

# BTI 2008 | Nicaragua Country Report

<b>Status Index</b>	1-10	<b>6.08</b>	# 54 of 125	
Democracy	1-10	6.65	# 49 of 125	➔
Market Economy	1-10	5.50	# 63 of 125	➔
<b>Management Index</b>	1-10	<b>5.57</b>	# 47 of 125	

scale: 1 (lowest) to 10 (highest)    score    rank    trend

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## Key Indicators

Population	mn.	5.1	HDI	0.70	GDP p.c.	\$	3,269
Pop. growth <sup>1</sup>	% p.a.	0.5	HDI rank of 177	112	Gini Index		43.1
Life expectancy	years	70	UN Education Index	0.75	Poverty <sup>3</sup>	%	79.9
Urban population	%	59.0	Gender equality <sup>2</sup>	-	Aid per capita	\$	134.9

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

## Executive Summary

Turbulent politics ruled the day in Nicaragua during 2005 and 2006. The pacto político, a power-sharing agreement between Sandinista leader Daniel Ortega and Liberal Constitutional Party (PLC) leader Arnoldo Alemán, sustained its strong influence on Nicaraguan politics. This influence led parliament to pass constitutional reforms curtailing executive powers at the turn of the year from 2004 to 2005. President Enrique Bolaños rejected the reforms as a violation of the separation of powers. This spiraled into a crisis that largely halted ordinary political activity until October 2005, when internal and external support for Bolaños facilitated a compromise to postpone the proposed reforms until January 2007. In the meantime, the Bolaños administration resumed pursuit of a sound reform strategy. The elections in November 2006 were mostly free and fair. A split between the conservative parties allowed Ortega to win the presidential elections with 38% of the vote after three previous unsuccessful campaigns. Political turbulence is likely to continue, because the Sandinista National Liberation Front (FSLN) does not control a majority in parliament. The establishment of two “new” promising parties before the elections in 2006 shows promise for Nicaragua’s political future however. These new parties mark a potential break with the clientelism and polarization that have trapped Nicaraguan politics in a deadlock between the dominant camps of Sandinistas and Liberals, and they may well better represent societal interests in the future. The approval of democracy by the Nicaraguan people increased in 2006, but satisfaction with democracy in Nicaragua was low. With regard to economic developments, poverty persists despite macroeconomic achievements. Economic growth was relatively high, inflation contained and budget deficits reduced, but the chronic current account deficit persisted. The Bolaños administration achieved some major reform goals, most notably debt relief through a number of different initiatives and the ratification of the Dominican Republic-Central American Free Trade Agreement (DR-CAFTA). It was the first administration since 1990 to successfully finish an IMF program.

## History and Characteristics of Transformation

Nicaragua declared its independence from Spanish rule in 1821. It finally achieved independence after the end of the Central American Federation in 1838, but this did not end foreign influence and domination. Spanish rule had only covered the Pacific side of the country; British occupation of the territories on the Caribbean coast would only end 56 years after Nicaragua's independence.

The predominant foreign influence for the past 150 years has been the United States. In order to counterbalance British influence, Nicaraguan officials turned to the United States in 1849 for protection from foreign intervention, in return for exclusive transit rights across Nicaragua. During the civil war between Liberals from the northern town of Leon and Conservatives from the town of Granada on Lake Nicaragua (1854 – 1855), the Liberals called on U.S.-American William Walker to bring troops to their aid. After the surrender of the Conservatives, William Walker assumed power and control of the Nicaraguan army and installed himself as Nicaraguan president. This led to the “National War (1856 – 1857),” in which Conservatives and Liberals, aided by Central American forces, jointly fought Walker and defeated him. The National War was a unique occurrence in Nicaraguan politics.

Evolving from civil war, cooperation in the war against Walker enabled Nicaraguans to overcome a symptomatic bipartisanship of the country's politics. U.S. influence remained strong even after the decision to dig a canal across the Central American isthmus was made in favor of Panama instead of Nicaragua. Tensions between Liberals and Conservatives tightened again, and various uprisings between 1909 and 1912 provoked U.S. military intervention in favor of Conservative candidates. Military presence lasted until 1933, but armed conflicts persisted. The considerable death toll inflicted on U.S. troops by the rebel forces of Augusto César Sandino induced the United States to withdraw.

Despite the withdrawal of its troops, the United States maintained a strong influence on Nicaraguan politics during the following four decades, during which it backed the autocratic governments under different members of the Somoza family. Gross human rights violations by the National Guard in response to mounting opposition within the country and guerrilla attacks by the Sandinista National Liberation Front (FSLN) disposed the Carter administration to end U.S. support for the Somoza kleptocracy. During the Nicaraguan Revolution, Anastasio Somoza Debayle waged a full-blown war against opposition forces. Having lost U.S. support and military aid as well as facing a severe economic crisis and a further strengthened FSLN, Somoza went into exile to Miami on 17 July 1979. Three days later, the multiparty exile government entered Managua, which marked the culmination of the Nicaraguan Revolution.

Approximately 50,000 Nicaraguans died during the insurrection. Within one year of the end of the revolution, the FSLN had consolidated its leadership of the new government, of the military and police force as well as of organized interest groups. Although most Nicaraguans were in favor of the revolution, the emerging dominance of Sandinistas provoked dissent. When Ronald Reagan took office in 1981, the situation worsened for the new government. The new U.S. administration suspended all aid to Nicaragua and instead funded counter-revolutionary Contras – former National Guard members in exile – to overthrow the government. Nicaragua became a stage for Cold War confrontation.

After the Nicaraguan Revolution, the new government faced a severe economic and social crisis. GDP had fallen by more than 30% between 1977 and 1979, inflation was rising sharply and the banking sector was bankrupt due to massive capital flight. In addition, 600,000 Nicaraguans were homeless and food supplies exhausted. Foreign debt had skyrocketed during the last years of Somoza's rule, equaling GDP by the time he left office, and debt services accounted for up to half of state revenues. The Sandinista regime nationalized the enormous wealth of the Somoza family and its associates as well as the domestic banks and foreign trade. From 1978 to 1980, the state's share in generating GDP rose from 15% to 41%. The Sandinistas introduced drastic economic measures and adjustment programs during an internally and externally induced economic crisis at the end of the 1980s, characterized in 1988 by hyperinflation of up to 10,000% and foreign debt that equaled 500% of GDP.

