent in public sector governance.

Source: Bank documents.

164. The coordination of task managers around a cohesive sector perspective is in principle assigned to the local office, and recently it has become a formal requirement that every mission from Washington must brief and debrief the resident representative. The considerable number of projects in the portfolio, the largest in the Central American Region,

⁷⁰ Embassy of Norway (2003).

and the limited staffing of the local office do not always make this feasible, and staff recognizes that cohesiveness and consistency is not yet optimal. An envisioned reduction in the number of projects in the portfolio should ameliorate part of this problem.

165. As a complementary effort, the Bank is trying to reduce the number of task managers assigned to projects in the Central American region, so that task managers would have projects in more than one country.⁷¹ This should generate more efficient cross-country experience exchange. Task managers located in local offices in the region will also attend projects in various individual countries, which each are too small to warrant a decentralized task manager.

166. Bank staff, donors and government informants found that incoming, brief Bank missions from Washington does not always seek sufficient contacts with other stakeholders. Though the Bank has changed over the last 5 years, it is still perceived that Bank missions in some cases “arrive, instruct, and leave,” with insufficient sensitivity to the broader processes of relevance to Bank-supported projects.

Alignment of analytic and advisory activities

167. A poll conducted in connection with the consultation of the CAS found that respondents saw the role of the Bank as a financial institution far more important than its role as a provider of knowledge services.⁷² However, analytical and advisory services are clearly adding value to the financial operations, and informants found generally that the quality of technical advice was excellent, and better than similar advice from most other donors.

168. In support of implementation of the PRSP, a key analytical input from the Bank has been the Public Expenditure Review (PER), published only 3-4 months after the presentation of the PRSP. The PER explicitly aims at improving the poverty focus of public spending, and includes as mentioned earlier a very comprehensive set of recommendations. Some of these suggest modifications to the PRSP, including a review of the macroeconomic projections in the PRSP, strategy development in key areas and review of investment portfolios in key sectors. The PER thus details and underpins many of the observations in the JSA.

169. Observing the wide ranging set of recommendations, it may appear that the PER would have been a useful input earlier in the process, before the PRSP was completed. The choice to prepare the study just when the PRSP was being completed may not have been entirely voluntary, and it does underline that the Bank has not considered the PRSP to be a finished document, which cannot and should not be modified, amended and further detailed.

⁷¹ Source: Interview with the current World Bank Country Director.

⁷² World Bank (2002a), Annex E.

170. To strengthen pillar 1, which was broadly recognized by most stakeholders to be the weakest in the PRSP, the Bank contributed a study on competitiveness and broad based growth promotion in agriculture (World Bank (2002)). The agricultural growth study is an example of a responsive and participatory approach to analytical and advisory services. The study was not envisaged in the previous CAS, but made on the request of the government, with funding from several donors and virtual no direct costs to the Bank. The study was produced in very close cooperation with government officials, and represents a more participative approach which may have weakened the consistency of the policy recommendations somewhat, but which also have lead to greater acceptance and use of the document.

171. Most recently, the Bank has completed the 2003 Nicaragua Poverty Assessment that provided an update of the 2001 Poverty Assessment and draws on the results of the 2001 LSMS. This assessment has provided support to the government in monitoring progress in PRSP implementation. The analysis revealed that nearly half of the ten PRSP targets were not on track and needed additional efforts, and that progress measured by intermediate indicators was mixed. The Bank's analysis showed that continued progress toward the MDGs and PRSP goals to be closely linked to the recovery of growth in Nicaragua.⁷³

172. There are also a number of on-going analytical products being prepared by the Bank that are well aligned to furthering the PRSP process. These include a Country Financial Accountability Assessment which is in the final stages of completion and a Country Procurement Assessment Report currently under preparation. Apart from their particular value outlining actions necessary to strengthen financial and procurement management and transparency, they are also core diagnostic requirements for moving toward a PRSC framework. (discussed below). In addition, both have been prepared in a joint partnership effort with the IDB. A broader-based Poverty and Social Impact Analysis as well as a Development Policy Review focused on the sources of economic growth have been included in the new CAS for 2004.⁷⁴ As part of the non-lending services, the Bank office in Managua operates a World Bank Institute Distance Learning Center, with up-to-date technology funded by Spain. However, budget limitations have made it difficult to ensure operation and maintenance of the Center. Finally, the Bank is assisting in the analysis and classification of pro-poor expenditures.

173. With the adoption of budget-support type operations as the PRSC, technical and advisory assistance will in the future find less funding from sector operations. The core

⁷³ Points raised concerning the use of the 2003 Nicaragua Poverty Assessment are based on Box 8 of the most recent joint Bank/Fund Analysis of Progress in PRSP Implementation (September 2003).

⁷⁴ Recently, PSIA was concluded on the Tax Reform and the Education for All Initiative, and is currently underway on the Public Investment Program and Decentralization.

economic sector work (Poverty Assessment, Public Expenditure Review, Country Procurement Assessment Report, Country Financial Accountability Assessment and Development Policy Review) will consume a considerable part of the available NLS budget for Nicaragua, potentially squeezing the options for providing timely analytical assistance in a flexible manner.

174. To provide such services, the Bank already draws on trust funds made available by other donors, or seeks co-funding for studies directly from donor agencies in Nicaragua, which in many cases have decentralized authority to allocate and disburse funds for such purposes. This obviously has positive effects in terms of donor coordination. At the same time, Bank staff did observe that the programming and funding mechanisms for Bank analytical and advisory assistance is stiff and not as flexible as it should be. A small fund for advisory work under the authority of the resident representative would increase the ability of the Bank to provide flexible and timely assistance.

Country assistance strategy (CAS) 2003-2005

175. The present CAS of the Bank was approved in December 2002 together with the PSAC, and around the same time as the Fund's PRGF. The main dimensions for assessing CAS alignment with the PRSP include those used in the most recent Joint Staff Annual Progress Report on PRSPs, namely vision, diagnosis, program, and results.

176. *Vision and diagnosis:* The CAS closely follows the main vision of the PRSP as laid out in the pillars and has detailed references to the document. It is clear the Bank team has used the government's poverty strategy as the basis for anchoring its new three-year assistance plan. Given the Bank's involvement on the key diagnostic analysis, it is not surprising the CAS matches the PRSP's poverty diagnosis. Consultations for the CAS were carried out in meetings in Managua in August 2002, including meetings with government, CONPES, members of the legislature and donors.

177. *Program:* The assistance strategy details the specific support to each pillar, in recognition of the main constraints to poverty reduction outlined in the PRSP. The IDA allocation is planned for roughly US\$120 million per year, representing a reduction from past annual commitments mainly due to Nicaragua's previous poor performance on governance under the previous administration. It is expected that with the new government's strong focus on governance, IDA allocations to Nicaragua should increase in future years.

