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An Evaluation of Swedish Development
Cooperation with Nicaragua

Ds 1994:112

Report 4

SASDA

Secretariat for Analysis of
Swedish Development Assistance

FOREWORD

On the basis of a government report on forms of management and co-operation in overseas aid (SOU 1993:1) the Swedish Parliament approved a proposal to carry out country profiles and country studies as an essential tool for the management of aid to individual countries.

Examinations of the overall management of the bilateral aid programmes, in terms of results or the effectiveness of programmes in each country, have seldom been carried out in Sweden. The recipient country is an appropriate level at which to address the question of results because it is the level where bilateral funding allocations are made by the Swedish Parliament, where the strategy for results can be determined, where goals are set and where bilateral agreements are signed for programmes and projects. A country specific strategy would enable Swedish development co-operation agencies to focus on specific and measurable results, country by country.

The Secretariat for Analysis of Swedish Development Assistance (SASDA) has commissioned a number of country-case-studies in order to analyse the results achieved by Swedish aid, taking into account other donors' experience. The objectives are to analyse the effect and effectiveness of Swedish aid in the sense of appropriateness to the objectives set for aid, to analyse its cost-effectiveness, to make recommendations to improve its effectiveness and efficiency in development co-operation in the future, and to make proposals for the methodology to be employed in analysing and following up the effectiveness and efficiency of aid in country studies.

In the report, Associate Professor Jaime Behar, Institute of Latin American Studies, University of Stockholm and Professor Mats Lundahl, Department of International Economics and Geography, Stockholm School of Economics analyse Swedish development co-operation with Nicaragua for the the period 1979-1993.

The opinions and conclusions of the authors of the report are their own.

Stockholm, September 1994.

Ingemar Mundebo
Chairman

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Chapter 1. THE SCOPE OF THE STUDY

The present study is intended as a contribution to the discussion of the effectiveness of Swedish development cooperation or foreign aid. More specifically, it takes a look at Swedish assistance to Nicaragua between 1979 and 1993 and analyzes to what extent this assistance achieved its objectives. Was aid 'effective' in this case? In order to answer this question, the reasons for aid, in general, and for Swedish aid, in particular, must be examined. This ultimately leads to a discussion of the official objectives of Swedish development cooperation, with special emphasis on the relative weight of these different objectives in the case of Nicaragua.

Second, the very process of economic development and the potential role which aid can play in this process must be examined. This will make it possible to draw some conclusions about the macroeconomic effects of Swedish aid. Once the analysis moves from the macroeconomic to the microeconomic level, the road is paved for exploring the question of efficiency which entails identifying a yardstick that can be used to assess individual programs and projects.

This chapter looks at all of the above and further provides an overview of the rest of the study and a brief discussion of its limitations.

1.1. Why Development Assistance?

Developed countries give assistance to developing countries for a variety of reasons¹, some of which are 'selfish'. Security reasons, for example, are known to have dictated the foreign aid policy of the United States and the Soviet Union, especially during the Cold War of the 1950s and 1960s, when both countries employed aid systematically to further their political interests. In the case of France, the desire to spread the French language, and French customs and culture in general, has to a large extent shaped French foreign aid policy.

The desire to develop commercial ties with Third World countries has also, to varying degrees, influenced the development assistance policies of virtually all developed countries, although it is rarely the overriding factor, for the simple reason that there are far more effective ways of expanding exports than by providing financial aid to poor countries.

There are also 'altruistic' reasons for providing development assistance. These stem from the moral obligation to assist the poor and feelings of solidarity. Linked to

¹ See e.g. Edgren and Odén (1972), Chapter 1, or Anell (1984) for an overview. Riddell (1987), Part I, provides a more in-depth discussion of the ethical foundations of aid. Cf. also e.g. Jay and Michalopoulos (1989) for a discussion of donor interests.

solidarity reasons, are humanitarian reasons. Humanitarian aid is most visible in times of war, famine, hurricanes or earthquakes, all of which call for emergency relief.

Finally, there are 'educational' reasons for providing development assistance which are neither purely 'selfish' nor 'altruistic'. That is the case when a developed country for some reason wants a developing one to follow a path similar to its own. This can take the form of anything from 'civilizing missions' to the transfer of technology which springs from the desire to make available to developing countries methods that have worked well at home.

1.2. The Objectives of Swedish Development Cooperation

Needless to say, all or most of the motives enumerated in the preceding section have also been present to some extent in Swedish development cooperation policy.² Without a doubt, however, the 'altruistic' motives have dominated the picture, in a very pronounced way in the 1960s and 1970s, but also thereafter.³ The 'altruistic' orientation is clear not least from the formulation of the official objectives of Swedish development cooperation. With a single exception, these have remained unchanged since they were formulated systematically for the first time in a 1962 government proposition (white paper) to the Swedish Parliament.⁴ Swedish assistance to developing countries forms part of Swedish foreign policy:

An important purpose of the latter is to contribute to equality between nations and to thereby promote international solidarity and peaceful development in the world [...] Swedish development assistance ought to be in keeping with these objectives.⁵

The purpose of assistance is to enable the poor to improve their standard of living. To this end, emphasis was placed on achieving economic growth: growth of the total product and growth of production per capita. At the same time, assistance was to be devised in such a way as to contribute to social and economic equality. Of these two objectives, growth was seen as the most important.⁶ During the 1970s, the equality objective took on greater importance. Growth was gradually seen as a means of

² See Palmlund (1986), for a discussion of 'altruistic' versus other motives.

³ Anell (1984), p. 28.

⁴ *Kungl. Maj:t:s proposition* (1962). Ljunggren (1986) provides a short history of the traditional objectives and their practical application.

⁵ *Kungl. Maj:t:s proposition* (1962), p. 6.

⁶ Stokke (1978), p. 8.

furthering social development and equality.⁷ During the 1980s, the pendulum swung once again towards greater emphasis on the growth objective.⁸ The insight spread that redistribution and equality were not feasible in stagnant or retrograde economies. Today, growth is emphasized as a necessary condition for equality.

A third objective of Swedish foreign aid is to contribute to democratic development in the recipient countries. For a long time, this objective remained both somewhat vaguely formulated and subordinate to economic objectives.⁹ Perhaps the main reason for this was that many developing countries very strongly defended their right to define their political systems without foreign intervention.¹⁰ By and large, this was accepted by the Swedish government, as long as it was clear that the governments of the recipient nations made an effort to modernize the society and the economy. Only in extraordinary cases, such as Chile after the military takeover in 1973, was democracy made a binding constraint.¹¹ It was not until the late 1980s and the 1990s that a change began to take place in this respect, as support to Cuba was gradually phased out. Today, support of democracy and human rights stands out as a central issue in Swedish development cooperation.

The fourth objective is that of national independence. Historically, this was given much more weight than the objective of democracy, not least in the context of support to South Africa's neighbors and to various liberation movements.¹² Finally, we have the most recent development objective, that of environmental protection, added only in the 1980s, which stresses the need to arrive at a sustainable mode of production conserving the natural resource base. This objective has received growing attention since the UNCED conference on the environment in Rio de Janeiro in 1992.

1.3. The Case of Nicaragua

The five objectives of Swedish development cooperation will serve as guidelines in the present work. They will constitute the yardstick against which our evaluation of Swedish assistance to Nicaragua will be made. However, all five objectives have not carried the same weight in the case of Nicaragua. Quite the contrary, economic considerations, and in particular the growth objective, have dominated the picture. The objectives were made explicit in connection with the first regular two-year agreement between the two countries:

⁷ *Ibid.*, p. 9.

⁸ Hveem and McNeill (1994), Chapter 2.

⁹ Stokke (1978), p. 11.

¹⁰ Falk (1994), p. 136.

¹¹ Södersten and Gunnarsson (1994), p. 409.

¹² Stokke (1978), pp. 12-14.

Economic growth and independence are objectives of assistance policy which are of special importance for the support to Nicaragua [...] The government objective to redistribute income to the poor majority of the people can hardly be met unless the rate of economic growth increases and resources are thereby created which may be used to improve the living conditions of the majority of the population. [Thus] there are reasons for giving the growth objective a prominent position in the assistance to Nicaragua, as this will support social and economic distributional efforts.¹³

As we will see in Chapter 2, between 1979/80 and 1992/93, no less than 70 percent of all the funds disbursed to Nicaragua went to programs and projects which, in one way or another, were focused on production, either directly (mining, forestry, agriculture and energy) or indirectly (import support and balance of payments support). Between 1983/84 and 1989/90, this dominance was even more pronounced: 77 percent.¹⁴

It is not difficult to understand why the growth objective was allowed to dominate. When the Sandinistas took the helm after the fall of the Somoza regime in July 1979, Nicaragua was one of the poorest countries in Latin America --a country which in addition had been through a devastating civil war. Thus, there remained no doubt that economic growth was a paramount objective for the new government.

There was also a second reason: the strong commitment of the Sandinistas to distribution. This was manifested in several ways in the wake of the takeover. Extensive nationalizations, of the property that had formerly belonged to the Somoza family and their backers and collaborators, took place in virtually all sectors of the economy. What was obtained in this way came to constitute the core of the *Area de Propiedad del Pueblo* which gave the state an important stake in several sectors. The foreign trade and banking sectors were also nationalized because of Somoza's presence in the two. Finally, a land reform was undertaken, for exactly the same reasons, and resources were reallocated in favor of the thus reformed sector. In all three cases, the measures, no doubt, corresponded to popular demand.¹⁵

In addition, the Sandinistas gave priority to health and education and improved the human rights situation considerably *vis-à-vis* the situation which had prevailed during the Somoza period.¹⁶ Thus, it was clear that no need existed for placing special emphasis on distribution in the design of the Swedish assistance program. The

¹³ SIDA (1982-a).

¹⁴ Cf. also Palma (1992), p. 47.

¹⁵ Aguilar (1989), pp. 4-6.

¹⁶ Bulmer-Thomas (1987), p. 232.

Nicaraguan government would itself see to it that the fruits of growth would be distributed in an equitable fashion. What mattered was to make the pie from which redistribution could take place bigger.

Economic growth was also viewed as conducive to national independence:

Swedish assistance can support the independence effort through the contribution of Swedish resources to reducing the dependence on the United States for technology, spare parts and inputs for the manufacturing sector. [...] Assisting economic growth is important for Nicaragua's independence also when the large foreign debt of the country is taken into account.¹⁷

Swedish assistance to Nicaragua began with emergency relief during the last phases of the civil war that put an end to the Somoza regime. Thereafter, it passed through three different phases. The first one consisted largely of import support during the immediate reconstruction phase after the civil war, 1979-82. Thereafter, once the decision had been taken to increase the volume of aid, the focus was shifted towards support mainly for direct production in the mining, forestry, agricultural (rural cooperatives) and energy sectors. This continued until the late 1980s, when the lack of macroeconomic balance and the scarcity of foreign exchange had become so pronounced that the Nicaraguan government had to embark on a major stabilization and structural reform program. In connection with this, import support not related to particular projects and balance of payments support gained increased importance. (At the same time, aid to the social sectors increased.) The support to forestry and energy continues, while that to mining and rural cooperatives has been phased out.

1.4. The Development Process

The present study is an evaluation of Swedish development cooperation with Nicaragua. Our aim is to determine whether this assistance has served to meet the objectives established by the Swedish Parliament enumerated above. Hence, these objectives, and in particular that of economic growth, will be the guidelines for our investigation. The analysis will be undertaken both at the macro and the micro levels.

Beginning with the former, one important observation to be made is that the impact of aid on economic growth is indirect. It is simply not possible to establish any

¹⁷ SIDA (1982-a).

direct relation between these two variables.¹⁸ Thus, it may be helpful to explicitly spell out a picture of the process of growth and development.¹⁹

Developing countries typically start their efforts at low levels of per capita income and with a distribution of income and wealth that is highly uneven. Economic development may then be defined as the process whereby per capita income increases over time in a sustained fashion, without the distribution of incomes and wealth becoming more unequal and without the number of 'absolute poor' (defined according to some arbitrary criterion, e.g. a minimum income level) increasing.²⁰

On the macroeconomic level, economic growth may be taken to be a result of three interrelated accumulation processes: growth of the labor force, accumulation of physical capital as a result of domestic savings or capital inflow from abroad, and finally, technological progress --defined in a broad sense as everything that either makes it possible to produce existing goods and services with less inputs or makes new products available. Over time, the labor force and the capital stock both grow and this enhances the production possibilities of the economy. At the same time, the production functions of the various sectors change as a result of improved quality of both the human and the physical capital. New knowledge results, for example, from education, and better (more efficient) ways of organizing production are devised. New products are discovered.

These macroeconomic processes have their counterparts at the more disaggregate level. Thus, economic growth is usually accompanied by structural change, away from low-productivity sectors, toward sectors with higher private and public returns: typically away from primary pursuits and into manufacturing and modern services instead. International trade may have an important role to play as well. Today, there is ample evidence that a trade regime based on tariff protection and import substitution in manufacturing, an overvalued currency and administrative allocation of foreign exchange are not conducive to growth other than, possibly, during short periods, before the domestic market has been exhausted. The fastest-growing nations, those in East and Southeast Asia, on the other hand, have in the main relied on industrial production for the world market. To the extent that their imports have been subject to tariffs, the latter have not been excessively high and neither tariff nor exchange rate policies have discriminated strongly against exports.

¹⁸ White (1992), (1994).

¹⁹ Such pictures are available in the standard textbooks. See e.g. Meier (1989), Gillis et al. (1992) and Todaro (1994). Summaries are offered e.g. in Lundahl (1981) and, in the context of the present series of evaluations of Swedish development assistance, in Svedberg, Olofsgård and Ekman (1994). Our view is basically the same as that of the latter authors. The reader is referred to these publications for further bibliographical references.

²⁰ Meier (1976), p. 6.

For the macroeconomic processes to work neatly, proper microeconomic incentives are needed. This, in turn, raises the question of the proper role of the state: how can good governance be achieved? How are the political macro decisions transmitted to the individual decision-makers on the micro level: producers, consumers and factor owners? In this, the state has a central role to play, not least when it comes to defining a property rights structure which is conducive to growth. Ideally, these rights should be completely specified and the costs for ensuring that they are respected should be zero. Also, they should be specified in such a way as to make private and social benefits coincide. However, this is seldom or never the case in practice. The government may have objectives that diverge greatly from those of the population at large.

As shown not least by the recent World Bank study on the Asian 'miracle economies', it is of utmost importance not only that the incentive structure is one which is favorable to economic growth, but also that macroeconomic stabilization is achieved.²¹ Otherwise, no incentive structure will do the trick: 'When the time comes, a balance of payments crisis, a debt crisis, or a rate of inflation that is regarded by all segments of society as intolerable can wipe out the apparent gains of past growth over several years of stagnation or even declines in output.'²²

Our macroeconomic discussion of the effects of Swedish aid to Nicaragua will by and large concentrate on four issues: the impact of aid on the exchange rate and hence on foreign trade, the contribution of aid to capital formation, and hence implicitly to growth, the impact of aid on social development and income distribution and, finally, the role of aid in the stabilization effort that began in 1988 and continues today. This is as much as the data at our disposal permit and then it should be kept in mind that, as a rule, it is not possible to separate the effects of Swedish assistance from those of aid in general. (When Swedish assistance has deviated from the general trend we will of course point this out --most importantly in connection with the stabilization program.) It should also be stressed that the connection between capital formation and growth is not necessarily of the one-to-one type, but very much depends, on the one hand, on the general policy pursued by the government and, on the other, on the environment in which this policy has to work. Thus, as a background to our discussion of aid and capital formation, an overview will be provided of both these factors.

²¹ World Bank (1993).

²² Krueger and Ruttan (1989), p. 29.

1.5. The Elusive Concept of Efficiency

Once we turn from the macroeconomic to the microeconomic aspects of foreign aid we necessarily get involved with the central, but elusive concept of efficiency. The traditional definition of economics is that of a science which seeks to establish the most efficient use of scarce resources.²³ Resources are not to be wasted. The standard welfare-economics formulation of this is in terms of Pareto optimality: the allocation of resources is efficient when no person in the economy can be made better off without simultaneously making at least one other person worse off. The problem with this formulation is, on the one hand, that an infinite number of Pareto optimal allocations of resources exist and, on the other, that allocations that are not Pareto optimal may be preferred by society, for example, if they are associated with a distribution of incomes which in some sense is 'better' (typically more egalitarian) than the Pareto optimal ones.²⁴

A more restricted efficiency concept is the technological one. Given the amount of resources (factors) available to the economy, and given the technology, for technological efficiency to be obtained, it must not be possible to increase the production of a commodity without simultaneously having to reduce the production of at least one other commodity. The resources of the economy must be fully employed. However, the technological efficiency concept is plagued by the same problem as that of the Pareto formulation, namely that an infinite number of technologically efficient situations exist. To be able to choose between these we need to know something about the prices prevailing in the economy. Furthermore, these prices must reflect the true scarcity value of commodities and factors to society or we have to calculate shadow prices to the same effect. In both cases we need to bring the demand side of the economy into the picture.

