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Evaluation of Poverty Reduction Strategies in Latin America – 2005 Executive Summary

Nicaragua: Poverty in second place

Preface

The poverty reduction strategy responds to a legitimate concern for the problem of persistent and high poverty in many developing countries. The PRSPs intend to reduce poverty through a participatory, long-term, and result-oriented strategy that seeks to bring together both government and civil society in finding solutions to the country's poverty problems. The commitment of the donors is to support the strategy with resources and debt relief.

The Swedish International Development Cooperation Agency, Sida, has requested the Institute of Social Studies (ISS) in The Hague, to monitor and evaluate the PRSP processes in the three Latin America countries eligible for debt relief: Bolivia, Honduras and Nicaragua. The study will be carried out over a period of 5 years, beginning in 2003.

Each year five reports will be elaborated, including three country reports, one regional report and a thematic report. The country reports to be submitted in 2005 provide an update of the progress with the PRSP process in terms of strategy definition and implementation. This year specific attention is paid to the budgeting process in relation to poverty reduction policies and the problems countries are facing in making the budget process more transparent and more results-oriented. The analysis of the country reports is supported by a detailed and systematic stakeholder analysis, including the stock taking of local actors through visits to several municipalities in the three countries. A comparative analysis of the experience in the three countries is presented in the regional report, highlighting lessons to be learned for governments, civil society and the donor community. The thematic report for 2005 focuses on the potential of result-oriented budgeting in the case of primary education.

The five reports aim to make a contribution to existing evaluations of the PRSP process through the regional focus and an impartial assessment of the PRSP, resulting from the ISS's complete independency in the process of design, implementation and financing of the strategies.

All reports can be downloaded from the following website: http://www.iss.nl/prsp.

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September 2005

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Executive Summary

"Nicaragua: Poverty in second place"

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Content

Executive Summary

In 2005 the Nicaraguan PRSP has moved to a secondary position, if not permanently at least for a long period, in both the political debate and the government's priorities. This situation is a consequence of two main factors: on the one hand, the political confrontation between the various State powers of Nicaragua, which deepened immediately after the country reached the completion point under the enhanced HIPC Initiative; on the other, the publication of the latest version of the Operative National Development Plan (PND-O), which subordinates poverty reduction to the Plan's central priority, economic growth. The International Monetary Fund's (IMF) economic programme in the country has registered delays in the implementation of structural reforms directed at fiscal sustainability and at strengthening the national financial system.

Economic and Political Conditions in 2004–2005

In 2004 the political crisis continued unresolved. In October the relations between the State powers reached a point of high conflict, expressed in the disregarding of each other's actions, in proposals and threats to cut short the mandates of public servants of all State powers, and in threats to take the President of the Republic and members of his Cabinet to court. The crisis of governance was at long last resolved in October 2005, with an agreement between the President of the Republic and the General Secretary of the Frente Sandinista, which increased political stability and created conditions for the Executive to remain in function until the end of the presidential mandate.

Despite political and institutional strains, the country's economy seems to have experienced no negative consequences. Nevertheless, and despite improvements experienced by certain groups, inequity in the distribution of income as well as unemployment and poverty levels increased in 2004 as a consequence of neglect of the internal market by the government economic policy makers. Economic growth had a significant export bias and was concentrated into relatively few hands. The country reached the completion point of the HIPC Initiative at the beginning of 2005.

Monetary policy ensured macroeconomic stability, characterised by a rate of devaluation of the national currency of 5 percent per year, a rate of inflation under 10 percent despite even the increase associated with international petroleum prices, and a gap of 0.18 percent between the official exchange rate and the price of the US dollar in the financial market. The deficit in the balance of payments, largely due to a substantial trade deficit, is financed with the help of (i) migrants' remittances; (ii) international aid; and (iii) foreign direct investment.