178. The new CAS envisages the following support in the base case: (i) PSAC/PRSC budget support credits to PRSP (US\$50 million); (ii) Pillar I: rural microfinance, rural electrification, competitiveness (US\$27 million); (iii) Pillar II and III: basic education, health and nutrition (US\$26 million); and (iv) Pillar IV: economic management technical assistance (US\$17 million). Should a high case lending program be approved, an additional US\$25 million will be added in a PRSC and US\$14 million in Pillar I (agricultural technology and rural telecommunications development). If the base case program is reduced to a low case program, lending is expected to drop by one-third to US\$80 million.

179. The International Financial Corporation (IFC) will, according to the new CAS, support Pillar I of the PRSP through (i) strengthening the financial sector and capital market; (ii) promoting foreign private investment in Nicaragua; (iii) broadening private participation in infrastructure; and (iv) reactivating growth in agriculture and industry. The Multilateral Investment Guarantee Agency (MIGA) has, since 2001, worked to improve the ability of Nicaragua to attract foreign investment. It has in addition guaranteed for lending to power sector investment projects.

180. In addition to the strong content alignment of the CAS, the planned use of the PSAC/PRSC as the main instrument for financial support to Nicaragua represent a shift in the Bank's lending strategy towards budget support and away from the relatively high number of individual operations in the program. This move to programmatic lending is the most explicit expression of the alignment of the Bank's support to the PRSP on the ground.

Results: In general, the CAS progress indicators track reasonably well with those identified in the PRSP monitoring framework. Moving forward, performance indicators in the PRSP are planned to function as prior action triggers of the PRSC, but additional elements may be added. A key issue will be to what extent the PSAC/PRSC policy matrix is aligned with the PRSP and the PRGF and how this matrix will be managed and monitored in practice.

World Bank relations to civil society

181. Civil society representatives consulted by the evaluation team found that the World Bank was more accessible than it has been previously. However, this was the opinion of representatives who regularly participate in the various consultation fora and who are familiar with the PRPS process and the special discourse of donors. And though improving, the survey conducted in connection with the preparation of the CAS in 2002 found that only 25 percent of civil society representatives rated their relation to the Bank as good or excellent, and it was a clear message of the CAS consultation that the Bank needs to make greater effort to communicate beyond the government and donors. The hiring of a civil society specialist located in the Bank's office in Managua in 2002 is an important step in this regard.

World Bank role in promoting donor coordination and SWAPs

182. Coordination of donor funded assistance in Nicaragua has been, as discussed in section B, weakly developed. With a relatively weak physical presence in the country, the World Bank has not played a leading role in promoting improved operational coordination. Until now, the key mechanism for coordination has been co-funding of Bank supported projects by other donors. In some sectors (e.g. agriculture), Bank-supported analytical work has been important for policy development, but has not necessarily led to operational alignment of other donors.

183. Promising steps to change this situation in line with the partnership principle emphasized by the PRSP have been taken. The ongoing preparation of the future Bank support to public sector reform includes other donors. DFID, Denmark, Netherlands, and

Sweden will jointly fund a position in the local Bank office to work on public sector management issues, as a move towards joint programming and funding in this area, and initial steps have been taken to coordinate with the IDB. The PER draws on work prepared by other donors, and the more recent CFAA was co-authored with BID and coordinated with a European Union initiative in this area.

184. In other sectors, the Bank has due to its limited presence not been able to participate in the incipient sector financing pilot processes. In education, some informants find that the Bank is positively participating in relation to the development of an education SWAP, even with the limitations imposed by the fact that the operation is managed from Washington. On the other hand, severe and widespread criticism was raised on the Bank's handling of the Education for All (EFA) initiative, where both national authorities and donors see the Bank acting on its own, with little regard for the position of others (including national authorities), and poor communication.

185. The general perception of limited Bank participation in processes towards SWAPs prompted a group of "like-minded" bilateral donors to write a letter to the Bank representative encouraging the Bank to be more active in this field. In the consultations for the CAS, bilateral donors also emphasized that the Bank should move explicitly towards SWAPs in order to achieve a clearer division of responsibility among donors.

186. The CAS recognizes that more needs to be done to improve coordination of donor funded activities, and mentions that many donors favor the move towards a sector wide approach. The CAS argues that IDA's shift towards programmatic lending, supported by critical analytical and fiduciary work, will help to support donor's plans to begin to provide assistance in the context of a sector wide approach—thus not clearly committing the Bank itself, and indicating that it is not the agenda of the Bank itself to join such approaches.

187. Several donors have pointed out that the position of the Bank on the SWAP issue still lacks clarity, and for these donors it is not known if the Bank will limit its role to the PRSC and help establishing the fiduciary prerequisites for bilaterally financed SWAP, or if it will proactively work toward SWAPs and develop the planned basic education and health loans based on a sector-wide approach perspective.

188. Coordination between the IDB and the World Bank, the two biggest donors to Nicaragua, is according to a broad range of informants a particular problem. For one thing, the IDB's counterpart is the Ministry of Foreign Affairs, while the World Bank is anchored in the Ministry of Finance. But equally important is that the two organizations have very different work styles and cultures, and choose different approaches (e.g., in relation to social protection strategies, and transport infrastructure provision. In the latter, a bilateral donor is seen as a balancing force between the two Banks). In relation to public sector reform, the CFAA and the CPAR have been made jointly, and there is a division of labor—but it is more perceived as a division of turfs than as the considerate result of sensible coordination.

189. The government has taken initiative to make Nicaragua a pilot case for harmonization of IDB and World Bank procedures. This may help address some of these problems. Several informants noted that the World Bank is much more bureaucratic and slow in administrative matters than the IDB, whose field office is larger than the World Bank's, and with more decision making authority.

190. A perception also expressed by World Bank staff is that the fundamental obstacles towards increased coordination are rooted in government, rather than among donors. It was also expressed that the capacity of other donors to provide leadership may be limited, and that it would therefore be difficult for the Bank to accept a division of responsibilities where other donors assume leadership in sectors where the Bank is active. Finally, Bank staff recognized that there is competition among donors in Nicaragua.

191. As discussed in section B, an analytical study of obstacles to and opportunities for increased donor coordination in Nicaragua could be helpful, focusing both on factors on the government and the donor side. In the opinion of the evaluation team, there seem to be as many specific obstacles and opportunities for the Bank itself as for any other actor, both relating to organizational culture, performance incentives, distribution of authority and specific operational regulations, and these factors may warrant a separate study.