In the case where prices do not reflect scarcities in a correct way, yet another problem arises: that of second-best.²⁵ Once one or more of the stringent conditions that have to be met in order to arrive at a Pareto optimal situation are not fulfilled, only a lower level of welfare, defined in Pareto terms, (a second-best situation) can be reached. In this case, a departure from the conditions that apply in the (first-best) Pareto optimal situation will generally be necessary, i.e. some kind of policy intervention is called for. The market will not bring about the second-best situation without 'help'. Of course, any real economy is likely to display a number of imperfections which make it impossible to attain the first-best situation and each one of these requires its own particular

²³ Cf. Robbins (1932), for the classic statement.

²⁴ Cf. any standard text on welfare economics, e.g. Nath (1969).

²⁵ Lipsey and Lancaster (1956-57).

intervention --typically a combination of taxes and subsidies-- which is not likely to be employed in practice.

All of the above considerations naturally bear on the discussion of the effects of foreign aid as well, unfortunately, by making judgements, with respect to whether aid contributes to efficiency, more difficult. One possible solution would be to make systematic use of cost-benefit analysis, since this approach employs shadow prices which correct for distortions in the price system, e.g. by using world market prices or a shadow exchange rate. (Nicaragua is a small, open economy.) That would in principle allow us to determine whether those who gain from a particular project gain enough to make it possible to compensate the losers. This does of course not guarantee that compensation will take place in practice, but, as we argued above, in the case of Nicaragua, where redistribution has been an important government objective, other mechanisms would see to it that also the poor would gain.²⁶

However, the application of cost-benefit analysis to a given project would only tell us something about that particular project, but not about its economic desirability in relation to other projects. For this, explicit comparisons must be made (in cost-benefit terms). Thus, even if a cost-benefit analysis of a certain project were carried out, we would not know whether that project represented the 'best' use of aid funds.

Thus, sophisticated welfare economics is of little use within the context of the present study. Efficiency can only be defined given some kind of explicit value judgement with respect to what is desirable. Thus, also on the microeconomic level, the value judgements employed in the present study will be those expressed by the Swedish Parliament in the form of objectives for Swedish development cooperation, and then mainly growth. The only meaningful microeconomic exercise consists in finding out whether the projects and programs funded by Swedish assistance to Nicaragua have been successful in contributing toward the attainment of these goals.

1.6. Main Limitations

The study had to be carried out within a given time frame, which of course imposed certain limitations. First of all, we were obliged to work with existing data and statistics. Only in some instances were we able to gather original data. Often these statistics were constructed in a way which did not allow for unequivocal interpretation in keeping with the terms required by our study, and therefore could only be used as indirect, supporting evidence. Also, some central figures were entirely lacking, notably detailed information about the 1983-90 budgets, which was never published for

²⁶ See e.g. Friedman (1985), Chapter 5, for a detailed argument along these lines.

'security reasons'. Different sources at times offered data on the same issue which differed dramatically. This of course created problems of interpretation. The hyperinflation process of 1988-90 and the introduction in 1990 of a new currency introduced additional distortions in the official statistics. Finally, the shaky state of these statistics, together with the limited length of the available series (a maximum of fourteen years, but typically a few years less) also excluded the use of sophisticated econometric techniques.

Related to the problem of data availability and quality is the fact that we were unable to carry out any microeconomic evaluations (e.g. cost-benefit analyses) of our own when examining the individual projects. We simply had to make do with the evaluations, appraisals, etc. carried out in the course of the project assistance.²⁷ This necessarily left some information gaps. The latter were filled, in part, by the information obtained from meetings and interviews with program officials from SIDA and the Ministry for Foreign Affairs, as well as Nicaraguan authorities. The list of people contacted for the study is contained in Annex 1.

1.7. Plan of the Study

The present study is divided into eight chapters. The scope of the study is defined in *Chapter 1*. In *Chapter 2*, the statistical picture of foreign assistance to Nicaragua is presented, with emphasis on the Swedish contribution. The chapter begins with a breakdown of overall assistance according to source. The dominance of the socialist countries between 1979 and 1989 and that of grants over loans is highlighted. It is also shown that most of the assistance went to program support. Swedish assistance has consisted almost exclusively of grants.²⁸ The overwhelming part of it has been administered by the Swedish International Development Authority (SIDA) and the major part of the funds have been devoted to support to production.

The evaluation of Swedish support takes place on two levels: the macroeconomic and the microeconomic. Chapters 3-5 deal with macroeconomic matters. *Chapter 3* provides the necessary background for the analysis in Chapters 4 and 5 and, in addition, discusses the possible contribution of foreign aid to the progress made in terms of social

²⁷ The quality of evaluations of Swedish aid to Nicaragua and how these have been used by the Swedish aid agencies are analyzed in Metell (1994). We have made good use of this work when approaching the microeconomic effects of Swedish aid (Chapter 6) and the effectiveness of Swedish aid management (Chapter 7).

²⁸ Swedish claims with Nicaragua in the relevant period amounted to only 34 million Swedish kronor. These consisted of a 14 million Swedish kronor export credit granted by AB Svensk Exportkredit in 1985, a 16 million development credit from the Swedish Agency for International Technical and Economic Cooperation (BITS) and 4 million in companies' excess risk (SIDA, 1992-b). The former was repaid in 1986 with SIDA money. Remaining claims were forgiven in 1991, on the occasion of the Paris negotiations.

welfare in Nicaragua during the 1980s. It briefly reviews the experience of the Somoza period and the results of the ensuing civil war. However, most of the chapter is devoted to a cursory examination of the Sandinista period, 1979-90: the consequences of the conflict with the United States, the results in terms of social welfare, the ill-fated foreign trade regime, the fiscal and monetary laxity and its consequence --hyperinflation-- and, finally, investment (both its composition and the failure to provide the pertinent domestic financing).

Chapter 4 deals with the impact of aid on some central macroeconomic variables. The question of whether the inflow of foreign assistance funds has led to so-called Dutch disease is explored. The role of foreign aid in financing investment and (public) consumption in a situation where domestic savings turned negative is examined. Finally, disaggregated figures for aid and imports are presented which allow for analysis of capacity-building versus capacity utilization in the Nicaraguan context.

Finally, *Chapter 5*, focuses on the the most recent period and the short-run aspect: the contribution of Swedish aid to Nicaraguan stabilization efforts. Systematic stabilization policies are a relatively novel feature. During most of the 1980s, an increasingly chaotic economic situation was building up. The gross national product was falling, the trade deficit grew, prices had less and less to do with the prevailing scarcity of inputs and outputs, the government budget deficit soared and the price level increased rapidly. A command economy where resource allocation was determined by awkward administrative decisions was created. Half-hearted stabilization efforts between 1985 and 1987 failed, and it was not until 1988 and 1989 that a serious attack was launched on macroeconomic and structural imbalances.

These efforts were backed by Sweden both with technical assistance and in the form of import and balance of payments support. Chapter 5 provides an evaluation of this support and its continuation after the change of government in Nicaragua following the victory of Violeta Chamorro in the 1990 elections. The analysis focuses on the content and timing of Swedish policy against the background of donor behavior in general, notably that of the multilateral credit agencies.

In Chapters 6 and 7 we turn to the microeconomic effects of aid. *Chapter 6* is devoted to an examination of the most important projects and programs funded by Swedish aid: in mining, forestry, rural cooperatives, energy, import support and research. An effort is made to determine whether the projects in each one of these sectors were in keeping with the objectives of Swedish development cooperation and whether they were carried out in a way which did not involve any obvious waste of resources. Thus, the exercise is one of examining whether Swedish aid contributed to making the Nicaraguan economy 'muddle through' on the micro level rather than one of examining the 'optimality' of the programs.

Chapter 7 is devoted to examination of Swedish aid planning and management procedures. It is designed to give the reader a sense of how the individual projects and programs were prepared, monitored and evaluated, and to determine to what extent these procedures were in keeping with the stated objectives. The purpose of the exercise is to contribute to the discussion of the effectiveness of the Swedish assistance machinery.

Lastly, *Chapter 8*, summarizes the study and offers some recommendations for future assistance.

Chapter 2. SWEDISH DEVELOPMENT COOPERATION WITH NICARAGUA: THE STATISTICAL PICTURE

The purpose of the present chapter is to provide an overall picture of Swedish development assistance to Nicaragua since the beginning of development cooperation in 1979. We begin with a presentation of total assistance received by Nicaragua from multilateral and bilateral sources, broken down according to grants and loans as well as purpose of assistance.

The subsequent sections deal specifically with Swedish assistance: the Swedish contribution to the aid received by Nicaragua, its absolute size, its distribution among Swedish donor agencies, the relation between formal commitments and actual disbursements, its distribution among sectors and subsectors and, finally, its distribution according to economic function.

2.1. Data Sources

Three different sets of data have been used in this chapter. The data in *Figures 2.1-2.3* are based on OECD/DAC reports.¹ They correspond to official development assistance (ODA) from multilateral institutions and DAC countries and are expressed in current dollars. *Figures 2.10-2.21* draw on Swedish sources, mainly SIDA's statistical reports.² In this case, the original data were given in current Swedish kronor. Current US dollars and Swedish kronor have been converted to constant prices by using the United States consumer price index and the Swedish GDP deflator, respectively.

Finally, the data in *Figures 2.5-2.9* were taken from Nicaraguan sources.³ This information only covers the 1979-89 period, but it has the advantage of including the former Eastern European bloc, the other socialist countries and the Latin American nations. The data were given at a less aggregate level, often by end use. They differentiate between loans and grants but not between concessional and non-concessional loans. The figures do not, however, include short-term loans and other private capital inflows, which means that they could be regarded as roughly representative of what OECD/DAC reports define as 'Official Development Finance' (ODF). In *Figures 2.4* and *2.5*, we have combined these two data sources in order to obtain the amounts of ODA provided by all countries. This required estimating the grant equivalent of the loans granted by former socialist countries and Latin American

¹ OECD/DAC (various issues).

² SIDA (various issues-a) and SIDA (various issues-b).

³ Contreras et al. (1991) and *Ministerio de Cooperación Externa*.

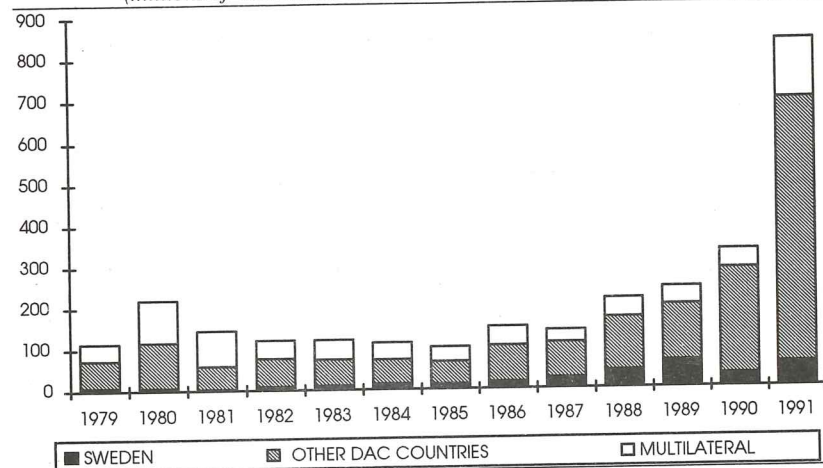
countries.⁴ The results indicate that 50 percent of the loans committed by the former socialist countries, compared to only 25 percent of those from Latin America, were given on concessional financial terms and therefore qualify as official development assistance.

An additional data source which has been used in later chapters of this study is balance of payments statistics. In this case, aid is defined as the sum of transfers and net concessional loans.

2.2. The Overall Assistance Picture

Figure 2.1 shows total official development assistance received by Nicaragua from DAC countries and multilateral agencies during the 1979-91 period in current US dollars. With the exception of 1981, the picture shows fluctuations, but no upward or downward trend until 1988, when a major increase was witnessed in both multilateral and bilateral assistance, including that from Sweden. In 1991, after the reappearance of

Figure 2.1: Official Development Assistance to Nicaragua. DAC Countries and Multilateral Agencies, 1979-1991 (millions of current US dollars)



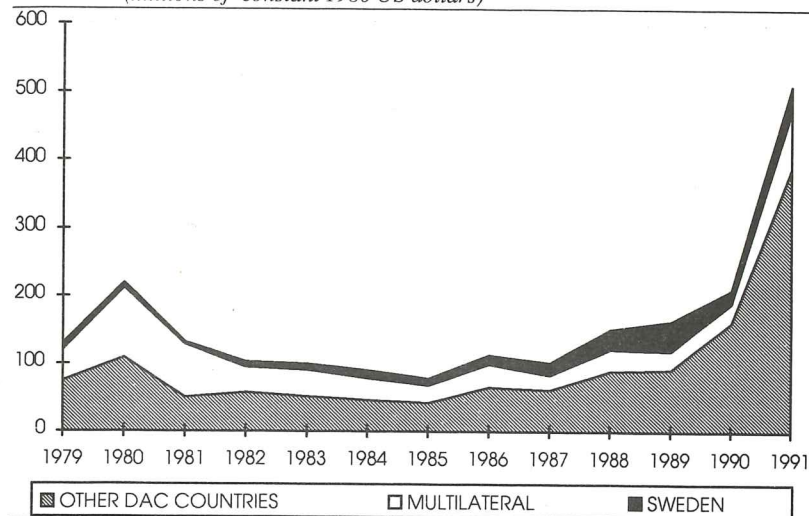
Source: OECD/DAC (various issues).

⁴ The *Ministerio de Cooperación Externa* furnished information on the terms at which the loans were given. We applied the DAC criteria with respect to maturity and interest rate to determine whether the loan was provided on concessional terms. See OECD/DAC (various issues) for a description of the criteria.

the United States as a donor country and the renegotiation of Nicaragua's foreign debt with the Paris Club and the multilateral lending agencies, multilateral assistance more than tripled in nominal terms and bilateral assistance increased 2.4 times, leading to an increase in overall assistance of two and a half times.

Figure 2.2 translates the information contained in Figure 2.1 into constant 1980 dollars, using the United States consumer price index as the deflator. Basically, the same U-shaped curve appears, with a relatively flat segment during the 1981-87 period, before the 1987-90 increase.

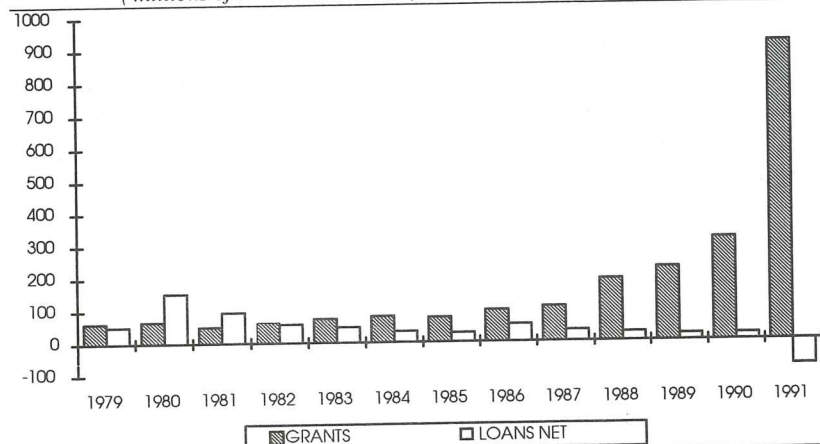
Figure 2.2: Official Development Assistance to Nicaragua. DAC Countries and Multilateral Agencies, 1979-1991 (millions of constant 1980 US dollars)



Source: OECD/DAC (various issues).

Figure 2.3 shows the distribution of assistance between pure grants and (soft) loans. With the exception of 1980 and 1981, grants (increasingly) account for the major share. Throughout the better part of the period, the major donors, notably the multilateral agencies, were absent. Substantial repayment of loans took place in 1991 following renegotiation with the Paris Club.

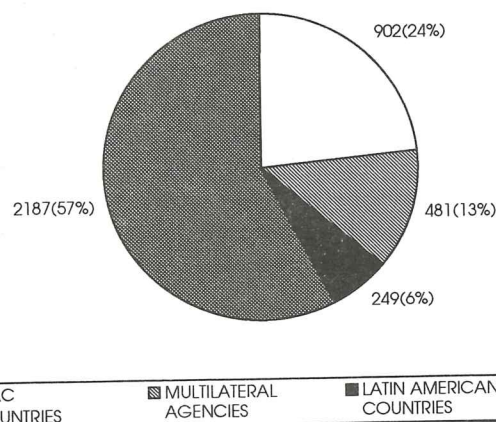
Figure 2.3: Grants and Concessional Loans (Net). DAC Countries and Multilateral Agencies, 1979-1991
(millions of current US dollars)



Source: OECD/DAC (various issues).

In Figure 2.4, assistance from Latin American and socialist countries has been added. The latter clearly dominate the picture, with 57 percent of the total over the 1979-89 period, whereas the Latin American contribution has been marginal.