Social Conditions

The adjustment of the budget for 2004 associated with constitutional transfers to the universities and with demands for increases in tariffs or in subsidies to passenger transport in urban buses in Managua was accompanied by severe social protests.

Has poverty decreased in Nicaragua? Without a new Living Standards Measurement Survey – the latest survey was carried out in 2001 – it is risky to say whether poverty in Nicaragua has decreased. If we consider only the official figures for economic growth and the country's population growth, we might perhaps be able to conclude that poverty has fallen over the period 2001–2004. However, this conclusion does not take into account either the quality of economic growth – export-biased, neglecting the internal market and generating few jobs – or the considerable inequity in income distribution.

HIPC Relief

In the framework of the HIPC relief of Nicaragua's external debt, between 2001 and 2005 the International Community liberated a total amount of US$ 1,140.6 million from the payment of Niaragua's external debt. In other words, during that five-year period, an annual average of US$228 million in tax revenue, that would normally have to be used for buying dollars to pay for external debt, were liberated and should instead have been assigned to finance poverty reduction projects, as was determined by the Group of 7 (G-7) when it approved the enhanced HIPC Initiative, in Cologne, in June 1999.

Despite this determination, only 51.9 percent of the resources liberated by debt relief over the period 2001–2005[1] were used to finance the expenditure associated with the Growth and Poverty Reduction Strategy (ERCERP).

The partial allocation of HIPC relief to the ERCERP ia well-known and has been pointed out in previous reports. Over the period 2001–2005, of a total of US$1,030.8 million liberated by external debt relief, only 36.3 percent, or US$374.6 million, were actually allocated to the implementation of the ERCERP. The remaining US$683.0 million were allocated to other purposes, mainly to the payment of the government's internal debt and to transfers from the national budget to the Central Bank of Nicaragua, in order to increase the government's deposits in the Central Bank and to make it easier for the Bank to pay its debt to the national financial system, due to the bond auctions and to the debt restructuring associated with the collapse of commercial banks. Official statistics also reveal that the government of Nicaragua has assigned smaller proportions of its own tax revenues to the financing of poverty reduction projects.

The National Development Plan (PND) 2005–2009

The government has presented the PND 2005–2009, which has also been called PRSP II. In this plan, economic growth replaces poverty reduction as the main objective. Although there is reference to "economic growth to reduce poverty", the growth proposed is based on "improv-

1 The figure for 2005 corresponds to the amount originally included in the draft budget law for 2005.

ing the business climate to take advantage of the competitive potential of the territories, fostering productive growth and inserting Nicaragua in the global trade flows". The relation between economic growth and poverty reduction is seen as almost automatic, and no questions are asked about the kind of growth that would be likely to have a more significant and sustainable impact upon poverty reduction.

Notwithstanding some innovative work carried out at the territorial level, some formal consultations in the sectoral area and some committee work on public investment proposals, the whole process of formulation and revision of the successive versions of the PND lacked a public consultation and discussion at the national level of this national plan. This fact inevitably decreases the legitimacy of the plan and weakens it as a proposal. Despite all the arguments concerning bottom-up construction, appropriation by and coordination of key actors, civil society, private sector and government, it is undeniable that the territorial level is not the most suitable level for a discussion of the broad traits of a national plan, or for proposing alternative visions.

Two aspects of the PND 2005–2009 appear as especially interesting: (i) the proposed decentralization policy, and (ii) the redefinition of what constitutes poverty-related expenditure. As to the first point, the initial proposal is to strengthen the intermediate level of government, based in the departments. This is therefore a proposal for deconcentration of central government functions, and not for devolution of powers and competencies to another level of government with its own legitimacy, as is the case with the municipalities. If municipal autonomy is not suitably protected and reinforced, the strengthening of the intermediate level of government may result in an institutional weakening of the municipalities and in their increased dependence in relation to the central government, deconcentrated or not.