The Contras' raids eroded the social revolutionary Sandinista regime's acceptance of political pluralism. Civil liberties were confined and social spending reduced to benefit the military budget. Still, the Sandinista government held and won technically correct elections in 1984 that were considered for the most part free and fair by international election observers. As part of the Central American peace process initiated in 1987, the government accelerated political opening and sought a negotiated solution for the armed conflict with the Contras. The following elections of 1990 marked an important step in Nicaragua's history: the first peaceful and accepted transfer of power by free elections was achieved, and a civil government that had not earned its merits in armed conflict assumed office. Civil presidents have been governing ever since, legitimized through competitive elections in 1990, 1996, 2001 and 2006. Nonetheless, Nicaragua's society has not overcome the strong polarization predominant since the end of Sandinista rule. As candidate of the opposition coalition Unión Nacional Opositora (UNO), Violeta Barrios de Chamorro won the election against the incumbent Sandinista president Daniel Ortega. The difficult process of reintegrating the rebels, the delayed de-politicization of the armed and security forces and fierce conflicts with parliament marked Chamorro's term of office (1990 – 1997). Due to her policy of reconciliation toward the Sandinistas, she soon lost the support of a large part of her coalition, bringing about conflicts with parliament as well as considerable governance problems. The succeeding Alemán government (1997 – 2002) of the Liberal

Constitutional Party (PLC) on the other hand had a secure parliamentary majority. Alemán's autocratic-populist style of governance, rampant corruption and power-sharing arrangements with the Sandinistas however undermined the balance of power and impaired the functioning of state institutions. The Bolaños government (2002 – 2007) initiated an anti-corruption campaign against Alemán that resulted in a stalemate between the different state powers. This institutional logjam frustrated the Bolaños government's ability to govern. Although ultimately convicted of embezzlement, Alemán maintained his power base in parliament and made further power-sharing agreements with Sandinista party leader Ortega. As regards economic policy, the transfer of power in 1990 spelled the end of the "mixed economy" of the Sandinista era. The Chamorro government followed a rigorous program of stabilization and structural adjustment based on a strictly market-economic and export-oriented development model. It abolished the foreign trade monopoly and most price controls, opened up the banking sector and privatized some 350 state-owned businesses.

The succeeding governments remained faithful to this development model and, in collaboration with international lenders, continued to pursue transformation toward a market economy. However, corruption and nepotism during Alemán's term as president and parliament's partial paralysis during Chamorro's and Bolaños' presidential terms impeded transformation. Even today, almost three decades after the revolution, per capita income still has not reached the level of 1977. Nevertheless, the Human Development Index has been increasing steadily since the end of the Somoza dynasty.

## Transformation Status

### I. Democracy

#### 1 | Stateness

In principle, the state's monopoly on the use of force extends throughout the entire country. The incidence of violent crime compared to other Latin American countries is astonishingly low. Large scale armed conflict comparable to the conflicts between Reconpas and Recontras during the Chamorro administration (1990 – 1997) today is highly unlikely. However, smaller violent conflicts concerning land disputes in rural areas and social protests in urban areas flare up occasionally. In parts of the country, the state has little presence, and crime in urban areas is growing due to poor law enforcement. In the autonomous regions on the Atlantic Coast, the lacking presence of state authorities has allowed drug trafficking to increase severely.

Monopoly on the use of force

Defining citizenship and who qualifies as a citizen is not a politically relevant issue. All citizens formally have the same civic rights. The nation-state is widely accepted as legitimate. Only in the two autonomous regions along the Atlantic coast, a small but growing separatist movement has gathered strength due to their desperate socioeconomic situation and central government neglect.

State identity

Church and state are formally separate, although the church exerts great political influence. Under the Alemán government, church and state were in fact tightly interwoven, even with respect to finances. The Bolaños government distanced itself from the church and insisted on the secular nature of the state. While the Catholic Church is still a very strong interest group, its influence does not lead to a direct transfer of religious dogmas into law. Laws banning therapeutic abortions or criminalizing same sex relationships show the influence of the Church, although politicians ultimately made the decisions.

No interference of religious dogmas

State infrastructure and administrative institutions are present almost everywhere in the country. Partly due to social exclusions, some parts of the population do not have access to state institutions, which in addition are somewhat functionally deficient. In remote regions, peace commissions run by local citizens resolve disputes.

Basic administration

## 2 | Political Participation

The right to vote by general, direct, equal, secret and free ballot is constitutionally guaranteed. Democratic elections take place regularly on the national and regional level. Presidential and parliamentary elections were last held in November 2006, elections in the two autonomous regions in March 2006 and municipal elections in November 2004. Although the pacto político has given the Sandinista National Liberation Front (FSLN) the majority in the electoral council, campaigning and voting in the 2006 presidential and parliamentary elections were generally free and fair. Only during the last days of the vote count for the parliamentary elections did some observers note serious irregularities. They claimed that an unproportionally large number of seats were awarded to the Liberal Constitutional Party (PLC), enough to end the elections as runner-up and to outnumber the Alianza Liberal Nicaragüense (ALN-PC). Observers ascribed this to an offer by the FSLN to prolong the pacto político. Yet the PLC also challenged the vote summation in the Atlantic Autonomous Region, based on the claim that it had been deprived of one seat. A national observer organization that had collected all tally sheets verified this claim, but the national electoral council awarded the seat to the FSLN.

Free and fair elections

In principle, the power to govern is vested in the elected representatives, but serious conflicts between state institutions continually pushed the country to the verge of ungovernability during the observation period. These conflicts can usually be traced back to elite agreements based on self-interest that diminish the influence of elections on political outcomes. Consequently, voter turnout has seriously decreased. In the national elections of 2006, 70% of the electorate used its right to vote, as compared to 90% in 2001. After the extensive de-politicization of the armed and security forces in the 1990s, extra-constitutional veto powers no longer exist within the country. Considering Nicaragua's dependence on ODA, the veto power held by international financial institutions, donors and especially the U.S. administration cannot be ignored.

Effective power to govern

There is unrestricted freedom of association and of assembly de jure. However, de facto economic constraints inhibit the freedom of association and of assembly. All public and private sector workers except the military and the police are entitled to form and join unions of their own choosing. Half of Nicaragua's workforce, including agricultural workers, is unionized.