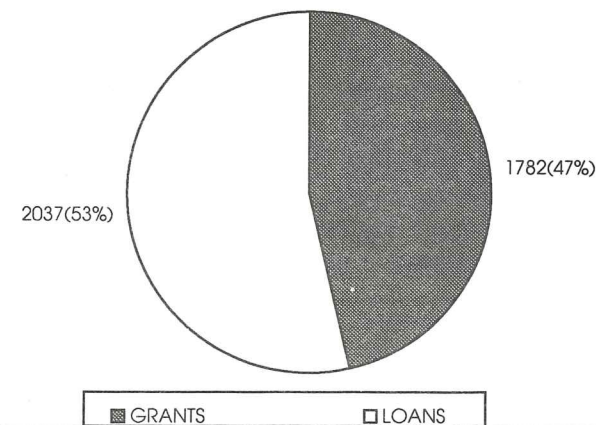
Figure 2.4: Total Official Development Assistance to Nicaragua. All Sources, Distribution of 1979-1989 Totals by Donor Group
(millions of constant 1980 US dollars)



Sources: Contreras et al. (1991), Ministerio de Cooperación Externa and OECD/DAC (various issues).

The distribution between grants and soft loans, as depicted in Figure 2.5, indicates that the former (53 percent) has been slightly larger than the latter (48 percent).

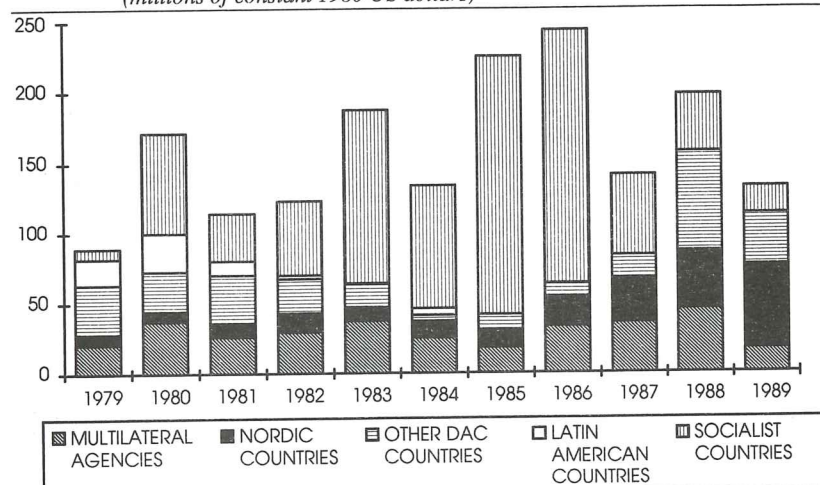
Figure 2.5: Total Official Development Assistance to Nicaragua. All Sources, Grants and Loans, 1979-1989
(millions of constant 1980 US dollars)



Source: Calculations based on the information in Figure 2.4.

The data obtained do not allow for direct calculation of the grants actually disbursed by each country or multilateral agency in every year of the period. Figures are available only for commitments. However, since the total of the grants actually disbursed between 1979 and 1989 amounts to almost 90 percent of the commitments, Figure 2.6 still conveys some idea of the distribution of total grant disbursements between the different donor categories. Two tendencies are to be noted: the increasing dominance of the socialist countries up to 1986 and the subsequent and abrupt decline of such assistance alongside the growth of DAC assistance, not least from the Nordic countries.

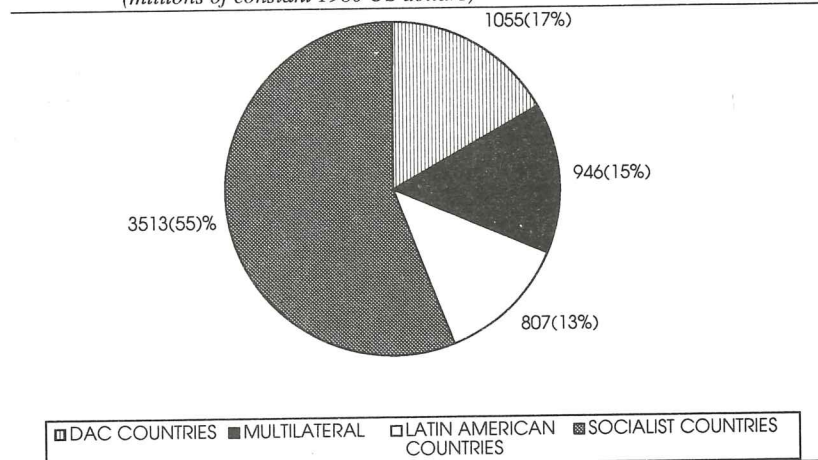
Figure 2.6: Grant Commitments by Donor Group, 1979-1989
(millions of constant 1980 US dollars)



Sources: Contreras et al. (1991) and Ministerio de Cooperación Externa.

In Figure 2.7, the total of grants and loans (both soft and hard), i.e. official development finance has been distributed among the various donor categories.

Figure 2.7: Official Development Finance to Nicaragua. All Sources, Distribution of 1979-1989 Totals by Donor Group
(millions of constant 1980 US dollars)

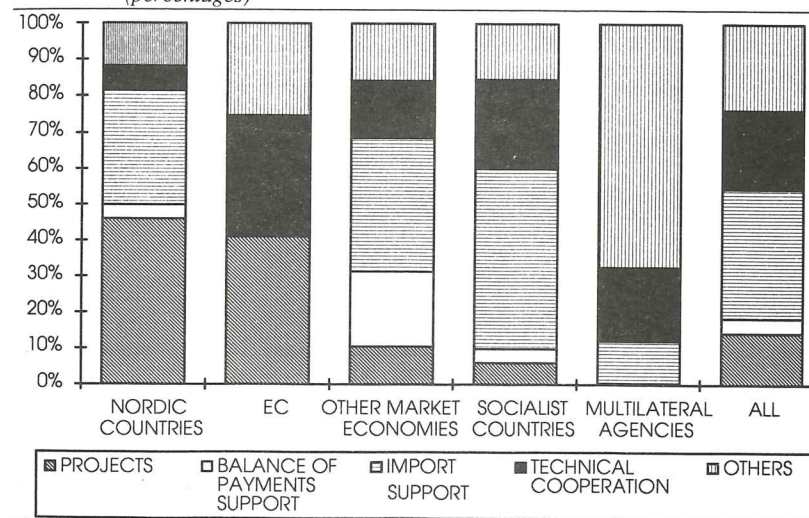


Sources: Contreras et al. (1991) and Ministerio de Cooperación Externa.

Comparison of this figure with Figure 2.4 reveals a substantial increase in the relative importance of the Latin American countries. The reason for this is that Nicaragua obtained loans for buying oil from Mexico and Venezuela that were later to constitute an important part of Nicaragua's foreign debt, which in 1991 was renegotiated on terms that were very favorable to Nicaragua.⁵

In Figure 2.8, the grants received by Nicaragua are broken down according to purpose and donor group. The figure reveals a number of interesting features. The assistance of the multilateral agencies has been heavily concentrated on emergency relief and food aid. A second characteristic is that the most important single component in the total is import support (machinery and equipment, consumer goods, intermediate inputs and petroleum). This phenomenon is particularly pronounced in the case of the socialist countries while it does not figure at all in the assistance from the European Community, where the emphasis has been on project assistance and technical assistance. Project aid has also dominated among the Nordic countries together with import support. Note also the limited weight of balance of payments support both overall and

Figure 2.8: Distribution of Grants by Purpose, 1979-1989
(percentages)



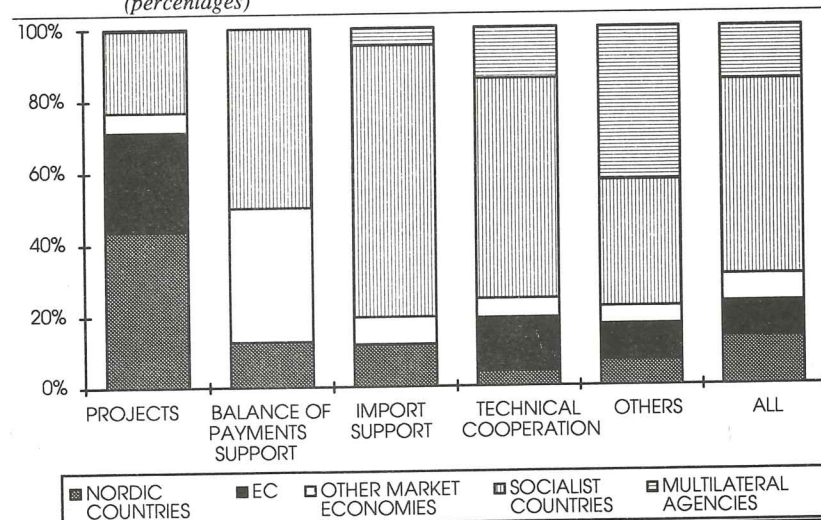
Sources: Contreras et al. (1991) and Ministerio de Cooperación Externa.

⁵ We will return to this in Chapter 3.

for the Nordic countries. This situation turns around in 1990, with the triumph of Violeta Chamorro in the presidential elections. We will return to this further on in the text.

Finally, *Figure 2.9* shows the shares of each donor category in each category of assistance. The dominance of the socialist countries, especially in program aid in kind and technical cooperation, but also in terms of balance of payments support is particularly noteworthy. The multilateral agencies, followed by the socialist countries, dominate the 'others' category containing emergency and food aid. The figure also confirms that the assistance of the Nordic countries differs from that of other donor sources in its concentration on specific projects, where it dominates with 43.5 percent of the total.

Figure 2.9: Distribution of Grants by Country Group, 1979-1989
(percentages)



Sources: Contreras et al. (1991) and Ministerio de Cooperación Externa.

To summarize, during the 1979-89 period, Nicaragua received most of its official development assistance from the socialist countries of Eastern Europe, notably from the Soviet Union. More than 55 percent of total assistance came from this source. However, with the demise of communism at the beginning of the 1990s, this assistance collapsed completely. Furthermore, a new, non-socialist government took power around the same time. As a result of these two changes, Nicaragua today is completely dependent on the Western market economies and the multilateral agencies for aid. The DAC countries

constituted the second largest category of donors already in the 1980s, while the shares of multilateral agencies and Latin American nations were relatively smaller.

Between 1979 and 1989, loans dominated over grants, but not very markedly. However, grants have increasingly exceeded loans in recent years, not least after the collapse of communism and the beginning of the total predominance of Western sources.

The most important purpose of foreign assistance in the 1980s was program support, and then mainly import support in kind, with balance of payments accounting for only a minor share. Second in importance was emergency and food aid, followed by technical cooperation. Project aid, on the other hand, appears as a relatively unimportant category, with less than 15 percent of the total. However, both the Nordic countries and the EC have concentrated far more on this category, with shares ranging between 40 and 50 percent of their total commitments. Lastly, the multilateral agencies allocated almost 70 percent of their support to emergency relief and food aid.

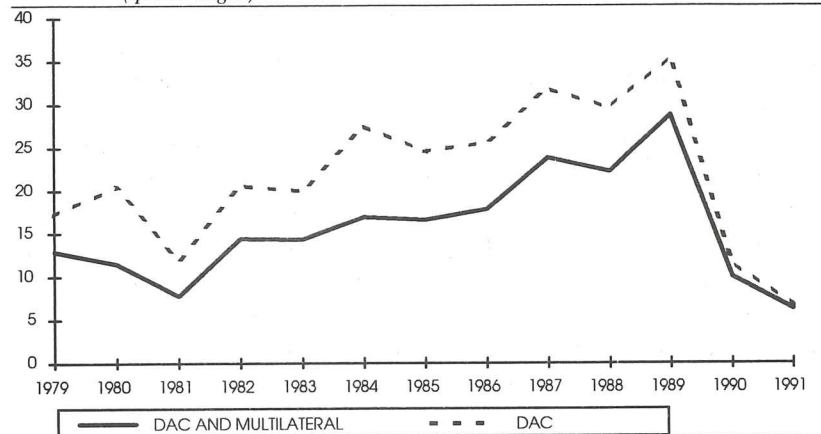
2.3. Swedish Assistance to Nicaragua

Figure 2.10 presents Sweden's share of DAC country and DAC country plus multilateral agency grants to Nicaragua. Swedish assistance began in 1979, after the fall of the Somoza government --a year which marked the beginning of the worst economic crisis in Central America since the onset of the depression in the 1930s.⁶ Sweden has given virtually nothing other than pure grants to Nicaragua.⁷ With the exception of mainly 1981, the Swedish share of both bilateral and total grants increased fairly steadily until 1989. However, with the change of government in Nicaragua in 1990, it took a downturn as assistance from the United States and the multilateral agencies began to expand. Thus, the Swedish share of bilateral (DAC) aid increased from 17.3 percent to a peak of 35.5 percent after about a decade, falling to 6.6 percent in 1991. By and large, the Swedish share of DAC plus multilateral aid followed a similar pattern, on a smaller scale, however, increasing from around 10 percent during the early years to 27.6 percent in 1989, dropping thereafter to 6.2 percent in 1991.

⁶ Bulmer-Thomas (1987), p. 29.

⁷ Cf. footnote 28 in Chapter 1.

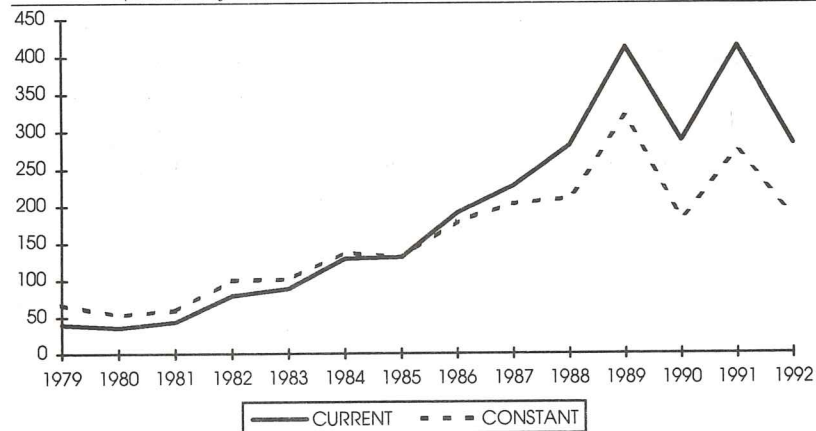
Figure 2.10: Sweden's Share of Nicaragua's Grants from DAC Countries and Multilateral Agencies, 1979-1991
(percentages)



Sources: SIDA (various issues-a,b) and OECD/DAC (various issues).

Figure 2.11 shows the development of Swedish aid to Nicaragua in current and constant terms. From a modest start in 1979, the current value climbed to a peak of 415 million Swedish kronor in 1991, only to fall by some 131 million the following year. In

Figure 2.11: Sweden's Official Development Assistance to Nicaragua, 1979-1991
(millions of current and constant 1985 Swedish kronor)

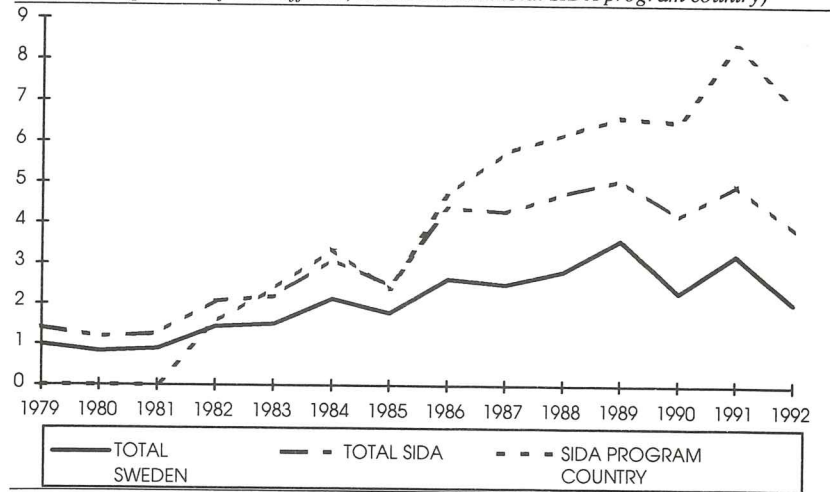


Sources: SIDA (various issues-a).

constant 1985 Swedish kronor, peaks of 321 million and 274 million were reached in 1989 and 1991, respectively, with a figure for 1992 of roughly 185 million.