192. Recognizing the weaknesses exposed above regarding the operations of the Bank, it was also recommended that future reviews of BWI support for the PRSP process be coordinated not only between the evaluation offices of the IMF and the Bank, but also with other donors who have recently conducted similar reviews, to lower the transaction costs of the government.⁷⁵

VI. BANK-FUND COOPERATION AND THE JSA

A. Role of the JSA

193. The purpose of the Joint Staff Assessment is to offer an overall analysis as to whether the strategy presented in the PRSP provides a sound basis for concessional assistance to the staff of the IMF and the World Bank. Following JSA guidelines,⁷⁶ this section analyzes the extent to which the JSA of the Nicaragua PRSP provided (i) an analysis of the risks to successful PRSP implementation; (ii) a clear and candid assessment of some key aspects of the PRSP (e.g., ownership and participation, poverty diagnosis, targets and monitoring, and

⁷⁵ In first half of 2003, the Swiss Development Corporation and SIDA also conducted reviews of the PRSP process, as part of wider review processes in these organizations.

⁷⁶ Poverty Reduction Strategy Papers—Progress in Implementation, Annex III.

priority public actions); and (iii) a due consideration of the country's context.⁷⁷ It also discusses how the JSA has been perceived and used by various stakeholders.

194. Both the JSA of the PRSP (JSA/PRSP) and the JSA of the PRSP progress report (JSA/PRSP-PR) provide a clear and candid assessment of the risks for the implementation of the PRSP strategy. In the case of the JSA/PRSP, five areas of concern are clearly identified and discussed: (i) the likely lack of fiscal discipline in the run up to the presidential election in November 2001; (ii) the uncertainties associated with whether the new government will endorse the PRSP; (iii) the threats to the macroeconomic objectives posed by the substantial vulnerability of the financial sector; (iv) the public sector's weak institutional capacity to implement poverty-reduction programs; and (v) the country's vulnerability to terms of trade shocks. In addition, the JSA/PRSP-PR highlights the significant risks associated with the implementation of the strategy and argues that the PRSP progress report does not evaluate them. These include tensions between the supporters of the current and previous administration, weaknesses in the courts and supreme audit agency, the continuous fragility of the banking system, and the problems associated with the rapidly expanding domestic debt.

195. The JSA/PRSP provides an extensive discussion of the participatory process associated with the PRSP, but the overall picture presented is excessively optimistic and excludes problems that the process had encountered (i.e., exclusion of some civil society groups, complaints of lack of impact by civil society, etc.). In addition, the discussion of ownership issues was minimal, with only a brief reference to the limited sense of ownership of the PRSP within civil society.⁷⁸ The JSA/PRSP-PR, on the other hand, provides a more balanced assessment of the limitations and problems associated with participation and consultation. For example, it clearly acknowledges that the reform of CONPES has led to a less fluid dialogue between the government and civil society, and that further efforts are needed to build more systematic participation at the local level.

196. The JSA/PRSP extensively analyzes the PRSP coverage of poverty issues, targets and monitoring, and priority public actions. As regards the diagnosis of poverty, the JSA argues that the PRSP used a sound method to systematically document poverty problems in Nicaragua. In terms of targets and monitoring, the JSA focuses on three issues: (i) the ambitiousness of some targets (which are based on high growth and aid assistance assumptions); (ii) the gaps in the proposed system of intermediate indicators; and (iii) the lack of specificity in the delineation of institutional responsibilities to effectively monitor

⁷⁷ Since Nicaragua also produced a PRSP progress report, the JSA of the PRSP progress report will also be discussed.

⁷⁸ As we document in other sections of the report, civil society and the government had different conceptions of what participation implied. Most civil society groups and private organizations felt that they had had no impact.

implementation. In addition, the JSA/PRSP-PR also provides an analysis of public management issues (including mechanism to track HIPC debt relief, and improving the public investment planning process).

197. Both the JSA/PRSP and the JSA/PRSP-PR provide an adequate discussion of country-specific factors that are useful to understand the context in which the PRSP has taken place. For example, they discuss the country's polarized political environment, the uncertainty associated with the upcoming presidential elections (in the case of the JSA/PRSP), the divisions between the supporters of the previous and the current administration (in the case of the JSA/PRSP-PR), and institutional weaknesses and governance problems.

198. Overall, Joint Staff Assessments, although insufficiently candid in some key areas, notably the constraints to participation, have played a useful role in Nicaragua, identifying clearly country-specific risks to the implementation of the strategy, and areas where further development of specific policies in the PRSP or policy prioritization is needed.

199. The donor community perceived that the JSAs were generally a useful instrument. In the case of the JSA/PRSP, however, many donors were of the view that the assessment of participation and ownership did not capture many of the deficiencies that the process had suffered. In the case of the JSA/PRSP-PR, the nearly simultaneous introduction of the new development strategy by the new government diverted attention from the assessment of the Progress Report. More generally, the Progress Report did not play the central role that would have been expected in the ongoing debate on the growth strategy and modification of Pillar I. The associated JSA could have signaled the limited use of the Progress Report in this respect.

B. Bank-Fund Cooperation

200. Interviews with World Bank and IMF staff, in Washington and in the field, suggest that the two institutions have collaborated closely since the PRSP was completed. The country office of the World Bank in Nicaragua and the IMF Resident Representative meet on a regular basis and provide inputs to their respective programs. Representatives of both institutions have participated regularly in meetings of civil society groups, in CONPES, and other fora.

201. In the area of governance and legal reform, collaboration between the IMF and the World Bank appears to have operated effectively. Given Nicaragua's institutional weaknesses, this is an area that has figured prominently in the agendas of the IMF, the World Bank, other international institutions (especially the IDB), and the bilateral donor community. In fact, all these stakeholders actively participated in setting the conditions to

improve governance to reach the completion point under the HIPC initiative,⁷⁹ and exerted significant joint pressure to have a fourth pillar in the PRSP that would focus on governance.

202. In addition, over the last two years, a better delineation of responsibilities between the two institutions has emerged in this area. For example, the 1998 ESAF contained a number of structural benchmarks in the areas of legal reform and governance.⁸⁰ Since this is an area where the World Bank has greater expertise, IMF-supported programs in Nicaragua initially relied on the advice of the World Bank to include these conditions in the program. More recently, however, the IMF no longer includes direct governance-related conditions in the context of program activities but has continued to pay attention to progress in this area through its interaction with the World Bank, the IDB, and donors, which have taken up most of the responsibilities in this area.⁸¹

203. On PSIA, the selection of priorities was initially an unsettled business, which complicated the role of PSIA to broadening the debate. Although both the authorities and the BWIs have a role in setting a PSIA agenda, in practice the Bank and Funs appear to have taken a subsidiary role in the process. Since many of the candidates for PSIA were politically charged issues with great analytical difficulties, in practice there appears to have been initially little enticement to jump into undertaking PSIAs in the course of the reform process. Recent developments, including the completion of PSIA on the tax reform and the Education for All Initiative and the undertaking of PSIA on the Public Investment Program and Decentralization, appear to indicate that some of the initial obstacles had been overcome. However, regarding the PSIA on the tax reform—which had broad support—donors and civil society complained of the limited value of an ex-post assessment. In addition, several civil society organizations had prioritized a PSIA of CAFTA to influence the negotiation stage.