Association / assembly rights

Freedom of speech and of the press are guaranteed by the constitution and vigorously exercised. A law passed in 2001 that would require journalists to register with a national body is under appeal at the Nicaraguan Supreme Court. Other restrictions include the classification of libel as a criminal offence, laws requiring journalists to reveal their sources under special circumstances and a

Freedom of expression

constitutional provision stipulating that freedom of information applies only to “truthful” information. In spite of these potentially harmful legal provisions, debate in the Nicaraguan press and public is vibrant and the legal possibilities to restrict freedom of speech are not used. President Bolaños put an end to the practice of using public advertising to punish and reward the media. Bolaños introduced a new system based on market shares to distribute public advertising funds, which has caused smaller media outlets to close. Repression of journalists is rare. Still, journalists investigating alleged links between drug traffickers and police officials on the Atlantic coast have been harassed. The murder of journalist María José Bravo by the outgoing mayor of El Ayote, Eugenio Hernández, during the regional elections in 2004 was the first political murder of a journalist in Nicaragua for years. Hernández was sentenced to 25 years in prison for premeditated murder. Nicaragua has 11 private television stations, two daily newspapers and 187 radio stations. The Sandinistas transferred radio and television stations to their supporters before handing over power in 1990. Therefore, radio and television coverage generally favors the Sandinistas. Newspapers are to a large extent in the hands of the Chamorro family. Access to media reveals the extent of social exclusion due to poverty. 80% of households own a radio, 60% a television and 20% a fixed telephone line. More than 750,000 people own a cellular phone and about 20,000 people have an Internet subscription.

### 3 | Rule of Law

State power is subject to the law. Besides the executive, legislative, and judicial branches, there is an institution responsible for organizing and holding elections (the Supreme Electoral Council). There is a formal balance of power, but this balance is compromised by the blatant politicization of state institutions. Due to the weak judiciary, checks and balances are mainly performed through the executive and legislative branches of government. When state powers are in conflict, they block one another to a dangerous extent, sometimes exceeding their authority. During such conflicts, the challenged governmental branch actively seeks the balance of power. When parliament revised the pacto político of 2000 by passing constitutional reforms in late 2004 and early 2005 that would curtail executive powers, President Bolaños rejected the reforms as a violation of the separation of powers thus precipitating a serious political crisis. The crisis lasted until October 2005, when internal and external support for Bolaños facilitated a compromise to postpone the proposed reforms until January 2007 when the newly sworn-in president Ortega postponed them for yet another year and introduced bills to strengthen executive power.

Separation of powers

The judicial branch is institutionally differentiated, formally independent and

Independent judiciary

constitutionally guaranteed 4% of state expenditure. However, it is subject to strong political influence and corruption, does not adequately cover the entire country and demonstrates considerable functional deficiencies. The training of judges is inadequate and the reforms of the Bolaños government aimed at a more professional and independent judiciary were protracted by parliament. The political influence of the pacto político worsened the already low performance of the judiciary system during the evaluation period. It has lost its credibility with the population.

Corruption is a fundamental problem in the country's political culture. For a long time, it merely attracted negative publicity but went unpunished. In the course of president Bolaños' anti-corruption campaign however, former president Alemán was prosecuted and sentenced for corruption (20 years in prison). Still, Bolaños' fight against corruption experienced a serious backlash when he admitted to having negotiated special treatment for Alemán and refrained from charging other officials of the Alemán administration in exchange for parliamentary support from the PLC. The PLC continues to accept Alemán's leadership despite of his conviction and the different attempts made by Bolaños, Montealegre and, most recently, Rizo (following the 2006 elections) to challenge his standing. Not even under Ortega have the Sandinistas distanced themselves from Alemán. They instead continued to side with him against the government, which serves their mutual favor. The Sandinistas exerted their influence over the Supreme Court to allow Alemán to serve his sentence at his home, although they did not sacrifice all leverage over him by suspending his sentence. This example reveals the extent to which politics – rather than the rule of law – determines the prosecution of corrupt officeholders.

Prosecution of  
office abuse

Civil freedoms and human rights are granted and are largely respected. However, the weakness of the judiciary impedes the state's ability to respond to violations of those rights. For example, threats against and harassment of human rights defenders as well as excessive use of force by public security forces are a problem but only a small number of cases are reported. Abuses have been investigated in the past and some of the offenders were punished, but a certain degree of impunity persists. Violence against women and children, including domestic violence, rape and sexual exploitation are prevalent. The constitution provides for freedom of religion, and the government's policy and practice generally respect these rights in full. The constitution also prohibits discrimination. Still, discrimination against indigenous people occurs, and salary discrimination against women is recurrent. Women earn less than half of men's salaries. Long distances and a lack of financial means hamper access to justice, especially for those living in rural areas. Local peace commissions and programs to train laypersons to become rural judicial facilitators have proven successful in spreading access to disadvantaged communities.

Civil rights

#### 4 | Stability of Democratic Institutions

Democratic institutions are stable and essentially fulfill their functions. Yet they are not particularly effective and institutional rivalries result in heavy efficiency losses. Political power struggles are perpetuated at the institutional level and regularly lead to political crises and stalemates. In 2002, parliament's work was brought to a standstill during the struggle surrounding the revocation of Alemán's immunity. In 2005, the cooperation of the Sandinistas and the PLC against the government escalated to the point that president Bolaños was at the brink of declaring the state of emergency. The politicization of the Comptroller General and the Supreme Electoral Council by the pacto político has undermined the two institutions' legitimacy. Yet, the mostly free and fair organization of the elections in 2006 positively surprised many observers. The judiciary performs worst of all democratic institutions.

Performance of democratic institutions

All relevant actors accept democratic institutions. The support for these institutions is however strongly linked to political power interests and is therefore unstable. The sudden change of Ortega's position from strengthening the legislature to strengthening the executive after his election as president is a very good example of this behavior. It is actors from within the political sphere – and not from the outside – that damage democratic institutions.