In Figure 2.12, Swedish aid to Nicaragua is shown as a percentage of total official Swedish assistance, total SIDA assistance and total SIDA program country assistance, respectively. Until the latter half of the 1980s, none of these figures reached the 3

Figure 2.12: Nicaragua's Share in Sweden's Official Development Assistance, 1979-92
(percent of total official, total SIDA and total SIDA program country)

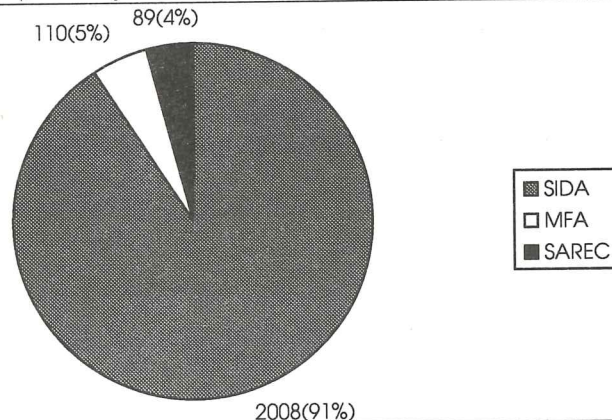


Sources: SIDA (various issues-a,b).

percent level. Thereafter, all three curves reflect a rise. However, the share of the total has remained low, basically below 3 percent. The share of overall SIDA assistance climbed to 4-5 percent and in terms of the assistance to the program countries, the figure increased from slightly more than 2 percent in 1985 to 8.4 and 6.9 percent in 1991 and 1992.

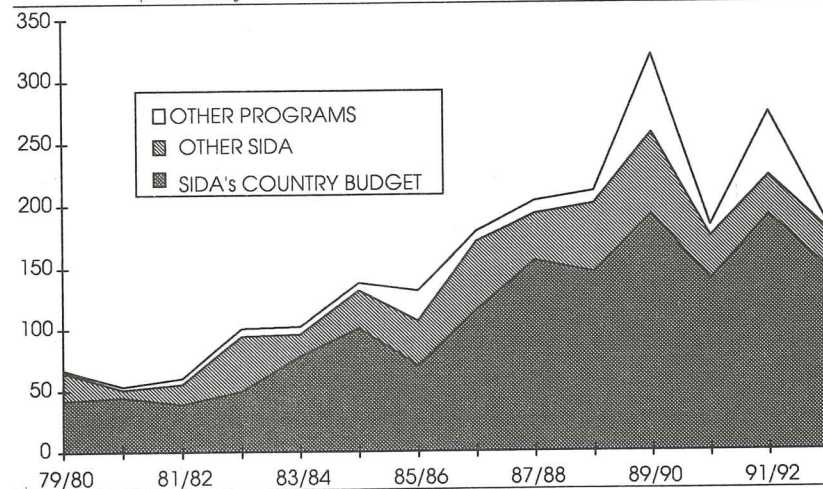
Figure 2.13 shows the distribution of Swedish assistance by agency over the entire 1979-93 period. SIDA dominates the picture completely with over 90 percent, while the shares channeled via SAREC and the Ministry for Foreign Affairs are very small by comparison.

Figure 2.13: Sweden's Official Development Assistance to Nicaragua. Total Disbursements by Agency, 1979-1993
(millions of constant 1985 Swedish kronor)



Sources: SIDA (various issues-a,b).

Figure 2.14: Total Disbursements of Sweden's Official Development Assistance to Nicaragua, 1979/80-1992/93
(millions of constant 1985 Swedish kronor)

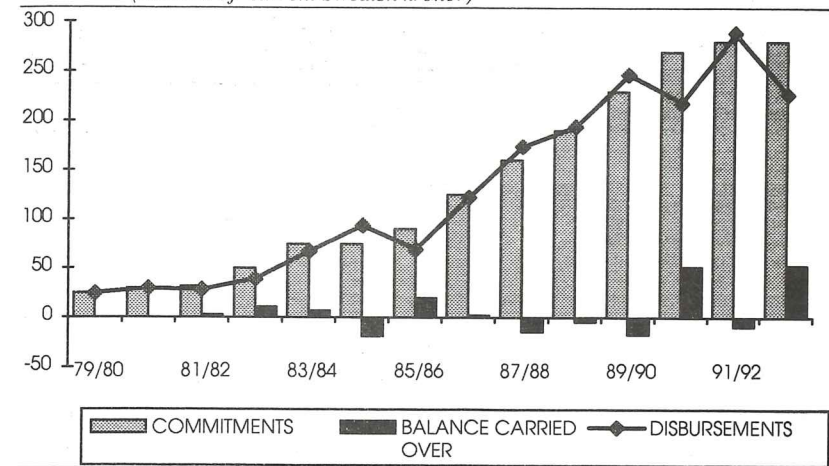


Sources: SIDA (various issues-a,b).

In Figure 2.14, total Swedish assistance has been broken down into SIDA's country budget, other SIDA funds and other programs. The country budget dominates the picture, but perhaps the most interesting feature is the two peaks in 1989/90 and 1991/92, resulting from increased balance of payments support.

In Figure 2.15, we look at the relations between the SIDA country budget commitments, actual disbursements and balances carried over to subsequent years. The figure does not reveal any repeated pattern; instead, surplus years alternate with deficit ones without any apparent regularity.

Figure 2.15: Sweden's Official Development Assistance to Nicaragua through SIDA Country Budget. Commitments and Disbursements, 1979/80-1992/93
(millions of current Swedish kronor)

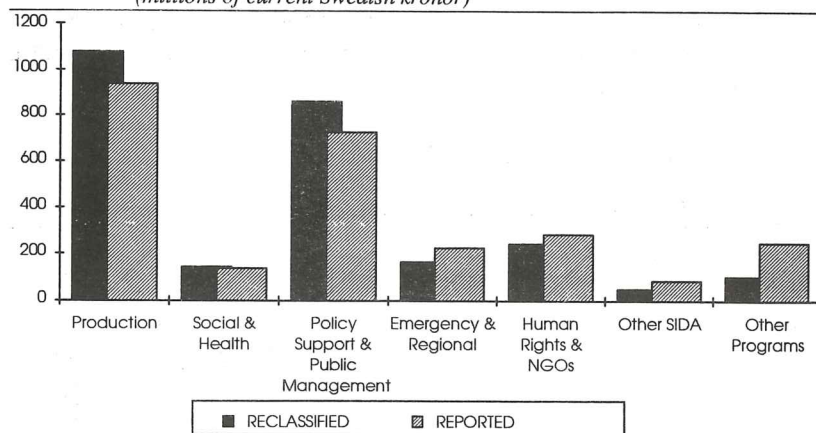


Sources: SIDA (various issues-a,b).

The numbers contained in Figures 2.13-2.15 refer to totals for SIDA, the Ministry for Foreign Affairs and SAREC. They are global figures and can be considered correct. Once we turn to analysis at the sectoral level, this is no longer the case. In Figure 2.16, an attempt has been made to reclassify the sectoral figures provided by SIDA to arrive at a more correct sectoral distribution. This exercise had to be undertaken for several reasons. In the first place, in the original figures only the assistance that falls under the country budget (*landram*) classification has been broken down according to sector. Second, it is not clear what the basis for this sectoral classification has been. It does not always seem to be based on economic criteria. This is true not least for the 'other SIDA'

category. Also, general headings such as 'emergency' or 'NGOs' contain funds actually allocated to specific economic sectors.

Figure 2.16: Classification Bias in Sweden's Official Development Assistance to Nicaragua. Total Disbursements, 1979-1992 (millions of current Swedish kronor)



Sources: Own estimations based on SIDA (various issues-a,b).

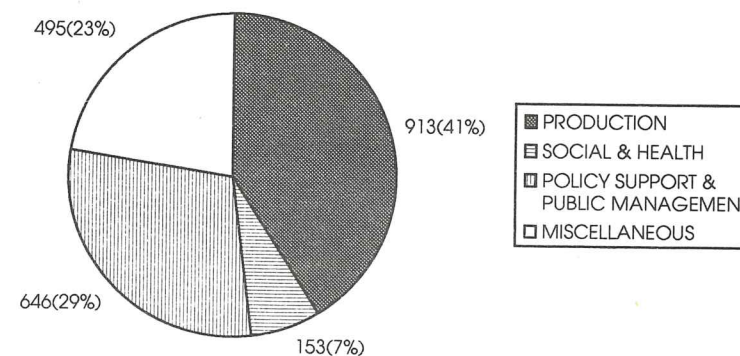
When a reclassification is attempted, the discrepancies illustrated in Figure 2.16 result. The criterion employed has been to reclassify items according to the type of sector where they end up. SIDA's classification, on the other hand, which employs categories such as 'country budget', 'multisector', 'emergency', 'regional programs' etc., may be helpful when it comes to looking at the internal origin of the funds, government decision-making etc., but it tells us very little about the economic use for which the funds were actually earmarked. Hence, it cannot be used for economic analysis.

While the reclassification allows us to reduce the size of some of the more nebulous items, it is still not quite satisfactory. The data do not allow cutting down further on the 'emergency and regional', 'NGOs', 'other SIDA' and 'other programs' categories. What is needed in the future is an overhaul of SIDA's system of statistical reporting in such a fashion as to allow for a classification of *total* assistance according to some criterion that make the figures useful for economic analysis.

Figure 2.17 translates the reclassified Swedish assistance to Nicaragua by sector into percentages of the total in real terms. As can be seen, the bulk of the support has gone to production, with policy support and public management coming second. Social sectors and health have received only a minor share --7 percent. The figure also

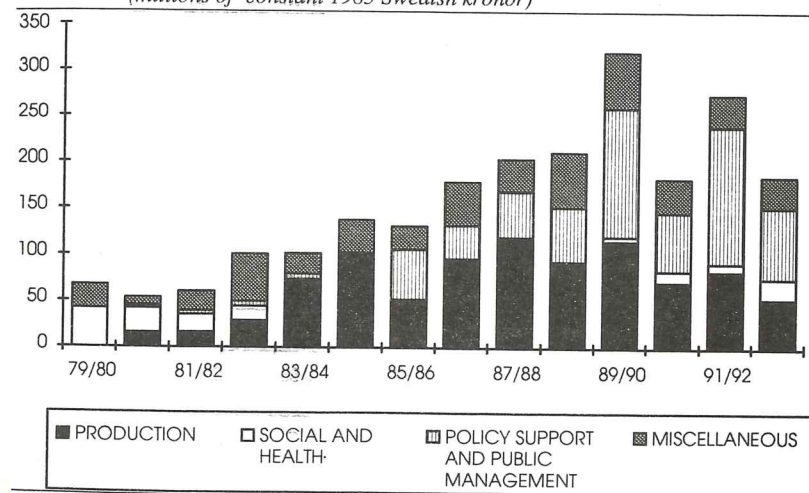
illustrates the problem with the remaining 'residual' of sectors that are difficult to classify --no less than 23 percent.

Figure 2.17: Sweden's Official Development Assistance to Nicaragua by Sector. Total Disbursements, 1979-1993 (millions of constant 1985 Swedish kronor)



Sources: Own estimations based on SIDA (various issues-a,b).

Figure 2.18: Sweden's Official Development Assistance to Nicaragua by Sector 1979-1993 (millions of constant 1985 Swedish kronor)

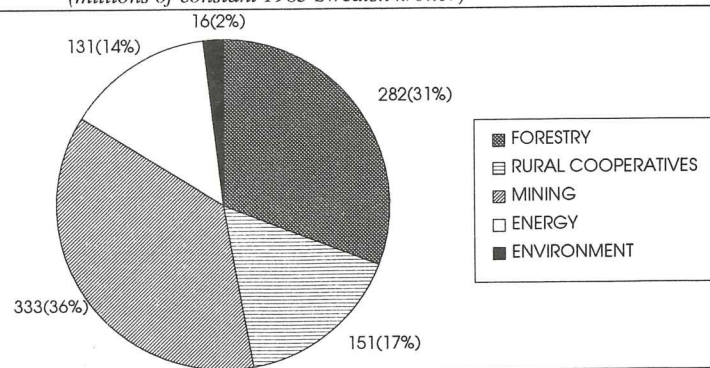


Sources: Own estimations based on SIDA (various issues-a,b).

Figure 2.18 shows the development, over time, of the four sectors included in Figure 2.17. The most striking observation is the shift of emphasis, over time, away from production, i.e. projects, towards more general programs in the form of policy support and support to public management. The chart also shows the checkered fate of social and health support, which constituted the largest sector during the first few years and thereafter disappeared almost entirely, to re-emerge at the end of the 1980s. The trends illustrated in the figure can be expected to continue in the near future, based on the contracts signed.

Figures 2.19-2.22 reveal the composition of the various (reclassified) sectors in Figures 2.16 and 2.17. Figure 2.19 deals with production. Here, the emphasis has been on mining and forestry, in that order, with rural cooperatives and energy accounting for slightly more than half as much.

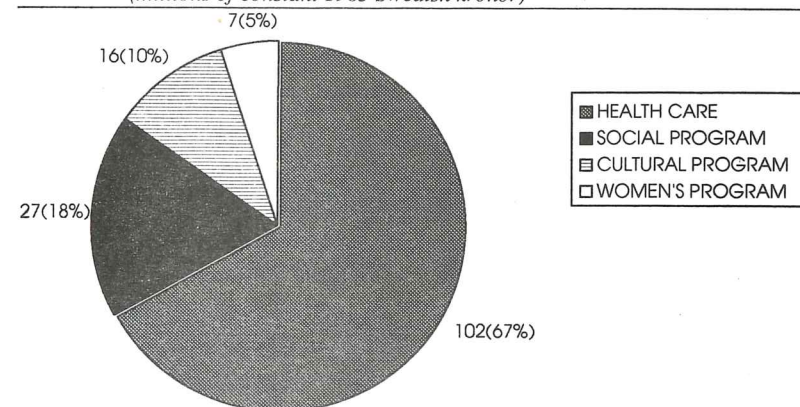
Figure 2.19: Swedish Contribution to the Production Sector by Subsector. Total Disbursements, 1979-1993
(millions of constant 1985 Swedish kronor)



Sources: Own estimations based on SIDA (various issues-a,b).

Figure 2.20 shows that in the social sector, health care programs dominate the picture, with close to half the total allocation, followed by social, cultural and women's programs.

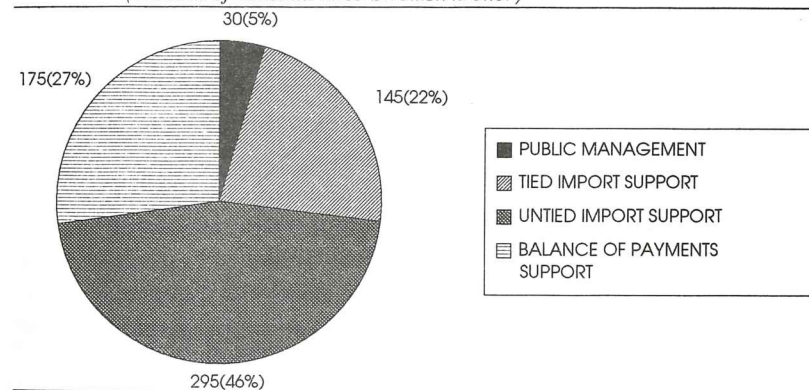
Figure 2.20: Swedish Contribution to Social Sector by Subsector. Total Disbursements, 1979-1993
(millions of constant 1985 Swedish kronor)



Sources: Own estimations based on SIDA (various issues-a,b).

In Figure 2.21 we find the distribution of policy support, which is completely dominated by import support. Almost 50 percent has gone to untied and almost 20 percent to tied import support. Support to the balance of payments completes the

Figure 2.21: Swedish Contribution to Policy Support by Subsector. Total Disbursements, 1979-1993
(millions of constant 1985 Swedish kronor)

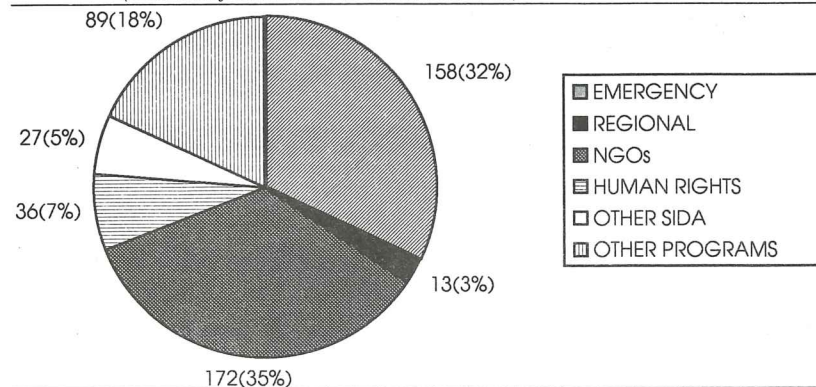


Sources: Own estimations based on SIDA (various issues-a,b).

picture.⁸ The policy support category called for some reclassification of the import support items, some of which corresponded not only to other specific projects outside the policy support category, but also to import support within the sector itself.

Finally, Figure 2.22 shows the subsectors of the 'miscellaneous' category, with NGOs in the lead, followed by emergency measures and a relatively large 'other' category.

Figure 2.22: Swedish Contribution to the 'Miscellaneous' Sector by Subsector. Total Disbursements, 1979-1993 (millions of constant 1985 Swedish kronor)



Sources: Own estimations based on SIDA (various issues-a,b).