⁷⁹ Some of the conditions of these conditions included (i) the adoption of measures to improve transparency and accountability in management of public finances; (ii) the approval of an administrative dispute settlement law; (iii) the establishment of a National Center for the Mediation of Property Claims; and (iv) implementation of a program to improve transparency and control of government procurement, etc.

⁸⁰ These measures included, for example: (i) presenting to the National Assembly a draft law for property rights to facilitate the resolution of the remaining property claims; and (ii) approval by the National Assembly of an appropriate property right law.

⁸¹ The World Bank's PSAC and PRSCs have supported this pillar through measures to improve public expenditure management, tax administration, civil service reform and donor coordination (CAS, p.19). The IDB has been particularly active in this area, providing technical assistance for a comprehensive revision of the legal framework to increase the effectiveness and independence of the National Assembly, and to improve the judicial system and the Comptroller's office.

The significant resource requirements and the time needed to deploy them was also identified as a constraint on PSIA efforts.

VII. MAIN CONCLUSIONS

The PRSP process

204. *Modest results initially, that needs to be viewed in the context of very difficult starting conditions.* The PRSP process in Nicaragua, including the modification of the strategy proposed in the ENADE, did not initially demonstrate clearly that it clarified and strengthened the different policy processes which together determine whether and how poverty will be reduced. If the intention of the PRSP process was to reduce the inherent complexities of poverty reduction in Nicaragua by having a comprehensive strategy to which all significant partners could subscribe, and if the expectation was that this broad-based, country-driven strategy would lead to better implementation of key policy elements, then the initial results must be assessed as modest. Importantly, the linkage of the PRSP to budget processes has been an area of weakness, in part due to major problems with public expenditure management in Nicaragua. Poor public expenditure management has been a hindrance to PRSP implementation. The assessment of modest results, however, should be weighed against what should realistically be expected to achieve in the initial PRSP cycle in a country with social and political fragmentation, weak institutional, and fragile economic conditions. Recent developments with the PND seem to point to a change in processes in the right direction, including consultation and the broadening of policy dialogue, but since it is still an ongoing process it would be too early to assess its full effects.

205. *The process has brought critical issues in the open.* The PRSP has added value in bringing the complex issues of poverty reduction out into the open, and thereby facilitating the subsequent work to create, in the medium term, the conditions for a more effective approach to poverty reduction. Expectations of what could be achieved in the short term may have been raised too high and the close linkage to HIPC has undoubtedly caused the government to press the pace, with some adverse effects on the depth and comprehensiveness of the policy debate. Nevertheless, progress in this direction is no trivial or straightforward task and needs to be judged accordingly.

206. *Participation and ownership.* The consultation process for the PRSP was a step forward, but differences in views about the purpose and legitimacy of such participation have determined that the assessment of the participatory process vary widely. The factors that have influenced the participation process highlight the inherent difficulties of participation in a country like Nicaragua with a highly polarized political system. As a result, broad country ownership of the PRSP was limited. Nevertheless, most observers agree that it was a helpful attempt to foster a dialogue among the government, donors, and civil society.

207. The experience with the introduction of the new development strategy (ENADE) illustrates some of the potential tensions between different elements of the PRSP process, notably between the provision of greater policy space to the government and other objectives.

These tensions were increased in the case of Nicaragua by the poor alignment of the PRSP process with the domestic political cycle and the limited policy debate early in the process on the tradeoffs involved in the growth strategy (Pillar I). But even with the considerable imperfections in the process, the fact that the debate is taking place now should be welcomed.

Main conclusions for the World Bank

208. A number of key findings and lessons emerge from the Bank's support to the PRSP process thus far:

209. *The Bank has provided important support to the PRSP process.*

- The Bank was closely involved in the PRSP process, providing relevant analytic inputs and advice. These non-financial services have been well aligned to the needs of Nicaragua through the PRSP process, including two completed Poverty Assessments, a PER, and an agriculture growth study. Key on-going analytical work includes a CFAA, a CPAR, and a PSIA. The quality of the technical assistance and analytical advice provided by the Bank is held in high regard by most informants.
- The Bank's CAS is well-aligned with the PRSP and closely follows the main strategic pillars. The assistance strategy details the specific support to each pillar, in recognition of the main constraints to poverty reduction outlined in the PRSP. The move to programmatic lending through the PSAC and planned PRSCs is the most explicit expression of the alignment of Bank support to the PRSP on the ground.

210. *The Bank is improving its behavior in terms of promoting the PRSP principles.*

- According to stakeholders the Bank has become more open to dialogue with the country and is taking steps to increase its responsiveness to civil society, both reported as areas of weakness in terms of country ownership. The Bank is increasing the cohesion of its large country program and is addressing the decentralization of task managers. The agriculture growth study is an example of unprogrammed analytic work being undertaken at the request of the government and demonstrates greater responsiveness on the Bank's part. The study was also produced in very close cooperation with government officials, and represents a more participative approach to the Bank's work.
- While the Bank may contribute to a technically sound strategy, the durability of a strategy requires both the substance and process dimensions. The Bank could do more in focusing on improving processes in Nicaragua and not just working towards preparation and refinement of a strategy. The process management skills and collaborative attitudes of the Bank need strengthening to allow country ownership to grow, to allow negotiation processes to get to better results, and to achieve the vital balance between technical and political quality in advisory services.

211. *The Bank could do more to advance the debate on broad based growth and the trade-offs between growth and poverty-related spending in Nicaragua.*

- There is widespread perception that the emphasis on social sector spending has been imposed by the Bank. In reality, there is an inherent incentive and bias towards social sector spending by government given the link with use of HIPC resources and, rather than an imposition of a “social agenda” by the Bank, the key issue is the absence of a frank discussion of growth issues in Nicaragua.
- The growth-social balance is a technically very complex discussion. It is connected to highly contended political issues and to conflictive political processes—but it needs precisely for that reason to become a more public debate in an appropriate forum, based on arguments rather than mutual mistrust. The Bank should promote and participate in this discussion, integrating the process under the PRSP framework. The ongoing Development Policy Review, with its focus on sources of economic growth, may play a positive role in this regard. Involvement of stakeholders during preparation, for example through feedback on drafts or presentations of preliminary findings, and appropriate dissemination are likely to be important factors in this works value-added to the PRSP process.