Commitment to democratic institutions

#### 5 | Political and Social Integration

The landscape of political parties is highly polarized and used to show characteristics of a two-party system. The party system fragmentation is moderate with an effective number of parties of 3.13. Political parties are very much based on personalities. Yet, the two decisive political camps until the elections 2006, the Liberals and the Sandinistas, also have steady social bases and programmatic platforms. These social bases are maintained partly by clientelistic structures and the partisan infiltration of associations and interest groups, which leads to low voter volatility. This was apparent in the 2006 elections, when two thirds of Nicaraguans voted for the FSLN and PLC, even though the sustained pacto político compromised the differing basic programmatic goals of both parties. While it would seem that the pacto político overcame Nicaragua's strong political polarization, the parties' leaders acted not for societal interests but solely for their own personal gain. The elections in 2006 brought about a very positive development. Herty Lewites, the former FSLN mayor of Managua, demanded primaries within the party to decide on the presidential candidate for the elections. As a consequence, he and his followers were expelled from the FSLN and joined the Movimiento de Renovación Sandinista (MRS). Lewites and the MRS clearly led the polls in the run-up to the elections, but Lewites died of a

Party system

heart attack in July 2006 and his successor, Edmundo Jarquín, could not uphold the momentum. Within the PLC, Alemán was also challenged. Like Herty Lewites, former PLC minister Eduardo Montealegre demanded a primary election to choose the party's next presidential candidate. He also failed and Alemán installed a loyal candidate, José Rizo. In the aftermath, Montealegre formed the Alianza Liberal Nicaragüense (ALN-PC) of his followers from the PLC, the Partido de la Resistencia Nicaragüense (PRN) and the Partido Conservador (PC). Until these events, the only way in which Nicaraguans could express their frustration about politicians' self-interested actions and political stalemate was by abstaining from voting. The foundation of the MRS and the ALN-PC introduced a possibility to break with clientelism and the polarization between both influential political camps. This could allow the party system to aggregate and articulate societal interests better in future. They show willingness to reform and can be characterized as center-left (MRS) and center-right parties. However, both parties still lack clear programmatic and social bases and depend on personalities. Certainly, the future of the MRS is more endangered after the death of Lewites, but the PRN also still has to establish itself in the long-term. If the pacto político remains intact during the Ortega presidency, this will require a very well-designed strategy and professional management of the party. Personal power ambitions and inner party conflicts occasionally lead to party splits that can affect parliamentary majorities. This happened in 2002, when the liberal party split between followers of Bolaños and followers of Alemán, and earlier during the administration of Violeta Barrios de Chamorro, when the UNO alliance of parties fell apart.

Interest groups are able to organize themselves and have played an important role in the country's history, but they are to some extent under the influence of partisan actors. Socioeconomic bottlenecks and the greater influence of partisan organizations limit the balancing of social interests. The NGO sector has become an important economic sector that receives strong financial support from external actors. While most of these organizations are active in the fields of self-help, there are also some very qualified lobbying groups. These do not only include subsidiaries of international NGOs, but also local groups that are skilled in advocacy and have specialist think tanks to call on for research. Yet overall the intermediation between society and the political system needs serious improvement, and the general mistrust between civil society, the government and political parties must be overcome.

Approval of the democratic form of government increased during the evaluation period. While in 1998 72% of respondents to Latinobarómetro polls indicated that democracy is preferable to all other forms of government, the approval rating had declined to 39% by 2004, then increased again to 56% in 2006. But satisfaction with democracy as practiced in Nicaragua was low, at 26%. If the described

Interest groups

Consent to  
democratic  
norms

problems of the political system and the self-serving attitude of politicians are considered, this is only worrisome because these problems are endemic to Nicaraguan politics. Only 15% of Nicaraguans said that the country is governed for the good of all. The data proves however that the low approval rating is not endemic. When Bolaños took office and launched his anti-corruption campaign, approval ratings soared from 43% in 2001 to 63% in 2002.

Self-organization among the population encounters socioeconomic barriers and is therefore generally weak. Self-help organizations are active to combat the most pressing social ills, like the prevalence of street children and drug abuse, but the lack of funds prevents major successes. The trust among the population generally is low. Wounds inflicted during the Somoza dictatorship and the Contra war have yet to heal.

Associational  
activities

## II. Market Economy

### 6 | Level of Socioeconomic Development

The country's development status is low. Nicaragua is the second poorest country in Latin America. Social exclusion through poverty and social hardship is quantitatively and qualitatively very pronounced and structurally entrenched. Since 1993, the population living on \$1 per day or less has decreased slightly from 50% to 46%, but has not improved further during the last five years despite a sound macroeconomic performance. The incidence of poverty is distributed unequally: 29% of the population in urban areas and 68% of the population in rural areas. The level of absolute poverty has decreased from 19% to 15% and has also remained unchanged for the last five years. In the rural areas, 27% of the population lives in absolute poverty. Considering population growth, the stagnation of poverty indicators implies an increase in absolute numbers. While the official unemployment figure was below 6% in 2006, underemployment is estimated at around 45%. The income Gini Index is at 43.1 (2001) and indicates social inequality. Nicaragua's Human Development Index value was 0.698 in 2004, placing Nicaragua at the rank of 112th of 177 countries. The Gender-related Development Index (GDI) showed a slightly worse score, with a value of 0.684 (rank: 88th).

Socioeconomic  
barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	4,026	4,102	4,498	<b>4,911</b>
Growth of GDP	%	0.8	2.5	5.1	<b>4.0</b>
Inflation (CPI)	%	4	5.1	8.4	<b>9.4</b>
Unemployment	%	12.2	7.8	-	-
Foreign direct investment	% of GDP	5.1	4.9	5.6	<b>4.9</b>
Export growth	%	-3.5	9.2	16.1	<b>5.3</b>
Import growth	%	-0.1	3.5	8.2	<b>6.2</b>
Current account balance	\$ mn.	-698.6	-651.1	-695.6	<b>-799.8</b>
Public debt	\$ mn.	5,573.2	5,893.5	4,125.1	<b>4,113.2</b>
External debt	\$ mn.	6,482.6	6,910.8	5,145.2	<b>5,143.6</b>
External debt service	% of GNI	4	4.8	2.9	<b>3.6</b>
Cash surplus or deficit	% of GDP	-1.7	-1.9	-1.1	<b>-0.7</b>
Tax Revenue	% of GDP	13.5	15.2	15.7	<b>16.6</b>
Government consumption	% of GDP	10.7	11.4	11.2	<b>11.1</b>
Public expnd. on edu.	% of GDP	3.1	3.1	-	-
Public expnd. on health	% of GDP	3.9	3.7	3.9	-
R&D expenditure	% of GDP	0.1	-	-	-
Military expenditure	% of GDP	0.9	0.9	0.7	<b>0.7</b>