To sum up, Swedish assistance to Nicaragua has been given exclusively in the form of grants. Its share of the funds provided by DAC countries and multilateral lending agencies increased up until 1989 and decreased thereafter, with the re-entry of the United States and the major multilateral institutions after the change of government in Nicaragua. In real terms, Swedish assistance peaked in 1989 and (to a lesser extent) in 1991, as a result of increased balance of payments support.

Nicaragua's share of total Swedish official development assistance has always remained low --below 3 percent-- and its share of total assistance administered by SIDA has consistently stayed below 5 percent. (SIDA has handled over 90 percent of the total.) Most of the Swedish support has gone to production (mainly mining and forestry), with policy support and public management (mainly import support) second

⁸ Generally speaking, Swedish import support was not policy-oriented in the 1980s. Presently, Swedish balance of payments support, which includes both import support and debt relief, is given only to those countries which are implementing an IMF/IBRD economic reform program.

in line, whereas the social sectors have received less than 7 percent of the total. However, the pattern has changed since 1989, moving away from projects toward mainly balance of payments support.

2.3.1 Technical Assistance in Swedish Aid to Nicaragua

A last issue to be considered in this chapter is the weight of technical assistance in Swedish support to Nicaragua. Here, we will approach the issue by classifying aid flows in two main categories, namely material resources, i.e. goods and money, and non-material ones, in the form of technical assistance.⁹

The rationale for this classification is that these two categories serve different macroeconomic functions. In principle, the main macroeconomic function of material resources is to enhance the production and consumption possibilities of the recipient country and to contribute to the stabilization and restructuring of the economy. The macroeconomic function of technical cooperation is more diffuse.¹⁰ As a transfer of expert services, technical cooperation comprises a large variety of activities performed by foreign experts working under contract with donor agencies, most often in connection with the implementation of specific development projects and programs. In this sense, the function of technical assistance is to ensure the success of projects and programs and to facilitate resource flows. As a transfer of knowledge, technical cooperation includes training assistance, institution-building assistance, and, more generally, the dissemination of new technologies. In this sense, the function of technical assistance is to contribute to the development of institutional and human capabilities and, ultimately, to create conditions for self-reliance.

These two facets of technical assistance are difficult to separate in the present case. During the first years of the Sandinista government, Swedish aid to Nicaragua mainly consisted of material resources (import support) for the health sector. Technical assistance was limited to pre-feasibility studies within the mining and forestry programs and two small projects in the field of public administration.¹¹ During following years, technical assistance to Nicaragua increased as the execution of the

⁹ A third category is debt relief. This has not been considered because of its limited size. Between 1985 and 1991, Sweden's debt relief operations amounted to 600 million Swedish kronor. Of these, 18 million corresponded to Nicaragua. Cf. SIDA (1992-a).

¹⁰ As stated by Cassen et al. (1986), the macroeconomic function of technical assistance is to facilitate the transition to self-reliance. The authors, however, indicate that this objective 'remains poorly defined'.

¹¹ The two projects were the Tax Administration Project carried out by a Swedish consultancy firm (Statskonsult International) in close collaboration with the Nicaraguan Ministry of Finance and the preparation of a manual on Sweden as a partner in international development.

three development projects gained momentum. These, however, have educational, training and institution-building components.

Table 2.1: Swedish Aid by Macroeconomic Function, 1970-1993
(millions of current Swedish kronor)

	1986/1988 ^a			1989/1993			1979-93
	Material Resources %	Technical Assistance %	Total Paid	Material Resources %	Technical Assistance %	Total Paid	Share in Total Aid %
Forestry	58.2	41.8	65.6	67.2	32.7	132.7	13.0
Mining	61.5	38.5	90.3	74.8	25.2	97.4	15.0
Energy	71.1	28.9	45.0	70.8	29.2	130.6	6.0
Import-support	-	-	-	99.9	0.1	481.9	20.0
Bal-of-P support	-	-	-	100.0	0.0	127.8	8.0
Social sector	-	-	-	99.9	0.1	39.6	7.0
Rural cooperatives	-	-	-	99.6	0.4	57.6	7.0
Women's program	-	-	-	97.7	2.3	4.6	-
Cultural program	-	-	-	99.3	0.7	20.4	-
Other programs	-	-	-	88.7	11.3	127.8	24.0
Total	-	-	-	90.0	10.0	1,220.4	100.0

a) 1987/1989 for Energy.

Sources: SIDA EA-system and diverse SIDA documentation.

Statistics which allow for the distribution of Swedish aid by macroeconomic function were not available for the whole 1979-93 period, but we were able to produce estimates for the sub-periods 1986-89 and 1989-93¹². These estimates are shown in *Table 2.1*. As reflected in the table, technical cooperation constituted only one-tenth of total aid from 1989 to 1993. There are, however, some indications that the share for the entire 1979-93 period was larger. The 1986-89 shares of technical cooperation for the mining and forestry programs exceed the corresponding 1989-93 figures by about 10 percentage points and no change is recorded in the energy sector. Together, these sectors represent more than 30 percent of the aid provided during the entire 1979-93 period.

¹² The SIDA EA-system provides data broken down by type of expenditure only for the last four budget years. We have used these figures, after some adjustments, to estimate the 1989-93 distribution. The transfers of material resources were estimated on the basis of the expenses under accounts 7 and 5343 and balance of payments support from the Ministry for Foreign Affairs. In principle, technical assistance was estimated on the basis of the expenses under account 5 (excluding item 5343). The expenses under accounts 4 and 6 (SIDA's personnel and administration) were also considered, but these represented less than 1 percent of the amount disbursed during the period. We have not considered the expenses included in the Personnel and Consultancy fund (1.5 percent of the amount disbursed during the period) because it was not possible to classify these by sector. For the 1986-89 period (1987-89 in the case of the energy project), we have had to rely on the information supplied by consulting firms. Two limitations of this information were: a) it was not complete with respect to the activities included in the projects, and b) it was discontinued in several years. Useful information was available only for the mining, forestry and energy projects.

Additional evidence is provided by Nicaraguan sources.¹³ Using data from these sources, we produced a gross estimate of the 1979-89 share. The estimate put the value of the share at 18 percent. All of the foregoing leads us to conclude that technical assistance represented about 15 percent of Swedish aid to Nicaragua in 1979-93.

¹³ Contreras et al. (1991) and *Ministerio de Cooperación Externa*.

Chapter 3. ECONOMIC GROWTH, SOCIAL PERFORMANCE AND POLICY CHANGE

This chapter focuses on Nicaragua's economic and social performance during the Sandinista period, which is the main period under consideration in the present study. Our aim is twofold. On the one hand, we provide the reader with a general background of Sandinista economic policy, before entering specifically, in Chapters 4 and 5, into considerations of the macroeconomic effects of aid. On the other, we give a brief account of the extraordinary conditions under which economic policy had to be formulated during those years.

We begin with a cursory sketch of the growth experience of the Nicaraguan economy during the three decades after 1950, including the war against Somoza. The second section deals with the macroeconomic effects of the conflict between the Sandinistas and the Reagan administration in the United States. This is followed by an analysis of the social achievements of the 1980s and the possible contribution of foreign aid to that process. In the fourth section we review the foreign trade experience of Nicaragua in the context of the Central American Common Market. Section 5 deals with the disastrous exchange rate policy of the 1980s and its impact on foreign trade. Subsequent sections examine Nicaragua's fiscal and monetary policies and their role in the hyperinflation process. Finally, the evolution of investment and savings is traced.

3.1. Economic Growth and Structural Change

The generally favorable growth pattern of the Nicaraguan economy up to 1978 is clearly mirrored in the first group of indicators displayed in *Table 3.1*. The Nicaraguan economy expanded at an average annual rate of almost 6 percent between 1950 and 1975. During the same period, manufacturing grew at a rate of 8 percent. The share of investment in GDP, in turn, expanded at an average annual rate of 13.5 percent between 1960 and 1970 and 11 percent during the subsequent five years. This sustained economic growth allowed for a remarkable increase in real income per capita. Per capita GDP rose at an annual rate of 1.7 percent between 1950 and 1960 and 3.5 percent between 1960 and 1970, despite accelerated population growth.

As might be expected, rapid economic growth induced changes in the economic structure. Increases in per capita GDP, for instance, were associated with increasing shares of manufacturing output in GDP and with the simultaneous transfer of labor from low-productivity activities, such as agriculture, to high-productivity activities such as manufacturing. As a whole, the share of GDP represented by manufacturing, construction and electricity rose from 19.6 percent in the 1950s to 29.6 percent in the mid-1970s.

Table 3.1: Economic Growth and Structural Change, 1950-1993
(constant 1980 prices)

	1950-60	1960-70	1970-75	1975-1980	1980-90	1990-93
1. Economic growth ^a						
Investment ^b	n.a.	4.9	5.0	-15.2	5.4	3.6
GDP	5.3	6.9	5.1	-4.2	-1.5	-0.2
Per capita GDP	1.7	3.5	1.7	-6.9	-4.1	-3.7
Agriculture	3.0	6.2	4.9	-4.7	-0.9	-0.2
Mining	2.5	1.3	-4.5	-22.8	-3.7	5.6
Manufacturing	7.3	11.1	5.9	-0.9	-3.2	-0.2
2. Shares in GDP ^c						
Agriculture	23.7	25.3	22.5	23.2	31.1	30.4
Mining	1.3	0.6	0.4	0.7	0.5	0.6
Manufacturing	16.0	20.2	22.5	25.6	16.9	16.4
Construction	2.3	3.2	5.5	2.9	2.6	2.3
Electricity	1.3	1.5	1.6	2.1	1.1	1.1
Services	55.3	49.2	47.6	45.4	47.8	49.1

a) average annual rates b) share of investment in GDP c) end of period

Source: Banco Central.

The process of economic development and industrialization was not accompanied by a concomitant improvement in income distribution and social welfare. In 1976, one year before economic growth was abruptly interrupted by the Sandinista insurrection, more than 70 percent of the rural population had per capita earnings below the \$150 required to meet minimum subsistence needs. Life expectancy at birth was the lowest in Central America and nearly 50 percent of the population was illiterate.

The defeat of the Somoza dictatorship called for enormous sacrifices on the part of the Nicaraguan people. According to ECLAC estimates, more than 35,000 people lost their lives in the struggle, 10,000 were seriously injured and 50,000 children were orphaned. Proportionally, these human losses exceeded those of most of the combatant countries in World War II, and ranks the Nicaraguan revolution as a human catastrophe.¹ Furthermore, production losses amounted to over 2 billion US dollars while direct damage to infrastructure and productive capacity was estimated at 471 million US dollars.² As a consequence, the high rates of growth of GDP, investment and industrial output attained in the 1960s and the early 1970s turned into negative figures in subsequent years. When the Sandinista government took office in 1979, GDP and consumption per capita were 35 percent below their 1976 levels (cf. *Figure 3.1* below).

The new government initiated an economic policy aimed at reconstructing the damaged economic infrastructure, increasing the consumption level of the low-income groups and dismantling the economic base of the old regime. At the same time, it

¹ Weeks (1985), p. 156.

² Ibid.

implemented an expansive investment policy and provided incentives to production, especially agriculture. However, the results of the new policy were extremely unsuccessful in most respects, for reasons that we will examine at some length below. Efforts to stimulate industrial production and exports failed and GDP continued to fall during the 1980s despite the large inflows of foreign aid. As shown in *Table 3.1*, the largest output reductions were recorded in manufacturing and mining. This resulted in the increasing share of agriculture in GDP. Between 1970 and 1975, this share averaged about 23 percent. The corresponding figure for the 1980-90 period was 31 percent. By 1990, Nicaragua's industrialization level, as measured by the share of industrial output (manufacturing, construction and electricity) in GDP, was about 20 percent, only slightly above the level attained during the 1950s. Four years later it remained unchanged.

3.2. Macroeconomic Effects of the US-Nicaragua Conflict

One cannot speak of normal conditions in Nicaragua between 1982 and 1990. From the first years of the Sandinista government, the Reagan administration regarded it as an example of rabid radicalism, a new version of Castroism, which endangered vital American interests in the area. Consequently, this administration in 1981 began to provide financial and logistic assistance to the *Contras* and increased support for the political opposition. In the ensuing years, the US-Nicaragua conflict transformed into what William Robinson has called 'a war of attrition', that is, 'well-synchronized military, economic, political, diplomatic, psychological and ideological pressures'.³ Apart from covert and overt military actions, this special war included a blockade of multilateral funds, a trade embargo, and active diplomacy to obstruct economic support for the Nicaraguan economy. The *Contra* war continued until the 1990 elections. As we will see, this had devastating effects on the Nicaraguan economy.

In 1986, the Sandinista government conducted an evaluation of the social and economic costs of the unconventional conflict in which Nicaragua and the United States were engaged.⁴ The study was prepared by the *Ministerio de la Presidencia* with the technical assistance of the United Nations Economic Commission for Latin America and the Caribbean (ECLAC). According to the estimates of this study, the direct economic losses during the 1980-85 period amounted to 900 million US dollars including the damages caused by the US-financed *Contra* war, the trade embargo and the financial losses due to the blockade of hundreds of millions of dollars in development projects. A comparison of actual and forecast levels of real GDP produced

³ Robinson (1992), p. 12.

⁴ Nicaragua (1986).

by the World Bank in 1980 suggests that the total costs were higher still.⁵ The forecast took into account the damages due to the 1978-79 civil war against Somoza and the flight of capital precipitated by the Sandinista victory. A comparison of the two loss estimates is presented in *Table 3.2*.

Table 3.2: The Cost of the US-Nicaragua Conflict, 1980-1985
(millions of current US dollars)

	Direct losses	Actual	GDP Forecast	GDP loss
1977		2,931	2,931	
1980	1.5	2,080	2,080	--
1981	15.6	2,191	2,432	241
1982	70.4	2,174	2,500	326
1983	240.5	2,270	2,601	331
1984	304.7	2,238	2,696	458
1985	267.1	2,179	2,861	682
Total	899.8			2,038
Average annual growth rate		0.9	6.5	

Source: Nicaragua (1986).

As reflected in the table, the macroeconomic costs amounted to over 2 billion current US dollars or a reduction in the average annual growth rate of more than 5 percentage points. Later, in 1990, the *Ministerio de la Presidencia* used the same methodology to estimate the 1979-90 direct and total economic losses. The former amounted to 2 billion US dollars and the latter to 18 billion --almost half the per capita income.⁶ To this must be added the displacement of hundreds of thousands of people from their homes.⁷

Nothing could therefore be more misleading than the notion that the problems the Chamorro government faced in 1990 depended exclusively on worsening external economic conditions and faulty development strategies during the 1980s. Such a notion has been commonplace in World Bank and IMF reports after 1990. However, it contradicts these agencies' own appraisal of Nicaragua's economic prospects, as stated a decade earlier. In fact, what the World Bank forecast suggests is that if normal political circumstances had prevailed during the early 1980s, the Nicaraguan economy would more or less have reached its 1977 level already in 1985. It is worth noting here that real GDP increased at an average annual rate of 6.6 percent between 1970 and 1977 and

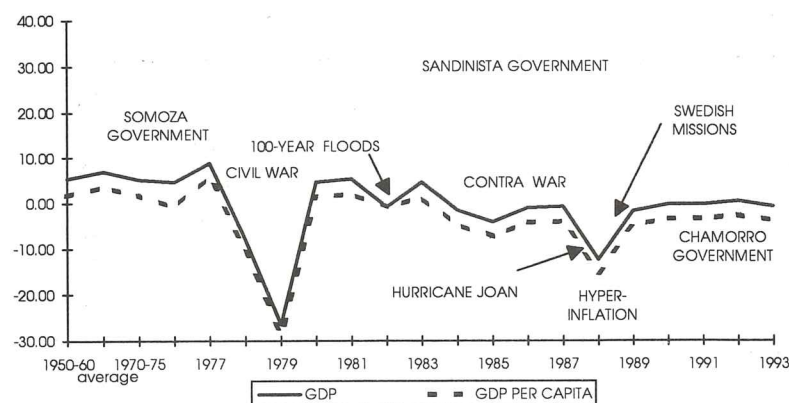
⁵ Reproduced in *ibid*.

⁶ Information taken from Contreras et al. (1991).

⁷ 300,000 were internally displaced persons and another 150,000 were refugees from neighboring countries. See PAHO (1983).

then decreased by 30 percent between 1977 and 1979 because of the civil war (cf. Figure 3.1).

Figure 3.1: Growth of Real GDP and GDP Per Capita, 1950-1993
(percent per annum)



Source: Banco Central.

Figure 3.1 provides a complete overview of Nicaragua's economic performance in terms of the evolution of GDP between 1950 and 1993 and relates it to a number of extra-economic factors hampering growth, namely the 1978-79 civil war, the 1982 '100-year floods',⁸ the *Contra* war and Hurricane Joan at the end of 1988. As shown in the figure, economic activity recovered after the civil war, but recuperation efforts were hampered in 1982 by the devastating floods. GDP increased the following year, but as *Contra* activities grew into open armed conflict, the negative impacts on production and resource availability were amplified. This, together with massive money emission to finance defense and central government operations, the United States trade embargo, and misguided foreign exchange and credit policies completely distorted the functioning of the markets (cf. below and Chapter 4, for an analysis). The destruction caused by Hurricane Joan at the end of 1988 aggravated the already difficult situation in the agricultural sector and fueled inflation. By 1989, the combination of all these factors had resulted in hyperinflation and the virtual collapse of the economy.