212. *The Bank could play a more aggressive role in supporting government led donor coordination.*

- The Bank has in the past not played an effective role in coordinating its activities with those of other donors in Nicaragua. There have recently been promising steps taken towards improving the situation on which the Bank can build. These include improved coordination and participation in its analytical work and the emphasis on SWApS in the CAS.
- Improved aid coordination will require continuing efforts to clarify own policies, positions and procedures, willingness to cede donor-side leadership to other donors, and, as a particularly important signal in this area, assistance to the government enabling and motivating it to coordinate the support from the World Bank and the IDB.

Main findings about Fund support

213. *Internal IMF Processes.* The Fund’s internal policy formulation process for Nicaragua was initially not very different from previous practices, although there is some evidence of improvement over time. Macroeconomic stabilization efforts took up most of the attention, and while emphasis on growth and poverty issues has occupied a more prominent place, they still do not constitute the backbone of the internal process.

214. *Alignment.* PRGF/SMP program negotiations, rather than the PRSP, remained the driving force behind the formulation of the macroeconomic framework because of several

factors—including pressing initial conditions and lack of government credibility, a PRSP macroeconomic framework superseded by events, and lack of operational guidance in the PRSP. Also, some sensitive but critical issues (e.g., how to deal with the banking crisis and its fiscal consequences) were not part of the policy debate except in a small inner circle. The focus of the PRGF-supported program on macroeconomic stability issues diverted efforts from its linkage to the PRSP's growth pillar.

215. *Program design.* The initial design of the PRGF-supported program did not differ significantly from earlier ESAF-supported programs, in part because both the government and the IMF staff considered stabilization a priority and made it the main axis of the program. However, more recently there appears to be greater fiscal flexibility to aid flows. Structural conditionality in the PRGF-supported program was streamlined, but the burden of quantitative performance criteria did not diminish. To the extent that macroeconomic stability constitutes a precondition and a degree of sequencing is required, transition into PRGF arrangements may necessitate taking into consideration initial country circumstances and the effective speed limits that the process of aligning Fund support may encounter. However, going forward the issues of how to transit from stabilization to growth and enhanced growth analysis—including consideration of key tradeoffs—would require heightened attention to move towards the key features of the initiative.

216. Nevertheless, the policy space for government-led initiatives in the context of the PRGF-supported program did expand over time—amid increased government credibility and a more stabilized macroeconomic environment. This move is in step with PRSP objectives. *The effects of broadening the policy space and of increased participation on the objectives of policy sustainability and continuity—which has been an issue in Nicaragua—are yet to be ascertained.*

217. *Participation and ownership.* Key components of the PRGF-supported program—the need of fiscal consolidation and macroeconomic stability—have been government owned, but the program has lacked broader ownership. Despite recognition of increased outreach efforts by the Fund, the formulation of macroeconomic policy is still regarded as not being open to a broader policy debate outside of traditional negotiations between the IMF staff and the authorities. This reflected the choice of the government. *Opening program negotiations to non-government actors is not realistic, but efforts by both the government and the IMF to broaden the discussions of macroeconomic policy could contribute to fostering a better understanding of trade-offs and policy choices.* So far, the PRSP has had little impact in this area, although the approach of a technical commission, drawn from various groups, that was used to formulate tax reform proposals may be one avenue worth exploring further.

LIST OF INTERVIEWEES

Name	Organization
Amparo Ballivian	World Bank
Eduardo Barcarcel	IDB
Bayardo Arce	FSLN
Carmen Largaespada	Ministry of Family
Luis Velazquez	CONPES
Claudia Guadamuz	CONPES
Anastasio Somarriba	COSEP
Jurg Benz	COSUDE
Embassador Rasmussen	Danish Embassy
Orlando Mendoza	Danish Embassy
Florencia Castro-Leal	World Bank
Jose Angel Bermudez	Frente Nacional de los Trabajadores
Georgia Taylor	DFID
Hellen Appleton	European Union
Alejandro Fiallos	INIFON
Omar Gonzalez	INIFON
Luis Ribas	Ministry of Finance
Mario Flores	Central Bank
Nestor Avendaño	American Friends Service
Lesbia Morales	Casa Sol
Lucy Hayes	Trocaire
Aasa Thomasson	Forum Syd
Ms. Barragona	Casa Sol
Ms. Keppa	Casa Sol
Ana Quiros	CISAS
Ricardo Zambrano	CISAS
Maribel Gamboa	Ministry of Labor
Mario Arana	Ministry of Development, Industry and Commerce
Mario de Franco	Ministry of the Presidency
Mauricio Gomez	Ministry of Foreign Affairs
Mignone Vega	FUNDEMOS
Jose Augusto Navarro	Ministry of Agriculture
Pedro Solorzano	Ministry of Transportation
Jose Antonio Alvarado	Ministry of Health
Norman Piccioni	World Bank
Rene Herrera	Partido Liberal Constitucionalista
Silvio de Franco	Ministry of Education
Luis Angel Hernandez	SECEP
Eddy Jerez	SNIP/SECEP
Maria Jose Joaquin	UCRESEP
Maria Rosa Renzi	UNDP
Violeta Granera	World Bank

SURVEY RESULTS

1. As part of the OED and IEO evaluations of the PRSP Process and PRGF, a survey of PRSP stakeholders was administered in each of the ten countries where a case study is being undertaken. The objective of the survey was to obtain perceptions of the PRSP process and the role of the World Bank and IMF in supporting the initiative. The primary use of the survey results will be to analyze perceptions of the various PRSP stakeholder groups across all ten countries.

2. A standard survey of 39 questions was administered in each country. The full questionnaire can be found on both of the evaluation websites www.worldbank.org/oed/prsp and www.imf.org/ieo/external/np/ieo/2002/prsp/index.htm. The survey consisted of four main components: information on respondents; the PRSP process (covering ownership, results orientation, comprehensiveness, partnership-orientation and long term perspective); World Bank performance; and the role of the IMF. In most cases, respondents were asked to indicate the extent of their agreement with statements on a five point scale⁸². The survey was translated, where necessary, and pre-tested before being applied. A local consultant with survey experience was engaged in each country to assist with administration of the survey. Survey results were coded by the local consultant and sent back to Washington and an outside contractor, Fusion Analytics, was hired to analyze the data.