As for the redefinition of what constitutes poverty-related expenditure, the Plan groups expenditures into three classes according to their impact – direct or indirect – in terms of improving incomes and living conditions of the poor. The first group includes expenditure that has a direct impact, such as resource transfers with direct effects upon redistribution. Group 2, expenditure with an indirect impact, comprises all expenditure that focuses on strengthening the capacity of the poor to increase their own incomes, such as the construction of productive infrastructure (trunk roads, ports and airports); electrical energy (rural electrification, development and modernization of the sector); environmental protection and recovery; rural development (including technical support to agriculture and cattle raising); and secondary and technical education. Finally, a third group of expenditure addresses institutional strengthening and comprises expenditure aimed at improving governance and the business climate, and at increasing the efficiency of institutions that provide basic social services. On the other hand, expenditure associated with the strengthening and modernization of institutions that are not direct providers of basic social services, and current expenditure with central activities of "social" ministries, are no longer considered as poverty reduction expenditure.

This redefinition of what constitutes poverty reduction-related expenditure is consistent with the ideology of the PND. If economic growth is all that is needed to reduce poverty, then every investment that leads to growth may be considered as an investment for the reduction, direct or indirect, of poverty. The problem with this approach is that any "developmentalist" strategy may be considered as a poverty reduction strategy.

The classification of expenditure aimed at improving the business climate, or of investments in productive infrastructure, including ports and airports, or in the development and modernization of the electricity sector, as poverty reduction expenditures, is rather doubtful.

Institutional Strengthening

Progress has continued in the consolidation of programmes initiated during ERCERP I, some of which have potentially positive impacts upon poverty reduction. These include the regulation of the Fondo Social Suplementario (FSS – Supplementary Social Fund), the consolidation of the Sistema Nacional de Inversiones Públicas (SNIP – National System for Public Investments) and of the SIGFA, the expansion of the PASE programme (Program for Appropriation, Monitoring and Evaluation of the ERCERP) to more departments and the beginning of the implementation of the Sistema Nacional de Seguimiento a Indicadores de Desarrollo (SINASID – National System for Monitoring of Development Indicators).

Advances in Decentralization

Departmental Development Committees have been set up and all municipalities use the municipal planning system as a technical tool.

An important advance in municipal decentralization has been the increase, in 2004, of central government transfers to municipalities, from 1.5% to 4.0% of tax revenue, without the establishment by the central government of any 'conditionality' for the use of those resources at municipal level. During the process of approval of the Budget for 2005, the National Assembly increased the volume of such transfers to 6% of tax revenue; according to the law, municipal transfers should equal 10% of total tax revenue by 2010.

On the other hand, the IMF has made the actual transfer of resources to the municipalities dependent on the approval of a set of regulations that determine that municipalities should take responsibility for competences that imply costs of at least 30% of the total amount transferred by the central government. In this way, the IMF tries to decrease the fiscal impact of such transfers. The IMF and the Government have produced an outline of central and municipal government responsibilities. Responsibilities that are exclusively municipal comprise municipal urban and rural development and maintenance; the administration of local public services; the promotion of agriculture, forestry and small industry; the construction and management of local cemeteries; local planning, regulation and control of land use; and the building and maintenance of recreational services.

Donor Coordination

Considerable progress has been made in relation to the coordination, harmonization and alignment of international cooperation, including budget support, and the government plays an increasingly active role in this process. In September 2004, in the III Forum for the Coordination of Cooperation, the progress of the five Roundtables for Sectoral Coordination (dealing with Health, Education, Production and Competitiveness, Good Governance and Infrastructure) was assessed. Some sectors have succeeded in adopting multi-annual work plans or have taken other stepd towards the sectoral approach. There is also some progress in the creation of external resource funds. Furthermore, some participation of civil society in several of these Roundtables has been achieved although, on the other hand, the government has tried to exclude civil society from some of them. There are also some doubts about the relevance or effectiveness of some of the sectoral progammes, such as that for education or the new PRORURAL.