⁸ More than 6,000 people living in the districts (*departamentos*) of Managua, Chinandega, Carazo and Estelí were affected by the floods. In order to support the reconstruction of those areas, Sweden made extra financial assistance, in the order of 10 million Swedish kronor, available to Nicaragua.

3.3. Social Development and Income Distribution

Robert Cassen and his collaborators analyze the development objectives of aid and state that both donors and recipients need 'to strike a balance between [...] long-term development, support for import needs and policy reforms, and schemes for tackling poverty'.⁹ They furthermore point out that 'despite rapid growth in many developing countries, widespread poverty remains [and] has often worsened', and conclude that, 'these are the grim realities against which aid's record must be judged'.¹⁰ On this count, however, the Sandinistas were successful. In this section, we assess the nature of poverty in Nicaragua and analyze its evolution during the 1980s when Nicaragua was receiving considerable external resource inflows in the form of both concessional loans and grants.

Table 3.3: Selected Social Development Indicators, 1970-1990

	1970-75	1975-80	1980-85	1985-90
Total population growth ^a	3.2	2.8	3.3	3.4
Birth rate ^b	47.2	46.0	45.0	43.5
Mortality rate ^c	12.7	11.3	10.3	8.8
Life expectancy at birth ^d	55.2	57.6	59.3	62.4
Infant mortality ^e	100.0	96.6	85.6	71.1
Population per physician ^f	2.1 ^o	2.0 ^m	1.8	1.8
Public expenditure on health ^g	0.7 ^o	4.4 ^m	5.0 ^m	6.6 ^p
Public expenditure on education ^g	2.3 ^o	3.5 ^m	6.6 ^m	5.8 ^p
Illiteracy ^h	42.5 ⁿ	n.a.	13.0 ^m	n.a.
Education: gross enrolment rates ⁱ	39.9 ^o	n.a.	52.3 ^m	53.5 ^m
Growth of per capita private consumption ^j	n.a.	-2.2 ⁿ	-7.8	-8.3 ^m
Quantum indexes of per capita food production ^k	113 ^m	86 ^m	74 ^m	60 ^m
Very poor urban households ^l	n.a.	21.6 ^m	n.a.	21.2 ^q
Poor urban households ^l	n.a.	24.0 ^m	n.a.	22.0 ^q

a) average annual rates per 100 inhabitants b) gross birth rates per 1,000 inhabitants c) average annual rates per 1,000 inhabitants d) years e) average annual rates per thousand live births f) 1,000 inhabitants per physician g) percentage of gross domestic product at current prices h) percentage of the population aged 15 years and over i) total number of enrolled persons between 7 and 21 years of age divided by population in that age group, multiplied by 100 j) average annual rates k) base 1979-81=100 l) percentage of total urban households m) end of period n) 1970-1980 o) beginning of period p) 1986 q) 1992

Sources: ECLAC (various issues), Wilkie and Lorey (various issues), Renzi and Agurto (1993).

A major observation contained in Table 3.3 is that the Sandinista government made great efforts to improve the social infrastructure. As the table indicates, the share of public expenditure in health and education grew from 3 percent in 1975 to more than 12 percent in 1986. This had a clear positive effect on the welfare of the poor who are potentially the most important beneficiaries of these types of services. Note, for

⁹ Cassen et al. (1986), p. 66.

¹⁰ Ibid. p. 63.

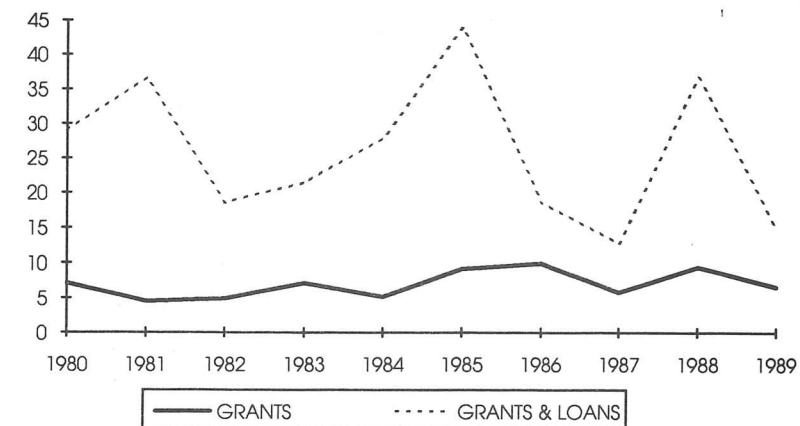
instance, the reduced infant mortality and the increasing life expectancy at birth. Literacy and school enrolment rates also improved markedly. Per capita private consumption and food production deteriorated but the Sandinista policy of controlling nominal food prices, together with substantial food aid, virtually put an end to famine-related deaths. Note, finally, the slight improvement in the income distribution of the urban population, as suggested by the indicators displayed in the last two rows of the table. The overall impression is that social welfare improved in the 1980s.

A pertinent question which emerges in this context is to what extent foreign aid contributed to these achievements. As shown in Chapter 2, most of the external resources were tied to either investment projects or specific import programs. Of the latter, only twenty percent were clearly poverty-oriented, including projects and programs intended to increase the supply of consumption goods and/or improve the social infrastructure. This indicates that the *direct* contribution of foreign aid to the relief of poverty was rather limited. Possibly, however, the *indirect* contribution was larger. Three main objectives of the Sandinista government were to improve income distribution, to raise living standards and to rebuild the devastated economy. It was understood that these three objectives had equal priority and that they were compatible with each other in the short term. Yet, this strategy would not have been feasible even from this perspective without the massive aid that Nicaragua received after the Sandinista triumph.

As shown by Figure 3.2, the share of grants in GDP amounted to about 10 percent on average during the 1980s. Including medium- and long-term credits makes the average share increase to about 35 percent. It is evident that if aid flows had not been sustained at that level, the Sandinista government would have been obliged either to sacrifice the gains in living standards in order to finance investment or, alternatively, to postpone the rebuilding of the country's productive capacity. The conclusion, therefore, if we are to judge from the social indicators in Table 3.3, is that aid to Nicaragua had a short-term positive impact on equity and living standards but that this mainly depended on the fact that the Sandinistas were highly committed to implementing social policies which favored the poor.

On the other hand, the failure of the Sandinista government to increase food production should be a matter of immediate concern for donors. There is no doubt that this depended in part on the direct damage to agricultural production caused by war, but it is also true that Sandinista agricultural policy failed to increase output and productivity despite a massive infusion of credit. Hence, the question remains if foreign aid was actually a force driving in the right direction.

Figure 3.2: Official Development Finance to Nicaragua. Commitments from All Sources, 1980-1989
(percent of GDP, current US dollars)



Sources: Banco Central and Contreras et al. (1990).

From a long-term perspective, another question arises with respect to the role of aid. During the 1980s, as we will see below, a catastrophic economic policy was implemented which finally (cf. Chapter 5) forced stabilization and adjustment measures on the Nicaraguan economy. It may thus be argued that if the inflow of foreign aid had been smaller in the 1980s, this necessary change of course, without which the gains in terms of social welfare would be unsustainable in the long run, would have come sooner. From this perspective, aid may have done indirect damage. Thus, the conclusion to be drawn with respect to the contribution of foreign aid to social welfare in Nicaragua to a certain extent depends on the time reference one chooses to employ.

In this context, as discussed at greater length in Chapter 5, it should be noted that Sweden made a pioneering contribution when it came to establishing a policy dialogue which contributed to the stabilization effort.

3.4. External Imbalance and Industrial Protection

External imbalance has been a constant source of economic instability in Latin American countries. Nicaragua and the other Central American countries are no exceptions.¹¹ During the years of intensive import substitution and rapid intra-regional

¹¹ Cf. Bulmer-Thomas (1987), *passim*, for an analysis of the region since 1920.

trade expansion within the protected Central American Common Market (CACM), external imbalance constrained economic growth by limiting the capacity of CACM members to import the necessary investment goods. This can be seen in *Table 3.4* which provides basic information on the external performance of the CACM and compares said performance with that of Nicaragua. The comparison is made with reference to three main indicators: the share of intra-regional trade in total trade, the merchandise trade balance and the current account balance.

Table 3.4: Foreign Trade of Nicaragua and CACM Countries, 1960-1985
(millions of current US dollars)

Year	Intra-regional Trade		Merchandise Trade Balance		Current Account Balance	
	CACM	Nicaragua	CACM	Nicaragua	CACM	Nicaragua
1960	6.8	4.5	-23.3	7.4	-81.8	-11.2
1965	17.4	8.3	-28.6	15.3	-163.6	-27.2
1970	24.9	25.8	-9.1	0.0	-192.9	-43.1
1975	23.3	24.7	-353.3	-107.2	-700.6	-197.5
1980	25.4	17.3	-604.9	-371.0	-1,644.6	-430.0
1985	13.9	8.8	-873.5	-489.2	-1,968.2	-726.5

Source: ECLAC (various issues).

Until the early 1970s Nicaragua had run trade surpluses almost all of the time, although the country frequently was in deficit with respect to intra-regional trade. However, as the table shows, the current account balance situation was quite different. It was persistently negative during the 1960s, as a result of non-factor service payments and large profit remittances abroad. Current account deficits had to be financed by external borrowing. However, because of the relatively small size of the deficits (less than 10 percent of GDP), both the external debt and the debt service remained at manageable levels.¹²

The remarkable external performance of the preceding decade did not carry on into the early 1970s as a consequence of a number of external and domestic factors, among others, the earthquake of December 1972, the first oil price shock in 1973 and the stagnation of intra-regional trade. Note that the share of intra-CACM exports in total exports, which amounted to only 7 percent in 1960, more than tripled to 25 percent in 1970, but ceased to increase thereafter. The corresponding figures for Nicaragua are 4 and 26 percent. The Nicaraguan terms of trade in turn fell by more than 20 percentage points between 1970 and 1975.¹³ These adverse trends generated large trade deficits and

¹² The debt service represented on average 17 percent of exports in the 1960s.

¹³ Defined as the quotient of the index of unit value of exports and the index of unit value of imports.

made the external debt increase rapidly from 260 million US dollars in 1972 to 1,347 million in 1979. By 1980, interest payments had become one of the main sources of external imbalance. Illustrative of this is the considerable increase in the share of interest payments in exports of goods and services, from 4 percent in 1970 to about 13 percent in 1979.

At the beginning of the 1980s, Nicaragua and the other CACM countries were experiencing increasing difficulties in balancing their external accounts.¹⁴ Mutually reinforcing factors behind these difficulties were the sharp decline in the prices of their main agricultural exports, the oil price hike and the unprecedented increase in international interest rates. However, there is no doubt that a major factor contributing to the region's extreme vulnerability to external disturbances was the structure of trade that developed behind the high protective barriers of the CACM.¹⁵

In order to promote industrialization, Nicaragua and its CACM partners applied high tariff rates to imports from third countries. In 1972, the ad-valorem-equivalent external tariff rate for CACM countries was 49 percent on average. The corresponding figure for Nicaragua was 54 percent.¹⁶ Supplementary incentives in the form of subsidies and duty exemptions for imported inputs and capital goods were also provided.

Nicaragua's manufacturing sector responded positively to this policy, but the latter paradoxically made the country more dependent on external circumstances. On the one hand, the enhanced market stimulated the installation of new industrial plants and the diversification of manufacturing exports. On the other, the demand for extra-regional imported inputs for the sector serving the regional market increased markedly.

As exports to third countries continued to be concentrated on relatively few agricultural commodities, and these were (and are), the dominant source of foreign exchange earnings, the vulnerability of the Nicaraguan economy to external fluctuations increased. In addition, all the CACM countries displayed a roughly similar trade pattern, i.e. intra-regional trade mostly consisted of manufactured products and extra-regional trade highly concentrated on a limited set of agricultural commodities on the export side and on intermediate and capital goods on the import side. This obviously amplified the impact of adverse external conditions on the Central American economies.

From 1980 onward, balance of payments disequilibrium and inappropriate exchange rate policies made the CACM countries introduce foreign exchange control

¹⁴ See Bulmer-Thomas (1988), Chapter 7, for a discussion.

¹⁵ Ibid., Chapter 4, Blomqvist and Lindholm (1992).

¹⁶ World Bank (1989).

and restrictions on imports. This, combined with the collapse of the regional payments clearing house and growing political and social tensions, brought about the virtual disintegration of the CACM and, subsequently, aggravation of the economic recession. Under these circumstances, the region's policy-makers were compelled to adopt reforms in their trade regimes at both the country and the common market levels. The trade reform program included reductions in external tariff rates and rationalization of the system of export incentives, but it was clear from the start that a necessary condition for the success of the reform program was to achieve more flexible exchange rate management.¹⁷

3.5. Exchange Rate Policy and Export Performance

Like the other CACM countries, Nicaragua employed a fixed exchange rate during the 1960s and the 1970s. This meant that the Nicaraguan national currency (the córdoba) was freely convertible and pegged to the US dollar. This policy was continued until 1978-79 when the Somoza government reintroduced foreign exchange controls and devalued the córdoba. In 1982, the Sandinista government replaced the fixed exchange rate system with a multiple exchange rate system. The latter combined rigorous foreign currency and imports controls with discontinuous and selective devaluations intended to promote exports.

These measures had a negative impact on the external sector. The deficits both in the trade balance and on the current account increased and, as a consequence, the distortions in the foreign exchange market were amplified. By 1984, the gap between official and parallel market rates¹⁸ amounted to 400 percent. The response of the authorities came in 1985 when the official exchange rate was changed from 10 córdobas per dollar to 28. Nevertheless, the Nicaraguan currency continued to depreciate rapidly, forcing the government to implement a new major devaluation in March 1986. On this occasion the official exchange rate was fixed at 70 córdobas per dollar. It was maintained at this level until 1988 when the government launched its first stabilization program (cf. Chapter 5).

¹⁷ Ibid.

¹⁸ The parallel market exchange rate was also administrated by the *Banco Central*. This market, however, was confined to tourist and other short-term transactions.

Table 3.5: The External Sector. Selected Indicators, 1980-1988

	1980	1982	1984	1985	1986	1987	1988
<i>Exchange rates</i>							
Nominal ^a							
Official	10	10	10	27	67	70	130 ^b
Parallel	17	28	n.a.	446	1,304	6,575	359 ^b
Black	n.a.	55	276	717	2,183	12,400	443 ^b
Real ^c							
Official	100	74	49	53	38	9	83
Parallel	100	120	n.a.	n.a.	389	344	143
Black	100	139	451	874	681	609	265
<i>Inflation rate</i>	25	22	50	334	747	1,347	33,600
<i>External accounts^d</i>							
Exports	445	408	413	305	248	273	233
Imports	816	714	735	794	677	734	717
Trade balance	-371	-305	-322	-489	-430	-462	-484
Current account balance ^e	-522	-500	-468	-627	-687	-608	-594
Net current transfers	124	52	90	127	115	135	189
Official long-term capital ^f	295	455	347	598	614	490	286

a) córdobas per US dollar b) 1 new córdoba=1000 old córdobas c) index numbers (base 1980=100)

d) millions of US dollars e) before transfers and excluding unpaid interest f) disbursements

Sources: IMF and Banco Central.

As mentioned earlier, two of the main objectives of the Sandinista exchange rate policy were to stimulate export growth and to stabilize the foreign exchange market. Neither objective was attained, in spite of the magnitude of the 1984-86 devaluations. Table 3.5 shows that overvaluation of the córdoba continued and was reinforced in the following years as the rate of inflation increased dramatically. Export earnings in turn decreased between 1985 and 1988 and this had a negative impact both on the trade balance and on the current account. Note, finally, that the sum of aid inflows, that is, officially guaranteed loans and transfers (mostly grants), almost corresponds to the deficit on the current account.

The data in Table 3.5 suggest the existence of an inverse relationship between a highly overvalued official exchange rate and export growth. This is hardly surprising in view of the fact that overvalued currencies usually shift incentives from traded to non-traded goods and, at the same time, heavily penalize the agricultural sector. As we know, the latter has always been the main source of Nicaragua's export earnings. There are thus good reasons to believe that the faulty foreign exchange policy during the 1980s was the main factor behind the weak export performance and the disappointing results in terms of the current account.¹⁹

¹⁹ The system of multiple exchange rates contributed to this process. In 1987, there were seven different rates for exports and three for imports. The average exchange rate for exports was more than three times the average for imports.