3. The survey was targeted at key groups within the three main categories of PRSP stakeholders: Government, Civil Society, and International Partners.⁸³ Within each group, the survey sought to obtain an *institutional view* and was targeted at the most knowledgeable individuals. Respondents were asked to define the nature of their involvement in the PRSP process, and their level of familiarity with the PRSP document, the Bank, and the IMF. Given the targeted nature of the survey, respondents who were “Not Aware” of the PRSP Process were excluded from the results. The specific samples were selected using three main inputs: information gained through the country case study mission; participants listed in the PRSP document; and input from the local consultant. In some cases, samples were circulated to obtain broader input on their composition. The study teams also identified a set of highly relevant respondents in each country for whom a survey response was required. These included core ministries and agencies (Finance,

⁸² The 5-point scales used in most questions offered a range from 1: Completely Disagree to 5: Completely Agree. Respondents could also mark 0 for Don’t Know or Unsure.

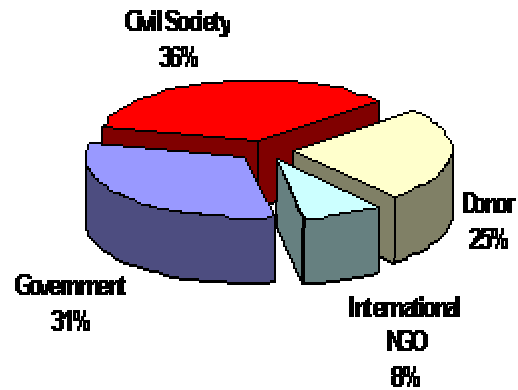
⁸³ Fourteen stakeholder groups were identified: Government—central government, line ministries and sector agencies, local government, Parliament—Civil Society—local NGOs, business sector, labor unions, academia, media, religious organization, political party, other—International Partner—donor, international NGO. Results at the stakeholder group level will be presented in the aggregate analysis across all countries.

SECEP, Central Bank), key PRSP-related ministries (Family, Education, Agriculture), and major donors. Survey questionnaires were tracked in order to ensure responses were obtained from key groups, however, individual respondents could choose to remain anonymous.

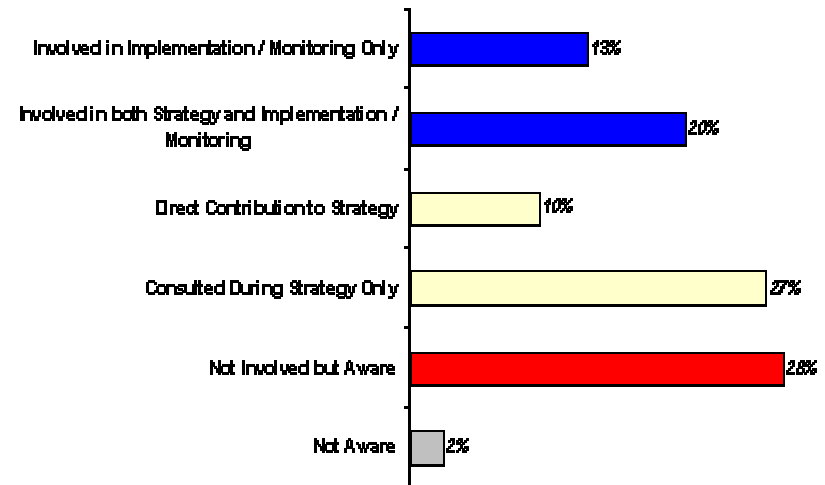
4. The following sections present findings from the survey applied in Nicaragua. Section A provides an overview of the survey respondents, including the nature of involvement and familiarity with the process. Section B provides an aggregated snapshot of stakeholder perceptions of the PRSP Process across each of five main sub-categories. Section C provides the mean results for all questions concerning the role and effectiveness of Bank and Fund support. Section D presents results for questions with the most positive and negative responses and questions where there was the greatest consensus or disagreement on issues.

A. Respondent Information

1. Composition of respondents (n = 83)



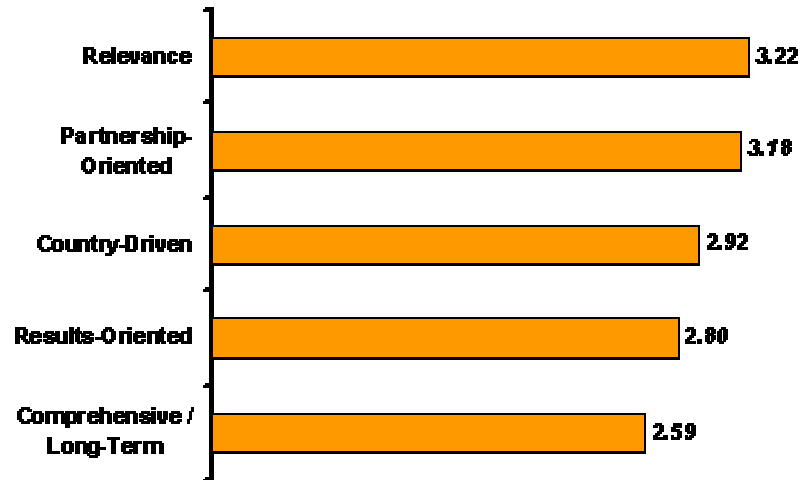
2. Nature of involvement (in percent)



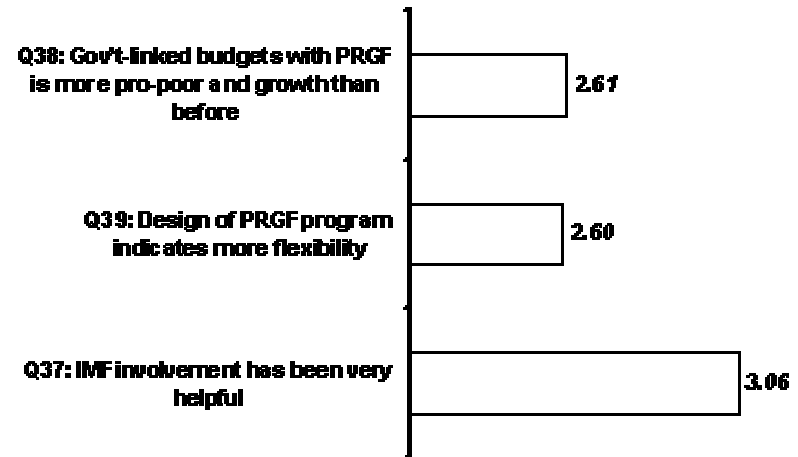
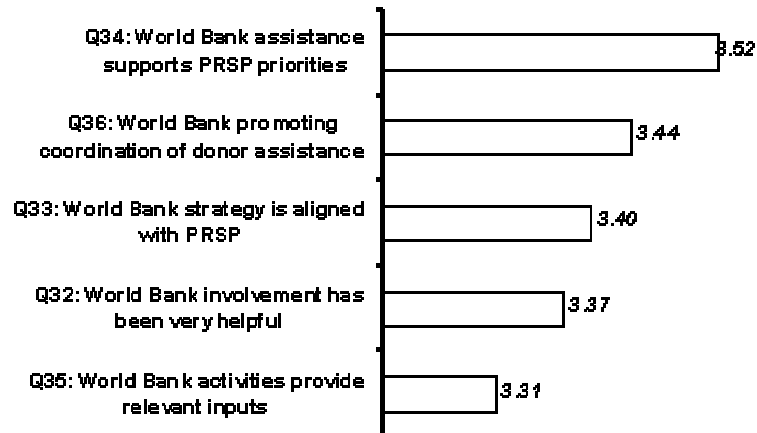
3. Level of Familiarity