The government, together with a group of donors, has developed a National Development Plan for Harmonization and Alignment. The most salient objectives of that plan include the formulation and presentation of the second-generation PRSP, the adoption of sectoral programmes as the main mechanism for the implementation of the PRSP, the incorporation of local development plans into the national planning system, the development of a Medium Term Expenditure Framework (MTEF), advance notice and better planning of donor missions (including a period during the year without such missions), the continuation of the shift from project support to sectoral support and joint financing, a progressive reduction in the number of 'parallel and non-integrated project management units' through closing down or integration into the corresponding ministries, etc. A Technical Group for the implementation and monitoring of the Plan has also been formed, comprising both government and donor representatives.

Budget Support

During 2004, the Budget Support Group (BSG) and the government negotiated the contents of the Joint Financing Agreement (JFA) and the indicators that should be included in the Performance Assessment Matrix (PAM) associated with the Agreement. On the 18th May 2005 the JFA was signed by the Government of Nicaragua and nine donors. The JFA provides a framework for BS and formulates a set of broad principles that guide the Agreement. The PAM contains a total of 160 actions and targets for two years (2004 and 2005), including 93 actions and 67 targets. Most of the aid resources that have been committed under this form of financing were not new resources, but aid that had already been committed and that was transferred to this new form of cooperation.

In September 2005, and although they recognized the government's achievements in economic management, the BSG donors informed the government that the decision to release the funds would depend on a letter of agreement issued by the IMF. This letter finally arrived in October, with several demands that the government was forced to accept. On the basis of the IMF letter, the BSG approved the disbursement of US$89 million for BS, or $20 million less than what had been promised initially. The reason for this difference lies in the continuing concern that the already agreed upon reforms may not actually be carried out. Assuming that there are no further problems, the BS committed for 2006 amounts to US$88 million.

Results Oriented Budgeting

The United Nations Manual defines results-oriented budgeting (ROB) as a programme in which (i) the budget is formulated on the basis of predefined objectives and expected results; (ii) the demand for resources follows from, and is explicitly connected to, the expected results; and (iii) the achievement of results is measured with the help of objective performance indicators. ROB is proposed by donors to make it easier for governments in aid-receiving countries to render accounts for the use of public funds, and to improve the efficiency and effectiveness of public expenditure by connecting policies, expenditure and results.

In Nicaragua the budgeting process combines top-down (in the setting of expenditure ceilings) and bottom-up (in the preparation of detailed sectoral budgets) elements. The budget cycle remains annual, and the only multi-annual programming takes place in connection with the public investment programme. Generally, the present budgeting process is not connected to specific objectives or targets. The lack of a relationship between the budget and targets, especially those that relate to poverty reduction, makes possible for instance an arbitrary increase in reserves to the detriment of the general welfare of the population, particularly the poor.

Efforts to move the budgeting process towards a results orientation have begun recently. The budget for 2006 will include an Annex with a Medium Term Expenditure Framework, containing projections, for at least the two subsequent budgets, of revenues by category and of expenditures classified by type of expenditure and by organization. The Annex will also present the physical targets of production of goods and services that are aimed for, the public investment programme, the programme of external payments, loans and grants, the evolution of public debt and a description of the policies and criteria that underlie the economic and financial results and projections. The government has prepared a strategy for the development of the MTEF which proposes the introduction of an MTEF and of ROB between 2005 and 2008, in such a way that by the latter year the system will already be in process of consolidation. Nevertheless, and despite the government's commendable efforts in recent years, the institutional capacity required for the successful introduction of ROB still seems weak. This capacity is weaker still al the level of local governments.