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

## 7 | Organization of the Market and Competition

Since the 1990s, the governments have been pursuing a strict market economic and export-oriented development model, based on the private economy and oriented toward the principles of free market competition. However, the rules of the game are not always followed. Apart from the possibility of presidential decrees that can suddenly change those rules, the greatest threats to a market economy are the aforementioned problems of corruption and a weak legal system. Besides utilities like energy and water, the state controls the prices of only very

Market-based  
competition

few products. The minimum wage differs for the different sectors of the economy and is lowest in agriculture at \$42 a month. According to the central bank, the informal sector accounts for almost two-thirds of jobs. Profits can be used and transferred freely. There is no limitation on currency convertibility. Foreign and domestic investments are treated equally. Yet, in a cluster approach to development, the Bolaños administration favored some sectors, like the tourism and maquila industry, by offering tax exemptions on profits, building materials and property. The Doing Business Report of the World Bank ranks Nicaragua 67th out of 175 countries. FDI inflows are concentrated on maquila operations and tourism projects. FDI inflows made up 5.5% of GDP in 2006 and cemented the trust of international investors.

In September 2006, parliament finally approved the competition promotion law with bipartisan support that had been discussed since the 1990s. The law comes into effect in May 2007 as a result of negotiations between the private sector, the Bolaños administration and parliament. It prohibits anti-competitive practices and installs a national institute for competition promotion to enforce the law. Government and private sector delegates head the institute. Especially small- and medium-sized enterprises should benefit in the future.

Anti-monopoly  
policy

Foreign trade has been liberalized since 1990. Trade openness measured by the ratio of imports and exports compared to GDP is high, at 87% in 2006. Nicaragua has abolished all WTO-inconsistent non-tariff barriers and does not have import prohibitions on commercial grounds. Nicaragua does not subsidize exports directly, or provide export financing. The MFN rate (most favorable nation rate) declined sharply during the 1990s and is now at around 4%. Nicaragua is also a member of different regional and bilateral trade agreements. It is very well integrated in Central America and has strong trade ties with the United States. Integration will further improve due to Nicaragua's membership of the Dominican Republic-Central American Free-Trade Agreement (DR-CAFTA) that Nicaragua signed in December 2003 and which came into effect in April 2006.

Liberalization of  
foreign trade

Nicaragua's banking sector is underdeveloped and the smallest in Latin America. The banking sector expanded during the 1990s with the founding of 14 new private banks. State banks were closed or privatized between 1994 and 2000. In 2001, the last state-owned bank, Banco Nicaragüense de Industria y Comercio, was closed due to severe losses. Many households were left without access to credit from the formal banking sector since the closing of the state-owned national development bank BANADES in 1998. The private banking sector is hardly present in rural areas. Microfinance institutions have partially filled this gap. Today, the banking sector consists of seven banks and two finance companies. Foreign ownership of banks has increased in 2005 and 2006 through investments of Citigroup, HSBC and General Electric. The state monopoly on insurance was abolished in 1997. Four private insurance companies have

Banking system

developed besides the state owned insurer INISER. On Nicaragua's stock exchange, Bolsanic, mainly government-issued bonds are traded. In June 2006, 84% of credits and 68% of deposits were dollarized. Total assets of the banking sector rose by 20% in 2006, totaling more than 3 billion USD. Credit expanded by 34% to above 32% of GDP. Household credits made up 30% and commercial credits 27% of total credits outstanding. Despite the expansion, intermediation is still very weak and hinders economic development. The high exposure of banks to the public sector is also worrisome, with 82% of investments made in public debt papers. The capital adequacy ratio increased by one percentage point to 14.8%, well above the 10% mandated by Nicaragua's banking supervision. The aggregated net profits of the sector increased by 14% to \$60 million during the review period. The average return on assets was 1.9% and on equity 20%. The percentage of non-performing loans was very low at 2.1%, but strong credit growth might raise the risk. After the closing of state banks and the bankruptcy of two smaller private banks at the end of the 1990s, a severe banking crisis was triggered in July 2000 when Interbank, the major bank at the time with a market share of 15%, went bankrupt. Within the next twelve months, three more private banks followed. The central bank lent its support by intervening to protect bank deposits. The requirements for banking operations had already become stricter when the National Assembly approved a series of laws to meet the principles of the Basel Accords in 1999. Since the crisis, the banking system has been regulated even more strictly in close cooperation with the IMF. Independent supervision of the banking sector was further strengthened and its scope of operations enlarged during the review period. The minimum capital needed to found a private bank was increased to \$10 million and the practice of lending to related companies confined by limiting loans to a single borrower to 15% of a bank's capital. In 2000, a law was passed providing deposit insurance up to \$20,000. Nicaragua also ratified its commitments to the 1997 WTO Financial Services Agreement, covering most banking services.

## 8 | Currency and Price Stability

In Nicaragua, the central bank is not an autonomous institution, but still pursues a largely consistent inflation and exchange rate policy despite political fluctuations. Since 1998, the inflation rate declined from 18.5% to 4% in 2002 mainly due to fiscal and monetary discipline. Inflation increased again to about 9.5% in 2005 and stabilized at 9.1% in 2006. This was mainly due to higher energy prices on the supply side and higher wages as well as credit growth on the demand side. The Nicaraguan currency (córdoba) has been devalued annually by a crawling peg mechanism since 1993. The crawling peg stood at an annual rate of 12% until 1999. In November 1999, it was adjusted to 6%, and since January 2004, it stands at 5%. The sustainability of the peg and its continuous decline prove the success

Anti-inflation /  
forex policy

of Nicaragua's exchange-driven monetary policy, creating greater stability of currency and prices as well as greater certainty for economic actors. Since 2004, the Córdoba has remained stable against the U.S. dollar in real terms, which provides a favorable environment for exports. It is expected that a new PRGF with the IMF will include a framework to gradually shift to a floating system. The central bank also was successful in building up foreign reserves. Excessive public spending and the banking crisis caused foreign reserves to drop below \$400 million in 2001. Since then, they more than doubled to \$870 million and covered three months of imports in August 2006. However, owing to the weakness of the current account, Nicaragua's gross foreign reserves remain dependent on foreign assistance.