Yet, the persistence of negative export growth rates in the late 1980s and, especially, in the 1990s, raises some questions about the issue. As we will discuss in Chapter 5, from 1989 to the present, the Nicaraguan government has embraced orthodox stabilization and structural adjustment policies. One of the central ingredients of these policies is substantial devaluation of the official exchange rate and its use as a nominal anchor for the entire economy.²⁰ However, despite these measures, the official exchange rate has continued to appreciate in real terms. The gap between the official real exchange rate and the black market rate continuously increased until 1987, the year of the first massive devaluation. From 1988 onward, the former rate depreciated while the latter appreciated. By 1990 they had converged at their 1980 level. However, in August 1993, the official real rate was again overvalued, this time by 19 percent with respect to the 1991 parity. We will elaborate on this point in the following chapter.

3.6. Fiscal and Monetary Policies

Most analysts agree that the impressive growth of both public expenditure and domestic credit during the 1980s was the main factor behind the uncontrolled expansion of the money supply and, ultimately, behind the traumatic experience of hyperinflation by the end of the decade. The issue has been analyzed exhaustively in many academic studies focusing on Sandinista macroeconomic policies. Besides, it has been at the center of the reports prepared by the SIDA-sponsored missions and IBRD and IMF staff members (cf. below, Chapter 5). Therefore, it would be redundant to repeat these arguments and explanations at this time. Instead, we shall make a number of general statements, drawing on the reports and the information provided in Table 3.6.

One of the most striking features of the table is the rapid growth of the share of central government expenditure in GDP, from 31 percent in 1980 to nearly 60 percent in 1984. Excluding military expenditure, the shares are 26 and 49 percent, respectively.

These resources were mainly used to finance large investment projects or consumption by low-income groups. In order to contain the increasing fiscal deficit, the government made efforts to reduce tax evasion and improve collection procedures. As a consequence, the share of government revenue in GDP grew by 50 percent between 1980 and 1984, reaching a record level of 35 percent in the latter year. These efforts, however, were insufficient to compensate for the explosive growth of expenditures. By 1984, the overall deficit of the central government had risen to 24

²⁰ In practice, this means that a freely convertible currency tied to the dollar at a fixed exchange rate is introduced and used as a unit of account. The new currency, the *córdoba oro*, was to be fixed at par with the US dollar and monetary policy was to be subordinated to sustaining that rate. New loans from the financial system would be denominated in *córdobas oro* and taxes and public utility rates would be indexed to the new currency.

percent, more than twice the figure for 1980. The corresponding figure for the entire public sector was 28 percent.

Table 3.6: Fiscal and Financial Indicators, 1980-1987

	1980	1982	1984	1986	1987
(billions of córdobas)					
<i>Central government operations</i>					
Total revenue	4.6	7.3	15.8	141.1	747.2
Taxes	4.0	5.9	13.9	120.5	663.3
Total expenditure	6.5	11.0	26.8	216.0	1,198.7
Overall deficit	1.8	3.6	10.9	74.9	451.5
Foreign grants	0.1	0.2	0.3	6.4	14.2
External financing	0.8	0.6	1.3	0.0	-1.6
Internal financing	0.9	2.8	9.3	68.5	438.9
<i>Financial system</i>					
Net domestic credit	17.1	26.2	54.1	265.0	1,451.0
Central government	3.3	6.8	25.8	105.5	416.1
Public enterprises	2.4	6.7	14.1	73.7	523.3
Private sector	8.6	10.0	11.3	70.5	354.0
Money and quasi-money	6.9	10.7	28.9	241.3	1,610.4
% of GDP					
<i>Central government operations</i>					
Total revenue	22.1	25.7	35.1	32.4	27.8
Taxes	19.2	20.8	30.9	27.7	24.7
Total expenditure	31.2	38.7	59.5	49.6	44.5
Military expenditure	4.8	6.3	10.9	20.9	22.0
Overall deficit	8.7	12.7	24.2	17.2	16.7
<i>Financial system</i>					
Net domestic credit	82.2	92.2 ^a	120.2	60.8	53.8
Money and quasi-money	33.2	37.7 ^a	64.2	55.4	59.7
Inflation ^b					
Consumer prices	24.8	22.2	50.2	747.4	1,347.2

a) 1983 b) percent per annum

Sources: Ministerio de Finanzas, Banco Central and SIPRI (various issues).

After 1984, intensification of the *Contra* war forced the government to dramatically restrain non-military outlays, but the erosion of the tax base partially neutralized the positive effect of expenditure cuts on fiscal performance. As shown in Table 3.6, the central government deficit still bordered on 17 percent of GDP in 1987 and this was incompatible with price and monetary stabilization. Note, indeed, that 98 percent of the resulting deficits was internally financed or, more precisely, financed through money creation. This, combined with the rapid growth of domestic credit, produced uncontrollable pressure on the money supply. As evidenced in the table, the share of money and quasi-money in GDP doubled in the early 1980s. This was mainly due to the continuous growth of credit to the central government. By 1987, the share

was still at the 60 percent level, this time, however, as a consequence of the expansion of credit to public enterprises and the private sector.

Note, finally, that the efforts to restore macroeconomic stability were severely constrained by war already in 1987. Undoubtedly, a necessary condition for attaining economic stabilization at that time was the implementation of a very strict fiscal policy. However, in an environment of hyperinflation, with military expenditure absorbing 50 percent of total expenditure, the strengthening of public finances through further reductions in public expenditure became a very arduous task. As evidenced in the same table, an additional reduction of the deficit by 1 percentage point of GDP in 1987 would have required a five percent reduction in the already low level (552 billion córdobas) of non-military spending. This means that, *ceteris paribus*, non-military expenditures, that is, government payroll, subsidies and investments would have had to be slashed by more than 50 percent relative to 1987 to reduce the deficit to 5 percent of GDP the following year.

3.7. Investment and Savings

A basic rationale for foreign aid is that it raises output and productivity by increasing the supply of both physical and human capital and by improving the methods of production in the recipient countries. Some analysts, however, allege that aid actually increases consumption, particularly public consumption, reduces savings and investment and encourages inefficient resource allocation.²¹ It is thus highly relevant for the purposes of the present work to analyze the evolution of investment and savings as well as their relationship with other main economic aggregates. This analysis is conducted in Table 3.7.

A number of interesting observations can be made from the table. First, the share of investment in GDP rose steadily from 16 percent in 1970 (not displayed in the table) to a peak of nearly 23 percent in 1975 and then declined to 15 percent in 1980. The explanations for this pattern are associated with the factors inducing economic growth and stagnation described at the beginning of this chapter. After 1980, investment rose again. Its average share of GDP over the decade was about 22 percent. By 1988, it had climbed to 30 percent --the highest figure for the entire period. Our concern, however, is with the distribution of investment between the private and the public sector. The growth rates in the upper half of the table indicate that investment resources gradually shifted from private to public projects. As a consequence, the share of the former in GDP fell from 17 percent on the average during the 1960-70 period to 4 percent in the

²¹ For a review of these issues see Lele and Nabi (1991).

1980s. Correspondingly, the share of public investment increased from 8 percent in the 1960s to 17 percent in the 1980s. By 1990, it had dropped to 14 percent. Still this was more than double the share of the private sector.

Table 3.7: Growth Rates of Aggregate Supply and Demand, 1971-1980
(percent per annum, constant 1980 US dollars)

	1971-1975	1976-1980	1981-1985	1986-1990
Aggregate supply	6.3	-2.0	0.9	-4.5
GDP	3.8	-2.3	0.5	-2.8
Imports	2.6	0.3	0.4	-1.7
Aggregate demand	4.9	0.4	1.7	-4.6
Gross fixed investment	1.0	-0.2	0.8	-1.0
Public	0.4	-0.1	0.6	-0.4
Private	0.6	-0.1	0.3	-0.6
Change in stocks	-0.3	1.2	0.1	0.3
Consumption	4.2	-0.6	0.8	-3.9
Central government	0.3	1.4	3.4	-1.8
Private	3.8	-1.9	-2.6	-2.2
Exports	1.4	-2.5	-0.8	0.1
Savings and Investment as Percentages of GDP				
	1975	1980	1988	1990
Domestic savings	12.5	-2.3	-13.5	0.8
Central government	2.0	0.8	-19.5	-15.8
Others	10.5	-3.1	6.0	16.6
External savings	8.9	19.0	40.3	18.5
Gross fixed investment	22.9	14.6	29.8	20.2
Public investment	8.1 ^a		17.5 ^b	14.2
Private investment	16.6 ^a		4.3 ^b	3.9

a) 1960-1970 average b) 1980-1989

Source: ECLAC (various issues).

The change in the structure of investment described above was naturally related to the increasing role of the State in the Nicaraguan economy. Prior to the fall of the Somoza government, investment funds were allocated through private markets. From 1980 onward, the allocation of investment and many other resources changed radically. Banking, insurance and foreign trade became a monopoly of the State. At the same time, the confiscation of the property of Somoza and his close associates created the basis for a sector of public-owned enterprises producing goods and services which rapidly developed alongside the private sector. Estimates of the ownership structure which prevailed in the 1980s indicate that the State accounted for more than 40 percent

of manufacturing output. For agriculture and mining, the corresponding figures were 45 and 90 percent.²²

A common proposition in development theory is that insufficient domestic savings may be a main constraint on capital accumulation and consequently on output growth as well. This is the view adopted in two-gap models of development where investment demand is assumed to increase, the domestic savings rate is taken as given, and, as a consequence, the gap between the two tends to amplify.²³ As shown in the table, Nicaragua's savings gap story was even more dramatic. The gap indeed increased impressively in the 1980s and this was due not only to the growth of investment demand but also to the abrupt fall in domestic savings. The latter financed more than 50 percent of investment in 1975. Five years later, the savings rate was negative, with the result that capital formation became completely dependent on the inflow of external resources. By 1988, the gap between domestic savings and investment had widened to more than 40 percent of GDP. As we shall see in the next chapter, the gap was filled by external resources in the form of grants and concessional credits and also by commercial credits. Thus, the poor level of savings, particularly in the public sector, was one of the main factors behind the rapid growth of indebtedness in the 1980s.

3.8. Conclusions

The Nicaraguan economy had grown in a fairly sustained fashion --with some 6 percent per annum-- between 1950 and 1975. So had GDP per capita and the share of manufacturing in GDP. The fruits of this growth, however, favored those who were already well off and never benefited the poor. Over 70 percent of the Nicaraguan population was living in absolute poverty in 1976. The civil war against Somoza did not improve the economic situation. Nicaragua suffered great losses in terms of human lives and injuries and by the time the Somoza regime gave up, in 1979, GDP had fallen to a level which was 35 percent lower in real terms relative to 1976.

The Sandinista government was to pursue a completely different economic policy --one which concentrated on redistribution and poverty alleviation. This, it had to do under adverse external conditions. The conflict with the Reagan administration in the United States did considerable damage through the *Contra* war, the trade embargo and the blocking of funds for development projects. The total effect of all this was equivalent to cutting per capita income in half over the 1979-90 period.

²² Martínez Cuenca (1992), p. 5.

²³ In two-gap models, growth is limited either by insufficient domestic savings or by a lack of foreign exchange. For a discussion of the two-gap approach, see Chapter 4.

The main achievements of the Sandinista government are to be found in the field of distribution. The shares of health and education in government expenditure increased dramatically during the 1980s and the social welfare indicators responded accordingly. To what extent foreign aid was a contributing factor is a difficult question. On the one hand, no more than some twenty percent of the funds received were devoted to poverty-oriented projects and programs. However, another way of looking at this problem is to argue that what mattered was the overall focus of government policy, which was clearly distribution-oriented, and that the aid flows received made it possible to avoid, at least to a certain extent, the otherwise difficult choice between its three main objectives: redistribution, raising living standards and rebuilding the economy. (The fact that faulty economic policies were employed is another story.) The foregoing must also be analyzed in light of the catastrophic performance of the agricultural sector, with deteriorating food production per capita, which was very much a result of government policy decisions directly or indirectly endorsed by the donors.

Turning to the foreign trade sector we see an even poorer performance. Like her Central American neighbors, Nicaragua was facing external problems at the beginning of the 1980s. The country's agricultural exports were suffering from adverse price trends and the Central American Common Market which had been in existence since the early 1960s, was growing exhausted. Economic integration in Central America had created manufacturing sectors which produced behind high tariff walls at high costs and which were unable to compete outside the small regional market. The import substitution policy also had the unfortunate effect of discriminating against agriculture --the sector which was the main source of foreign exchange earnings through exports to countries outside the CACM.

By 1980, the CACM had more or less disintegrated and the countries in the region had to reorient their trade policies to become more outward-oriented and to concentrate on non-traditional products. This required an active exchange rate policy. Unfortunately, the Sandinistas chose the wrong strategy: a complicated system of multiple exchange rates which discriminated against exports and hence failed to do the trick. The córdoba, when valued at the official exchange rate, became more and more overvalued and the black market premium on foreign exchange soared. This exchange rate policy was the main factor behind this dismal trade performance. The resulting current account deficit had to be financed by aid. (In our discussion of the microeconomic effects of aid in Chapter 6 we further explore how the exchange rate policy worked at the level of individual projects.)

Two other central components in the unfortunate economic policy pursued by the Sandinistas were the fiscal and monetary ones. Public expenditure, and with that the budget deficit, grew rapidly up to 1988. Virtually all of it was financed by the printing

presses. The foregoing was accompanied by an equally rapid growth of credit to both the public and the private sectors. The result was inevitable: hyperinflation, reaching a record level of 33,600 percent in 1988.

Finally, we addressed the problem of investment and its financing. During the 1980s in Nicaragua, the rate of investment increased and the composition of investment underwent a very dramatic change. The public sector increasingly took over from the private sector, ultimately becoming being more than four times larger than the latter over the decade as a whole. This of course reflected the Sandinista economic philosophy which conferred an important role on the state as a direct producer. Over the period, domestic savings became increasingly negative, with the result that capital formation became completely dependent on foreign resources: aid and commercial credits. This, in turn, contributed to the build-up of an enormous foreign debt which still acts as a tremendous obstacle to any and every effort to reactivate the economy and achieve sustained growth.

Chapter 4. MACROECONOMIC EFFECTS OF AID AND AID DEPENDENCY

In this chapter we examine the relationship between foreign aid and Nicaragua's economic performance. The ultimate objective is to provide the reader with some empirical evidence regarding aid effectiveness at the macro level. As stated previously, donors are supposed to provide aid with the objective of helping the recipient country to raise the standard of living of its poor. This objective is often equated with improved economic performance, or more specifically, sustained output growth. Donors may thus be tempted to approach the macroeconomic effectiveness of their assistance programs by looking at the statistical relationship between levels of aid and gross domestic product. However, this approach is highly unsatisfactory. On the one hand, output growth is determined by a large set of domestic and external factors which are usually beyond the donors' control. Since such factors relate to aid flows in an indirect and complex way, and no causality direction can be assumed a priori, there is no theoretical basis for associating correlated changes in output and aid with the effectiveness of the latter. On the other hand, aid flows are most often tied to specific projects or programs which normally have different returns within different time frames. This makes the aid-growth relationship highly dependent on the project or sector composition of aid and thus inherently unstable.¹

One way of avoiding the problems referred to above is to approach the issue indirectly. This means that instead of looking at the simple relationship between aid and GDP, one should analyze the response of those economic variables which are likely to affect economic growth to observed shifts in aid flows. We will employ this approach in the present chapter, focusing on exports, imports, investment, savings and fiscal balance. Again, it should be stressed that the purpose is not to statistically test hypotheses about the impact of aid on the relevant variable but, less ambitiously, to explore the degree of linear association between the two.

Two definitions of foreign aid are used in the present chapter. For the most part we have defined aid as is customary in similar studies, i.e. as the sum of the net disbursement of long-term capital to the public sector and the official unrequited transfers which appear in balance of payments statistics. In some sections, however, we have considered it convenient to use the data provided by Nicaraguan sources, especially the *Ministerio de Cooperación Externa* (MCE). As explained in Chapter 2, these figures include grants and concessional and non-concessional official loans.

¹ White (1994).

The chapter begins with an examination of the relation between foreign aid and export performance with emphasis on the question whether aid may have caused 'Dutch disease' in the Nicaraguan economy. The two subsequent sections examine the contribution of aid to savings. Section 4.2 deals with the role of foreign assistance in closing the gap between imports and exports, i.e. its contribution to foreign savings, and Section 4.3 shows how aid has had to serve as a substitute for domestic savings. It also examines whether foreign aid has been used to finance consumption in Nicaragua. The fourth section of the chapter relates foreign aid to the government budget, to shed more light on how investment and consumption were financed. Finally, Section 4.5 looks at how aid was transferred to Nicaragua, by studying its distribution among programs and projects, on the one hand, and the shares of aid finance in different types of imports, on the other.