PRSP document	71 percent
Bank	55 percent
IMF	49 percent

B. The PRSP Process



C. Bank and IMF



D. Composite Results Table

Question	Percent agree	Percent disagree	Means for highest standard deviations.	Means for lowest standard deviations	Percent don't know or unsure
Most positive responses					
Q26 Partnership-oriented: Donors aligning assistance	48.2				
Q8 Relevance: PRSP is a good model	45.8				
Q9 Relevance: PRSP adds value	45.8				
Q27 Partnership-oriented: Donor coordination improved	44.6				
Q10 Relevance: PRSP improves on past modalities	44.6				
Most negative responses					
Q23 Comprehensive: Balance between growth and poverty reduction		55.4			
Q22 Comprehensive: Macroeconomic framework participatory		48.2			
Q14 Country-driven: Final document was modified to accommodate viewpoints		41.0			
Q17 Results-oriented: Realistic targets and plans		41.0			
Q21 Comprehensive: Alternatives fully explored		41.0			
Most polarized responses					
Q29 Partnership-oriented: Coordination b/t World Bank and IMF improved			3.46		
Q30 Partnership-oriented: Quality of Bank/Fund collaboration			3.33		
Q25 Partnership-oriented: Donors supported formulation			3.15		
Q26 Partnership-oriented: Donors aligning assistance			3.49		
			3.03		
Areas of greatest consensus					
Q23 Comprehensive: Balance between growth and poverty reduction				2.26	
Q17 Results-oriented: Realistic targets and plans				2.71	
Q24 Comprehensive: Adequate road map for long-term goals				2.61	
Q28 Partnership-oriented: Current donor coordination				2.83	
Q12 Country-driven: PRSP driven by national stakeholders				2.99	
Most unfamiliar areas					
Q29 Partnership-oriented: Coordination b/t World Bank and IMF improved					42.2
Q30 Partnership-oriented: Quality of Bank/Fund collaboration					42.2
Q25 Partnership-oriented: Donors supported formulation					19.3
Q19 Results-oriented: Results feed back					18.1
Q16 Results-oriented: Outcomes benefit poor					15.7

Note: The percentage of those who “agree” or “disagree” relate to the total that responded to each question. The percentage of “don't know or unsure” is calculated on the basis of the respondents in the sample 83. To determine areas of low level of agreement among the sample (polarization), and high level of agreement (consensus), the means for all the questions were sorted by their standard deviation. The five highest (most polarized) and lowest (greatest consensus) ranking means are given in the table.

REVIEW OF EXTERNAL EVALUATIONS OF THE PRSP IN NICARAGUA⁸⁴

1. The PRSP process in Nicaragua has been the object of significant comment by civil society groups, non-governmental organizations, and some of the most important donors. By contrast, the PRGF-supported program and the World Bank's Country Assistance Strategy have so far received much less attention.⁸⁵ In addition, most of the discussion and comment around the PRSP has revolved around the question of participation. With very few exceptions, other aspects of the PRSP have received much less attention.
2. External observers generally agree that the PRSP has led to an expansion of participatory processes in Nicaragua, but they also note a number of significant problems and shortcomings. Most observers concede that the government made a significant effort to enhance participation, but this was only done after receiving pressures from civil society and the donor community to open up the space for more participatory processes (e.g. Bertelsen and Jensen, Ibis, Trocaire, etc.).
3. There is therefore a general perception that the government's efforts to foster participation have been insufficient, and that participation in the macroeconomic framework of the PRSP was virtually non-existent. A recent study by Bertelsen and Jensen (2002) found a significant amount of participation at the project level; some (though much less) participation at the sector level (e.g. health and education, etc.), and almost no participation at the macroeconomic level. The authors argued that limited participation in the macroeconomic part of the PRSP was due to two interrelated factors. One reason is the view (held by the government and IFIs) that members of civil society are often noneconomists, which limits their capacity to contribute to discussions of macroeconomic issues. The second reason is that in a divided society different civil society organizations are willing to pursue different interests that cannot be easily reconciled.⁸⁶

⁸⁴ By "external" we mean evaluations of the PRSP that have not been conducted by the IMF or the World Bank.

⁸⁵ This is not surprising given the fact that the latter were only completed in December 2002.

⁸⁶ The results of our own research in Nicaragua are generally in line with the findings of Bertelsen and Jensen, with two caveats. First, we found that, in terms of policy impact, civil society felt that even at the project level they had achieved very little. Most organizations interviewed agreed that participation at the project level had been intense and recognized the benefits of the process, but they still felt very frustrated for the lack of results. On the other hand, however, as regarded the macroeconomic framework of the PRSP, there have been some recent attempts to enhance participation. Despite their limited scope, there have been some positive changes since the Bertelsen and Jensen study appeared in mid-2002. We are referring, for example, to the tax experts of different political tendencies that the government entrusted with the preparation of a plan for tax reform. A similar commission will soon be

(continued)

4. The critical view about the limits of the participatory process is also shared by a number of additional external evaluations. For example, the evaluation conducted by COSUDE (the Nicaraguan office of the Swiss Agency of International Development) agrees with the limitations of the participatory processes described above and adds (i) that the process of producing the PRSP was rather long and controversial, (ii) that awareness of the document is weak even in the central government, and (iii) that ownership is very limited. Another important problem in their view is that the PRSP is still viewed as a donor-driven document. In addition the report argues that the PRSP is too geared toward the social sectors at the expense of production and growth. Similarly, the Canadian International Development Agency points out the fact that participation at the local level was limited because only half of the departments in Nicaragua were consulted. In addition, it highlights that a network of civil society organizations (Coordinadora Civil para la Emergencia y Reconstrucción) conducted parallel consultations in all the departments of Nicaragua and produced a list of recommendations. However, none of these recommendations were incorporated in the final PRSP. By contrast, DANIDA (the Danish donor agency) presents a slightly more positive view of the participatory processes, arguing that “the fairly extensive consultation process in most sectors is an important achievement”. However, the Danish agency also acknowledges that participation at the local level, and knowledge of the PRSP in Parliament and line ministries, was minimal.