Pushed by international lenders and their own commitments, Nicaraguan governments have been pursuing a policy of continuous stability since the 1990s. The Bolaños administration pursued a very well-designed fiscal and debt policy to support macroeconomic stability. The continuous improvements are shown by the fiscal deficit before grants that decreased from 9% in the period of 1999 to 2001 to 5.6% in the period of 2002 to 2006. After grants, the budget deficit has remained below 2% since 2002. Debt relief in recent years through the HIPC initiative, the Multilateral Debt Relief Initiative (MDRI) and bilateral schemes considerably reduced Nicaragua's external debts. While external debt stood at 170% of GDP in 2003, it was estimated at 70% at the end of 2006. When internal debt is also considered, total public debt was estimated at 80% of GDP. On the one hand, internal debt that is contracted on commercial terms must be restructured. On the other, the debt service ratio for external debt of 5.0 is sustainable and will decrease further thanks to export growth and the coming into effect of further debt relief.

Macrostability

## 9 | Private Property

In principle, property rights are well-defined. However, poorly enforced property rights and property disputes remain one of the most serious barriers to economic development in Nicaragua. The Sandinista regime expropriated and collectivized many properties, residences and companies. Subsequently, these were redistributed to agrarian collectives, and, during the piñata before power was handed over in 1990, they were also given to Sandinista leaders and top government officials. Because most of these transfers were carried out without due legal process or documentation to insure the new owners' legal claim, there have been severe conflicts with former owners who have since tried to reclaim their properties. Farmers suffer the most from this legal uncertainty.

Property rights

Since 1990, Nicaragua has privatized a significant number of its public utilities and disposed of more than 350 government-owned enterprises. Yet, envisaged privatizations of the Bolaños administration mostly came to a halt during the

Private  
enterprise

evaluation period due to opposition in parliament. The last large-scale privatization took place in December 2003, when the government sold its remaining 49% of the national telecommunications company Enitel. The Bolaños administration failed to implement other plans to strengthen private sector participation like the introduction of private pension funds or concessions for operating parts of the national water company. Although privatization did not progress further during the evaluation period, private companies already are the backbone of the economy and the appropriate legal framework is established.

## 10 | Welfare Regime

Nicaragua faces severe social problems. The small number of workers employed in the formal sector limits participation in official social security schemes with determined entitlements for old age, disability and health. Only 16% of the economically active population is insured by the official system. Large segments of the impoverished population, especially in rural areas, are beyond the reach of the country's social safety net. Systematic efforts to reduce poverty have been planned and implemented since 2001 within the framework of the Poverty Reduction Strategy Papers (PRSP). These social protection schemes range from food assistance, social infrastructure and programs for special target groups to rural development. With a budget of about \$50 million, the outreach of these programs remains limited. Overall, the government spends about \$700 million, or half of its budget, on the social and education sector. Therefore, poverty-related spending has increased from 10.2% in 2002 to 13.6% in 2006. Bear in mind however that most of the additional funds were used to finance higher wages. In April 2000, a law was passed to change the pension scheme from a pay-as-you-go system to an individually funded system. However, due to uncertainties regarding the transition costs, implementation was postponed and in November 2005 parliament repealed the law.

Social safety nets

The society is socially heterogeneous. There is a vast social gulf between the many poor and the few rich, and there is a clear divide between urban and rural areas. The two formally autonomous Atlantic regions are culturally very different from the rest of Nicaragua, as well as economically disadvantaged and neglected by the state. These regions' minority communities, both of African and indigenous descent, face extreme poverty as well as administrative and political discrimination. Public services cannot redress the existing imbalances to create equality of opportunity. The increase of poverty-related spending during the last five years did not show positive effects, since poverty levels only stagnated. Availability of social services even deteriorated in some areas, such as education and reproductive health. Women's literacy and school enrollment rates are as high as those of men, but on average women earn less than half as much as men.

Equal opportunity

## 11 | Economic Performance

The Nicaraguan economy is weak in spite of successful macroeconomic recovery since the 1990s. Per capita GDP still has not reached the levels seen before the Nicaraguan Revolution. The economy is extremely vulnerable given the weak fiscal situation, the large current account deficit, the Nicaragua's dependency on a small number of export products and the location's vulnerability to natural disasters like hurricanes and volcanic activity. In addition, Nicaragua is highly dependent on foreign aid. Other problems include high underemployment, low per capita GDP and productivity growth, as well as a large public debt. The trade deficit is the main reason for the large and chronic deficit of the current account balance. Nicaragua's economy lacks a sizable industrial base and therefore has to import many goods from abroad. Nicaragua's export base is narrow and depends on commodities. Coffee is Nicaragua's most important export good and accounted for 21% of exports in 2006. The terms of trade are continually worsening. With 1990 as the base year with a value of 100, they dropped to 46 in 2006. Foreign reserves cover three months of imports. Overall, Nicaragua is very vulnerable to external shocks. Economic growth is relatively high however, and inflation is contained. Remittances from Nicaraguans living abroad totaled \$600 million in 2005 and helped finance the current account deficit. FDI inflows that accounted for 5.5% of GDP in 2006 and foreign aid also stabilize the economy.

Output strength

## 12 | Sustainability

Environmental consciousness is underdeveloped in Nicaragua and subordinate to the push for growth. The 2005 Environmental Sustainability Index ranks Nicaragua 66th of 146 nations. Its main problems are degradation, pollution and erosion of land, overfishing and uncontrolled logging. From 1990 to 2000, the forest area was reduced from 37% to 27%. Economic growth in Nicaragua usually stems from expanding the use of resources and not from productivity gains, especially in agriculture. Therefore, Nicaragua's environmental sustainability will be at stake if the economy continues to grow without the necessary adjustments for sustainability. The country has an institutional and legal framework to address environmental matters, and has signed all relevant international treaties. However, the lack of financial resources and the social patterns of skills and attitudes are serious obstacles to an effective response to environmental challenges. Nicaragua has however collaborated internationally on environmental matters.