Among the main challenges that Nicaragua must face in order to have, in the future, an effective system of ROB may be mentioned the following: (i) the further development and effective integration of monitoring, evaluation and strategic planning systems so as to make possible a constant updating of knowledge about 'input-output' relations, essential for effective budgeting; (ii) the training of a sufficient number of functionaries so as to make it possible to 'populate' the institutions that will take part in the new budgeting system; (iii) the introduction of stable and transparent systems for hiring the same functionaries to ensure that their institutions will benefit fully and sustainably of their newly acquired knowledge and experience; and (iv) the introduction of an increasingly decentralized and participatory budgeting system, which will permit a progressive appropriation of the processes of budget formulation, implementation, monitoring and control by the population, and especially the poor.

Some conclusions

We may conclude by stating that a remarkable effort has been made in planning and in reforming the process of preparation and implementation of the budget. Important steps have also been taken towards a greater coordination, harmonization and alignment of international cooperation. On the other hand, and regardless of its weaknesses, the presentation of the PND 2005–2009 and, even more important, the agreement of the donors to accept it as a replacement for the ERCERP, represent a significant achievement for the government.

However, to achieve progress in the coordination, harmonization and alignment of foreign assistance – and in the much more important objective of reducing poverty in Nicaragua – the government must be ale to implement policies. In the current situation, in which the lack of implementation capacity of many public sector organizations is further complicated by the conflicts between the various State Powers, this condition is not fully realized. Failing to appreciate the seriousness of these political problems, foreign assistance agencies have accepted a plan with very problematic implications from the point of view of poverty reduction and have started to discuss the details of conditions and targets to be reached through budget support.

It does not seem very correct for the donors who have adopted budget support in order to reduce poverty in Nicaragua to accept a strategy of economic growth where there are few concrete indications that poverty reduction remains a priority for the government. It is also important to avoid, from the beginning of the implementation of the new modality of budget support, the lack of appropriation by the Nicaraguan population.

The budget support form of assistance sets down a large number of conditions for disbursing and for evaluating the use of 20 per cent of the foreign aid effectively delivered to the government (i.e. excluding the HIPC relief, which is an accounting donation). These conditions make BS similar to an IMF programme in Nicaragua, and the donors that take part in BS risk the accusation of undue interference in Nicaragua's internal affairs. Now conditions affect not only the loan of freely available liquid currency to support the balance of payments, but also external donations to decrease human poverty in the country.

The effectiveness of including such a large number of conditions may also be doubted, since the government is unlikely to be able to implement all those conditions, even if it has the political will to do so. The argument that 'what the donors follow, the government pays more attention to, and is therefore more likely to be implemented' is only valid if the government has sufficient monitoring and implementation capability. In Nicaragua there is evidence of delays in setting up a system for the continuous, permanent and realistic evaluation of poverty reduction indicators by the authorities. This can become the main barrier to an effective functioning of this modality of cooperation. Besides, this process also lacks an effective auditing by civil society and a genuine transparency.

For these reasons it seems desirable that the BSG reduce the number of conditions, and concentrate on the main Millennium Development Goals for 2015, especially in education, health, drinking water supply to urban areas, improved water supply to rural areas and sanitation. On the other hand, and without forgetting poverty reduction, the policy dialogue should focus primarily on areas where the Executive has both the will and the implementation capacity, such as for instance the improvement of budgeting processes and of public finance in general.

It also does not seem very correct that BSG donors have made the disbursement of BS aid for 2005 and 2006 exclusively dependent on the blessing of the IMF, an attitude which has caused consternation among functionaries both of the government and of the aid agencies themselves. To condition the new modality of aid directly to the approval of the IMF places at risk donations which support the financing of social expenditure and the implementation of public sector programmes and projects which are executed independently of the agreement with the IMF. This new risk, in a scenario characterized by political clashes among the different State Powers, could cause a fall in the external aid to social expenditure and increase the probability of not reaching some of the poverty reduction targets.

Halving poverty by 2015 is one of the greatest challenges of our time, requiring cooperation and sustainability. The partner countries are responsible for their own development. Sida provides resources and develops knowledge and expertise, making the world a richer place.

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