5. Finally, external observers have pointed out that the efforts to align the PRGF with the PRSP have been complicated by the different time frames of each document. The point they make is that the PRSP presents a medium-term strategy, while the PRGF is only a short-term program (IBIS, Trocaire). Our interviews with government officials showed that this is indeed a real preoccupation. In particular, as we discuss in section II, the focus on short-term macroeconomic adjustment has diverted efforts to focus on medium-term policies to foster growth over the medium-term. Finally, Oxfam International has pointed out that it is at best unclear whether the PRGF contains genuinely distinct policies from the previous ESAF.

established to assess priorities in public spending. Though some will certainly see these efforts as insufficiently inclusive, the government’s position is that participation and discussion of very complex issues (such as tax reform) is more effective when it takes place at the level of technical commissions.

**AN ASSESSMENT OF THE ADAPTATION OF THE IMF'S INTERNAL POLICY PROCESS BASED ON BRIEFING PAPERS AND REVIEW
DEPARTMENT COMMENTS ASSOCIATED WITH THE NICARAGUA 2002 PRGF-SUPPORTED PROGRAM**

Assessment criteria	Summary of change in policy approach as indicated by ESAF- and PRGF-related briefs/review department comments	Ranking of briefs and comments linked to programs on a scale of 1–4 1/	
<i>A. Briefing Papers</i>		March 4, 2002	June 21 2002
1. Does the brief discuss links between the PRSP and the PRGF objectives?	Initial briefs do not provide an in-depth discussion of the links between the PRGF and the PRSP, but later briefs and back to office reports show some preoccupation to embed the PRGF-supported program into the overall PRSP framework in a number of areas. First, there is an increasing preoccupation for poverty and social sector issues. For example, briefs insist that in the process of fiscal consolidation poverty-reducing expenditures should be protected (even increased) so that progress toward the PRSP objectives can be made. Briefs also explain that the staff will encourage the authorities to conduct PSIA in collaboration with the World Bank. Second, briefs emphasize that the mission will be guided by the overall PRSP policy framework. However, given the large slippages in 2001, the achievement of the PRSP objectives will be delayed to 2004–05. Finally, briefs note that the PRGF-supported program will incorporate a comprehensive two-stage tax reform package in line with the blueprint presented in the PRSP.	2	3
2. In resolving the key issues identified by the mission does the brief leave room for discussions of alternative policy options to achieve major objectives?	Initial briefs leave room for discussion of a narrow range of policy alternatives and these are not generally linked to the PRSP objectives. However, in later briefs and back-to-office reports there are signs of flexibility in two areas: the pace of implementation of the tax reform (where the authorities prefer a more gradual approach), and the choice of the exchange rate regime (the government wants to continue with the crawling peg while the Fund, especially MAE, would prefer a more flexible arrangement).	2	3
3. Are alternative macroeconomic frameworks and the tradeoffs between them considered?	Briefs do not discuss alternative macroeconomic frameworks and their tradeoffs	1	1

**AN ASSESSMENT OF THE ADAPTATION OF THE IMF’S INTERNAL POLICY PROCESS BASED ON BRIEFING PAPERS AND REVIEW
DEPARTMENT COMMENTS ASSOCIATED WITH THE NICARAGUA 2002 PRGF-SUPPORTED PROGRAM (CONTINUED)**

4. Does the program discuss how it will protect key objectives in the event of unanticipated negative shocks?	The program is in fact dealing with current macroeconomic shocks, especially the consequences of the banking crisis	Not applicable	Not applicable
5. Does the brief allow for flexibility to use additional concessional external financing if available?	Initially not discussed, when in fact this is a key issue that the World Bank had raised. In the World Bank’s view, the PRGF-supported program does not seem to permit a possible replacement of domestic, dollar-denominated debt for external debt that might be contracted on better terms. The WB argues that this substitution is feasible under the HIPC framework	2	2
6. Is a participatory process in resolving key issues considered?	There is no significant discussion of a participatory process.	2	2
7. Does the brief identify policy issues where poverty and social impact assessment (PSIA) inputs would be necessary/useful?	Identifies broad policy issues where poverty/social impact may be significant, but no discussion of actual impact or of how PSIA will be brought to bear on these issues.	2	2
<i>B. Review departments’ comments</i>			
8. Is the need for more “policy space” for home grown options recognized in the review process?	Departmental comments usually insist that the program should actually be strengthened. For example, FAD and PDR suggest that the tax reform package has been watered down considerably and that the staff should make no additional concessions in this area. The MD also insists on the importance of the tax package as a key element before “we can move forward”. MAE also expressed concern about the crawling exchange rate regime in a context of lack of fiscal discipline.	2	2

AN ASSESSMENT OF THE ADAPTATION OF THE IMF’S INTERNAL POLICY PROCESS BASED ON BRIEFING PAPERS AND REVIEW DEPARTMENT COMMENTS ASSOCIATED WITH THE NICARAGUA 2002 PRGF-SUPPORTED PROGRAM (CONCLUDED)

9. Are poverty issues discussed or their absence highlighted in review departments’ comments?	Yes. For example, PDR insists that the mission should seek reassurances that poverty-reducing expenditures will be protected. It also insists on the need to consider alternative policy options. In particular, it asks for an alternative strategy in case the assembly rejects the reduction of zero-rated VAT products and indicates that the report should provide details on any planned contingency cuts in spending if revenues fell short of expectations. In addition, the “staff report should include an assessment of the political economy considerations that help shape the authorities’ strategy, the risks involved, and an assessment of the ownership of the strategy by the government, the national assembly, and the population at large”	3	3
10. Did review departments press for more or less conditionality (prior actions, PCs, structural benchmarks) in the policy areas specified by the mission?	No specific discussion of conditionality during the review process.	2	2

1/ The ranking scheme is based on the degree of consistency with the PRSP/PRGF approach: 1=Highly inconsistent; 2=Inconsistent; 3=Consistent; 4=Highly consistent. The main briefing papers analyzed correspond to March 4, 2002, and June 21, 2002. However, the overall assessment is also based on previous and later additional documents such as back-to-office reports, and internal memoranda associated with the protracted negotiations that led to the December 2002 PRGF-supported program.

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