Environmental policy

Education is a constitutional right. In 1950, two-thirds of adult Nicaraguans had not even completed one school year. In 2005, this figure had dropped to 20%. Still, human capital is very low. State and private educational institutions exist in

Education policy / R&D

all segments from preschool to higher education, but their quality varies greatly. The non-university public expenditures amount to 3% of GDP or 11% of state expenditure. Although the ministry of education calculated that an increase to at least 4.7% of GDP is needed to reach the respective Millennium Development Goals, an agreement with the IMF prohibits any increases above this level. Universities are entitled to an additional 6% share of public expenditure under the constitution and, therefore, currently receive about 1.6% of GDP. Expenditure for research and development is below 0.2% of GDP. Primary education is the main focus of educational expenditures. However, if per student expenditures are considered, the focus of spending is not directed at Nicaragua's most pressing needs, especially if more equity is sought. While in 2003 \$100 was spent on each student in primary school and \$70 in secondary school, \$930 was spent on each university student. Enrollment rates for primary school increased steadily to 85.5% in 2002 but have since declined to 80% in 2005. The net enrollment ratio for secondary school is about 40%. This leaves more than 800,000 children – usually come from a poor background – outside the school system. The completion rate for primary school (6th grade) is 69%, and 34% for secondary school. One reason for the low completion rate is the high incidence of dropouts due to economic reasons; another is the poor teaching conditions. The pupil to teacher ratio is 36 for primary school and 45 for secondary school. Teachers in Nicaragua are often poorly qualified and despite wage increases in the last years only paid half of the average income of Nicaraguan workers, or the lowest teacher salary in Latin America. Student achievement was evaluated for the first time in 2002. In third grade, only 30% of students had reached a minimum acceptable level of Spanish and less than 14% had done so in mathematics. These figures did not increase for students in sixth grade.

## Transformation Management

### I. Level of Difficulty

The level of difficulty at the beginning of the evaluation period in 2005 had improved compared to 2003 due to better macroeconomic conditions and lower debt burdens. However, structural constraints to governance were still high. Per capita income was low, the budget depended on donor contributions to a significant degree, external debts were still high and internal debts rising, the vulnerability to natural disasters and world economic influences was high, the quality of transport infrastructure poor, and serious social problems such as widespread poverty and underemployment persisted. The educational level of the population, however, as measured against the U.N. Education Index, was in the middle range. The rate of adults with HIV and AIDS was still very low but increasing.

Structural  
constraints

During the Sandinista period, social mobilization had reached a high level that decreased to a certain extent over the course of the 1990s. Civic and public engagement was moderate at the beginning of the evaluation period. However, social trust and trust in institutions were both low.

Civil society  
traditions

With the exception of regionally concentrated minorities along the Atlantic coast, Nicaragua is an ethnically homogeneous society of predominantly Spanish-speaking mestizos. The line of ethnic conflict, therefore, had significance only in the Atlantic region during the period under review. The prevailing lines of conflict are politically and socially defined. Extreme political polarization and socioeconomic disparities did lead to open political and social conflicts, but resorting to violence had already become uncommon prior to the evaluation period.

Conflict intensity

## II. Management Performance

### 14 | Steering Capability

In consultation with the international donor community and to some extent with civil society, the Bolaños administration pursued the following goals: establishing macroeconomic stability, reducing poverty, establishing the rule of law, de-politicizing the administration, fighting corruption, increasing the efficiency of public expenditures through structural reforms, fostering regional economic integration and promoting foreign and domestic private investment. The government's medium and long-term strategy and action plans were mainly consistent and its policy priorities reasonable, but plans were sometimes over-optimistic with respect to the capabilities and resources available and the prospects for success within the anticipated timeframe. The government also postponed some reforms in order to seek consensus with the opposition in parliament. Within the political leadership, a split is apparent, with some members of the political elite setting priorities to further their own personal gain and others to further the goals of democracy and a market economy. Which group wins the upper hand will be decisive for future development.

Prioritization

The Bolaños administration achieved some major reform goals, most noticeably debt relief under different initiatives and the ratification of DR-CAFTA. It was also the first administration since 1990 to successfully finish an IMF program. The precarious situation in parliament and the cooperation between Ortega and Alemán did not allow other reforms aimed at furthering democracy and a market economy to come into effect. A particular example is the reform aimed at a more independent and professional judiciary that was blocked by parliament.

Implementation

The political leadership showed willingness and ability to learn. The administration usually proved flexible enough to make corrections and improvements in its economic, social and political programs. Yet, policies and planning still do not sufficiently heed the country's vulnerability to natural catastrophes and world economic influences, and also lack social cohesion. Despite the further increases of political instability and obstruction in parliament, the Bolaños administration showed great flexibility to implement the maximum of its envisaged reforms possible under the given circumstances.

Policy learning

## 15 | Resource Efficiency

In terms of generating revenues, the government was successful in attracting aid and debt relief from outside, and implemented a new tax code that provides more efficiency as well as equity and higher revenues. In terms of expenditure, budgetary discipline continued to improve during the evaluation period. In 2005, the government introduced a law on the tax authority and budgetary system that establishes external auditing and the consolidation of the entire public sector. Institutions are installed to monitor expenditure execution, reporting and auditing but must be improved. The government has not yet implemented a medium-term expenditure framework. The quality of public service and of the bureaucracy, the competence of civil servants and the independence of the civil service from political pressures were low during the evaluation period. This resulted in a percentile score of 24.9 in the World Bank's governance indicator on Government Effectiveness in 2005. The civil service law from 2003 establishes compensation, career and employment policies based on merit that have yet to be implemented consistently. The law on municipal transfer initiated a decentralization process in 2004. It establishes that 4% of central government tax revenues have to be channeled to municipalities. The share is supposed to reach 10% by 2010. While decentralization will show some positive effects on governance by empowering municipalities and fostering local participation, the law also has inadequacies: it does not transfer expenditure responsibilities along with the funds, and it also lacks proper auditing provisions.

Efficient use of assets

For the most part, the government coordinated conflicting objectives in a very simplistic manner. Economic growth was the clear priority. Therefore, policies mainly were intended to increase economic growth, while other areas like environmental sustainability received little attention. Yet the government also learned from past shortcomings: for example, since economic growth did not reduce poverty as expected, the government increased its poverty-related spending. Still, the policy priority of economic growth dominated, and donor funds were used most often for increased social expenditures that would not have been available for other purposes.

Policy coordination

Corruption is an acute and endemic problem in Nicaragua and its political culture. The legal, political and administrative accounting structures may enable transparency and integrity of the public administration and punish criminal conduct, but enforcement is lagging in most instances.

Anti-corruption policy

## 16 | Consensus-Building

All important political actors basically agree on the goals of a market economy and democracy. The parties still differ regarding their policies concerning redistribution of wealth and the emphasis on social aspects. Characteristically, foreign investors and local businesses reacted very cautiously to the electoral victory of Ortega in 2006. Ortega immediately tried to reassure investors of his economic policy. Internationally, he stressed the importance of good relations with the United States and the multilateral institutions as well as DR-CAFTA, despite his plans to deepen foreign relations with Venezuela. Influential political leaders, while claiming their support for democracy and a market economy, attempt to design these institutions to pursue their own economic interests and personal ambitions for power in a manner that is extremely detrimental to the functional capabilities of political institutions and to the welfare of the population. The constitutional amendment proposed by parliament curtailing executive powers provided a vivid example: the proposal triggered a serious political crisis that lasted for nearly the whole year of 2005. In the end, a compromise was reached to postpone the reforms until January 2007. However, after winning the elections in 2006, Ortega immediately proposed reforms strengthening the executive and allowing for the re-election of the president.

Consensus on goals

Anti-democratic veto powers had been appeased before the evaluation period. The danger rather rests with political actors who, within the democratic framework, undermine Nicaragua's democracy to further their personal aims.

Anti-democratic veto actors

The political leadership, despite pacts made behind closed doors, displays strong polarization along political and social cleavages. The low level of social cohesion due to socio-economic differences can only be reduced over the long term. The political divide created during the Sandinista regime and the injustices of the Contra war also have yet to be addressed sufficiently. Yet, politicians also prevent these cleavage-based conflicts from escalating, and sometimes use patriotic rhetoric to achieve greater unity and to foster a spirit of solidarity among citizens. Without actions to fortify these appeals, they remain largely unsuccessful. The actual risk of large-scale violent conflict is small, however.

Cleavage / conflict management

The government promoted the participation of civil society, but the record remained contradictory concerning the influence of participation. It also has to be heeded that many organizations are not independent actors but rather partisan organizations. Since 1999, an advisory body made up of different interest groups and organizations (CONPES) advises the president on economic and social programs. The Bolaños administration involved civil society in the political debate and the formulation of policies. However, after the political crisis during 2005, the participation of civil society decreased and was limited mostly to organizations that backed the reform program of the government.

Civil society participation

Political leaders have little incentive to redress historical injustices of the Sandinista era seriously, because they provide a comfortable base to mobilize the population for their respective causes. Therefore, reconciliation remains an exercise in rhetoric.

Reconciliation

## 17 | International Cooperation

Nicaragua is extremely dependent upon support from abroad. Efforts to attract international assistance and to reduce the external debt have been central foreign policy themes since the beginning of the 1990s. The Bolaños administration integrated international assistance well into domestic reform programs. It used its international acumen to enhance its reforms in many areas but also adapted external advice to domestic realities, coming up with innovations such as the introduction of sector round tables and sector-wide approaches. Foreign assistance historically has been inefficient and ineffective, due to a high degree of earmarking, the isolation of projects and a supply-driven character.

Effective use of support

The international donor community regarded the Bolaños administration as credible and reliable. Therefore, it introduced budget support in 2004 and doubled funds channeled through this instrument in 2005, totaling \$110 million. Other states also trusted the Bolaños administration. For the upcoming trade negotiations with the European Union, four Central American countries (excluding Costa Rica) have nominated the outgoing Nicaraguan minister of foreign affairs, Norman Caldera, as their negotiator. FDI inflows of \$290 million or 5.5% of GDP in 2006 also confirmed trust of international investors. However, negative commercial risk ratings illustrate the problems and risks of Nicaragua's economic and political development.

Credibility

The government actively sought to develop and consolidate cooperative international relationships. Nicaragua is a member of all important international bodies. Nicaragua also actively furthers Central American integration. The Bolaños administration's most important project of regional integration was the DR-CAFTA. Nicaragua has brought two territorial disputes before the International Court of Justice (ICJ) in The Hague that have not yet been decided. In December 1999, Nicaragua initiated proceedings against Honduras and, in December 2001, against Colombia over maritime delimitation. Hearings on both cases commence during 2007. Relations with neighboring Costa Rica were difficult during most of the evaluation period. In September 2005, Costa Rica took the issue of navigation rights on the San Juan River to the ICJ and passed a law to control inflows of migrant workers from Nicaragua. When the new Costa Rican president Óscar Arias took office in May 2006, relations improved again. On the Atlantic coast, drug trafficking and arms-for-drugs dealings increased. Nicaraguan police and naval guards have not yet been able to control the situation.

Regional cooperation

## Strategic Outlook

In January 2007, after three unsuccessful campaigns, Daniel Ortega resumed power as president. The split of the conservative parties allowed Ortega to win with only 38% of the vote. Political turbulence will continue under Ortega, because the Sandinista National Liberation Front (FSLN) does not control a majority in parliament; it will have to cooperate with the Liberal Constitutional Party (PLC) or the Nicaraguan Liberal Alliance (ALN). Most likely the pacto político will be renewed, but there is also the possibility that the two conservative parties will build a coalition. This would limit Ortega's room for maneuver considerably, as he cannot even draw legitimacy from a majority of votes. The renewal of the pacto político would be perhaps the worst outcome; the best solution would be a consensus on a reform program between the FSLN and ALN. To strengthen democracy, different reforms must be pursued. The politicization of important state institutions like the Supreme Court, the Comptroller General or the Electoral Commission must be reversed. The proposed reforms of the judiciary must be implemented in order to guarantee its independence, and corruption must be curtailed. The participation of civil society also must be strengthened and the administrative system enhanced. In the realm of economics, the reforms that have been implemented enable a sound macroeconomic framework and support economic growth. One of the most important tasks is to enhance the human capital of Nicaragua. To raise the participation of the population in the formal economy as well as to raise productivity levels that would create higher incomes will be decisive for Nicaragua's long-term economic growth. The internal debt situation has to be watched closely and its risks mitigated. Another key issue will be to reach a final decision on the property rights of formerly expropriated and collectivized lands and companies. This would especially boost agricultural production, entailing a direct positive impact on the lives of the rural poor. Besides the poverty-mitigating effects of economic reforms, measures directly targeting poverty also have to be implemented. The access to and quality of public services such as education and health care should be considerably increased. Furthermore, to mitigate the negative effects of ecological degradation and natural disasters, environmental considerations must carry more weight in policy-making. A national consensus on these reforms must be reached, and should be supported by the international community. The international community can resort to Nicaraguan actors and organizations that are committed to these causes, and can offer its expertise and financial resources as well as political pressure on the government to implement these reforms.