4.1. Aid and Export Performance

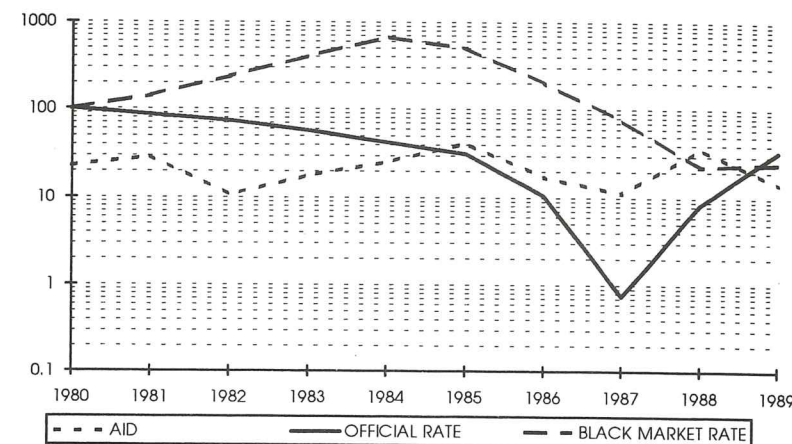
Chapter 3 described the continuous appreciation of the real exchange rate and its negative effects on export performance. An explanation of the former which may be relevant for donors seeking aid efficiency is provided in the literature. Dutch disease, as the phenomenon is called, originally referred to the problems that rapidly growing export earnings may cause the rest of the economy.² Adapted to the economic conditions of countries such as Nicaragua, the hypothesis would be that large aid inflows may cause Dutch disease in the economy by increasing the demand for non-tradable goods and services. This would raise the price of non-tradables relative to that of tradables and consequently appreciate the real exchange rate. The ultimate effect is on exports. These fall as exporters see their expected foreign incomes decrease in relation to the alternative earnings from domestic sales. The fact that nominal devaluations do not prevent the *real* exchange rate from appreciating during a period of growing foreign assistance is viewed as a symptom of Dutch disease.

Figure 4.1 provides some pertinent evidence on the subject. The figure shows the evolution of the real official exchange rate and the real black-market exchange rate, as well as the evolution of the share of foreign aid in GDP at constant 1980 prices. Foreign aid figures include grants and *all* external borrowing from official sources, net of

² See e.g. Corden and Neary (1982), Corden (1984), and Roemer (1985) for the Dutch disease problem in general, and van Wijnbergen (1985), (1986), as well as de Vylder (1992) for the relation between foreign aid and Dutch disease.

interest and amortization payments. The real exchange rates, in turn, were computed using the purchasing-power-parity approach.³

Figure 4.1: Real Exchange Rates and Foreign Aid, 1980-1989
(index numbers and percent of GDP at constant 1980 prices)



Sources: Banco Central, Contreras et al. (1991) and Ministerio de Cooperación Externa.

A first observation to be made regarding the figure is the extent of distortions in the foreign exchange market. We have already pointed to this issue in Section 5 of Chapter 3. Now we can get a clearer view of the size of these distortions by looking at the black market premium. As shown in the figure, this premium was very high between 1980 and 1985 and continued to exist until 1988. A second observation is that the black market rate continuously depreciated during the early 1980s, i.e. during the years when aid was steadily increasing. This is clearly inconsistent with the Dutch disease hypothesis. Yet, it could be claimed that since exporters were forced to convert their foreign income at the official rate, the latter is the relevant variable when analyzing the eventual transmission of Dutch disease to the export sector. Comparison of the official real exchange rate and aid curves during the 1980-85 period does reveal a close but inverse relationship between the two variables. This is consistent with the Dutch disease hypothesis, but it does not necessarily mean that aid was the main factor behind the appreciation of the official real exchange rate and, consequently, the poor

³ The purchasing-power-parity adjusted exchange rate is equal to the nominal rate multiplied by the ratio of the foreign price level to the domestic price level. The domestic and the US consumer price indexes have been used in this study.

export performance. Clearly, that role must be reserved for the dramatic increase in inflation which resulted from the unhampered expansion of the money supply. The aid inflow may, however, have had a complementary role to play in this process.

4.2. Aid and the Trade Gap

A standard approach to the effects of aid is in terms of the two-gap model.⁴ The basic idea of this model is that foreign exchange and domestic savings are both used to finance domestic investment. The growth rate in the economy depends on net investment. Investment, in turn, may be financed either out of domestic savings used to purchase domestic investment goods or out of foreign savings which are used to finance imports of foreign capital and intermediate goods, i.e. no substitution possibilities exist between the two. For investment to be large enough to guarantee a given growth rate, total savings must be of a certain magnitude. Given the inflow of foreign capital (savings), domestic savings may fall short of the required level. The economy has a 'savings gap' which serves to constrain investment and growth. Foreign exchange tends to be used for imports of consumer goods, typically luxury items, instead of investment.

Alternatively, foreign exchange is the binding constraint. Foreign savings are nothing but the excess of imports over exports. Imports rise with national income. Exports are typically an exogenous variable for a small open economy in the short run, but this may also be the case for the foreign capital inflow (foreign savings) which stems e.g. from credit, aid and foreign direct investments. If both exports and capital inflow are given, they may constrain imports at a lower level than the one given by the import propensity out of the national income, i.e. the imports allowed by the given exports and capital inflow are compatible only with a lower national income. A 'trade gap' or 'foreign exchange gap' ensues which constrains the growth rate. Some domestic capital cannot be used for lack of foreign complements.

Only one of the two gaps thus constitutes a binding constraint. Most developing countries tend to be constrained by foreign exchange rather than by domestic savings, especially at early stages of development.⁵ Additional foreign exchange, in the form of aid, for example, would allow for new investments, since complementary domestic savings would be automatically forthcoming to the extent which is necessary. Thus,

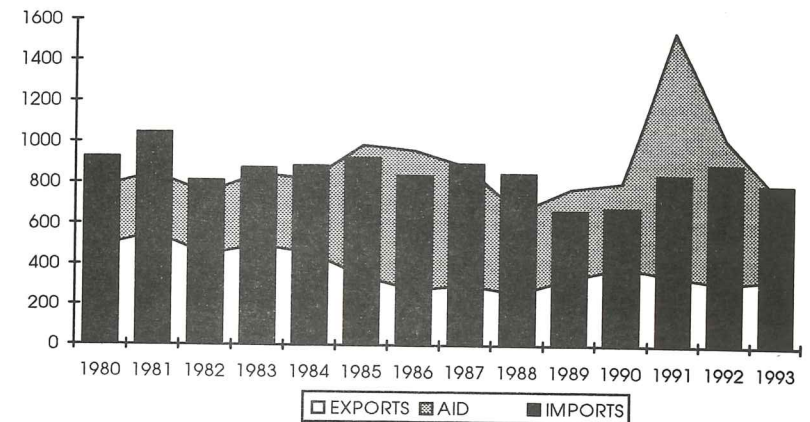
⁴ The theoretical considerations behind this model can be studied e.g. in Chenery and Bruno (1962), McKinnon (1964) and Chenery and Strout (1966). For criticism, see e.g. Findlay (1971) and White (1992).

⁵ Todaro (1985), p. 448.

foreign aid could serve to 'unlock' the economy by widening the foreign exchange bottleneck.

This sequence, however, did not work in Nicaragua. Foreign goods were made available through the inflow of foreign capital and aid clearly played a role in this, as shown in Figures 4.2 and 4.3. Until 1984, export proceeds exceeded aid as a source of

Figure 4.2: External Trade and Aid Flows, 1980-1993
(millions of current US dollars)



Source: Banco Central.

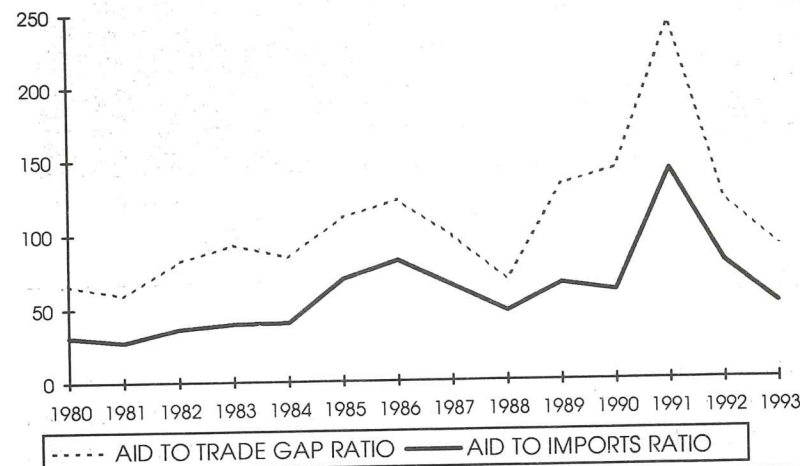
foreign exchange. Note, however, that due to the poor performance of exports, ever larger aid volumes were still required to bridge the gap between imports and exports. This trend was reinforced markedly between 1985 and 1989, when the economic crisis deepened and exports contracted even further. In 1991, the amount of aid received rose significantly, but most of the increase was used to pay debt arrears in accordance with the Paris Club agreement of that year.

A more relevant question is whether aid really contributed to easing the external constraint to *growth*. This question leads us to the issue of aid fungibility. As pointed out in the literature, aid fungibility occurs when aid actually finances projects which according to the donor's judgement are of low priority.⁶ This, evidently, provides a criterion for evaluating aid effectiveness from the donor's point of view. More generally, fungibility may be said to exist when the *final* outcome of a given aid policy

⁶ See White (1992) for a review of related issues.

is not consistent with its original purpose. This is the case, for instance, when donors provide large amounts of grants and concessional loans over a long period with the explicit objective of helping the recipient country to become less dependent on aid for the financing of its import requirements, but the final outcome is reduced import capacity and a larger trade deficit. Figure 4.3 suggests that the fungibility argument, at least in its most general version, was valid during the 1980s. Note that both the aid to imports ratio and the aid to trade gap ratio increased steadily during the period.⁷ This, together with the continuous fall in exports already analyzed, indicates that aid failed to raise the autonomous import capacity of Nicaragua in a self-sustained fashion, and therefore, the country became more aid-dependent.

Figure 4.3: Net Aid Transfers in Relation to Imports and Trade Gap, 1980-1993 (percentages)



Sources: Banco Central and ECLAC (various issues).

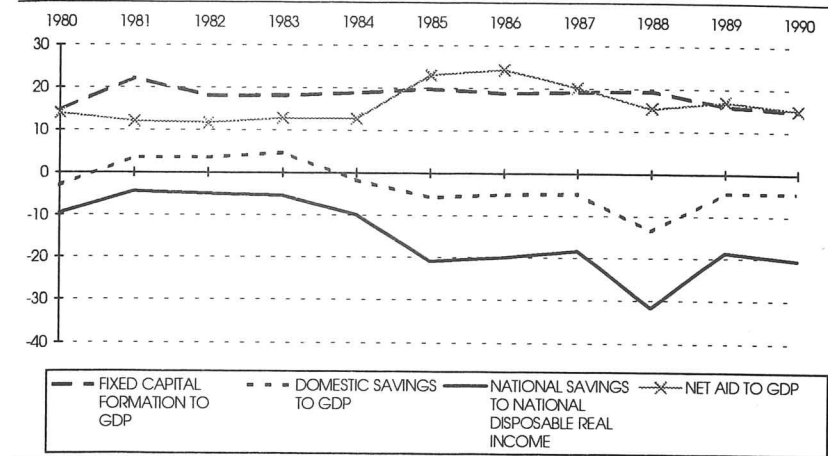
4.3. Aid and Domestic Savings

Foreign goods were made available to the Nicaraguan economy through foreign aid. The second part of the sequence envisaged in the two-gap model did not work, however. As shown in Figure 4.4, the investment rate remained relatively stable at around 20 percent of GDP during the 1980s, but the domestic savings rate, which was low but positive at the beginning of the decade, contracted quickly, and was negative

⁷ The trade gap ratio is defined as the ratio of aid to the difference between imports and exports.

already in 1984. Four years later it amounted to minus 13 percent and the savings gap -- the difference between investment and domestic savings -- amounted to no less than 30 percent of GDP. This meant that foreign savings, notably aid, had to shoulder the entire burden of capital formation in Nicaragua.

Figure 4.4: Investment, Savings and Aid Ratios, 1980-1990 (percent of GDP and real gross national disposable income, constant 1980 prices)



Sources: Banco Central and ECLAC (various issues)

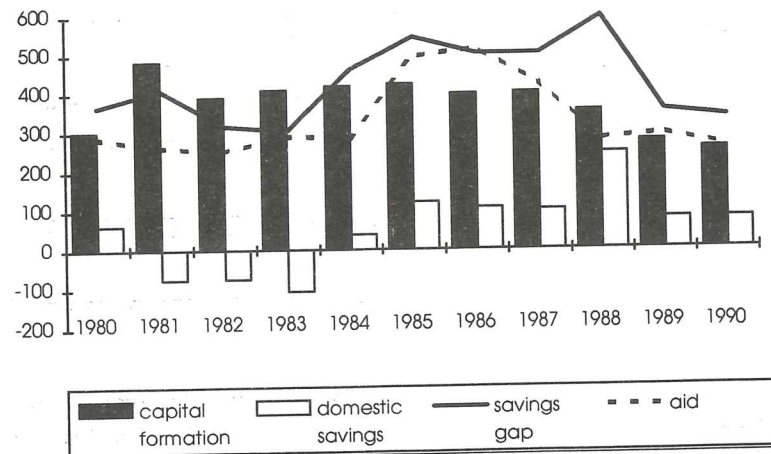
This raises the question about the extent to which aid replaced domestic savings. The figure provides no simple answer to this question. From 1980 up to 1983 the savings rate moved up along with the aid to GDP ratio but the two ratios tended to diverge from one other between 1984 and 1987. In 1988, the savings rate dropped dramatically and the aid ratio slightly, while in 1989, the former increased and the latter decreased. Note, finally, that the savings gap narrowed at the end of the period. This, however, was mainly a result of a declining investment rate. For comparative purposes, the ratio of national savings to national disposable real income is also displayed in the chart.⁸ This ratio takes into account changes in terms of trade and changes in net factor income and private transfers. Hence, it is a more accurate indicator of the country's capacity to finance investment on a domestic basis. As evidenced in the figure, this capacity was nil during the entire 1980-90 period. The catastrophic economic situation

⁸ See ECLAC (various issues), technical notes, for a description of the methodology used to estimate this indicator.

in the late 1980s is clearly mirrored in the extremely low national savings ratio of these years --minus 20 percent in 1986 and more than minus 30 percent in 1988.

Thus, aid was a main source of investment finance during the 1980s. An obvious question is whether aid contributed to the financing of consumption as well. *Figure 4.5* provides pertinent evidence. In the figure, the shaded columns and the blank columns correspond to capital formation and domestic savings, respectively. When the latter are positive, they are measured below the horizontal axis, downwards; when they are negative, they are measured above it, upwards. The savings gap curve shows the difference between capital formation and domestic savings.

Figure 4.5: Investment, Gross Domestic Savings and Net Aid Transfers, 1980-1990
(millions of constant 1980 US dollars)

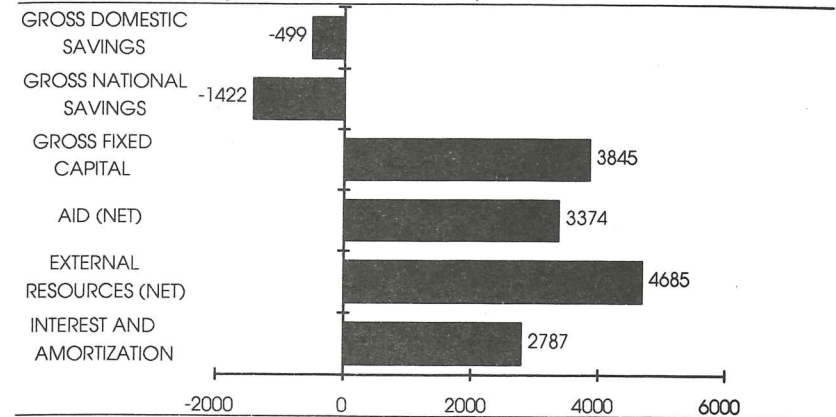


Sources: Banco Central and ECLAC (various issues).

Domestic savings were positive in 1981, 1982 and 1983. This implies first, that a part of investment was financed by domestic resources, and second, that external resources financed investment exclusively. After 1983, domestic savings became negative and this suggests that external resources were needed to finance both investment and consumption. Note, however, that most of the time aid transfers did not match the gap (with the exception of 1986), which implies that a part of the latter had to be financed by non-concessional loans. In other words, aid flows were insufficient to finance both investment and consumption.

We can assume that aid went first to finance investment and then to consumption but no conclusive evidence can be provided at the present level of analysis. In some years, the level of aid exceeded investment. This suggests that part of the aid went to consumption. In the remaining years, non-concessional loans may, however, have financed a part of investment and, consequently, allowed the government to divert aid to consumption, particularly by the public sector. Thus, we cannot reject the argument that aid actually financed some consumption.

Figure 4.6: Capital Formation and Financing, All Sources, 1980-1989
(millions of constant 1980 US dollars)



Sources: Banco Central, ECLAC (various issues), Contreras et al. (1991) and Ministerio de Cooperación Externa.

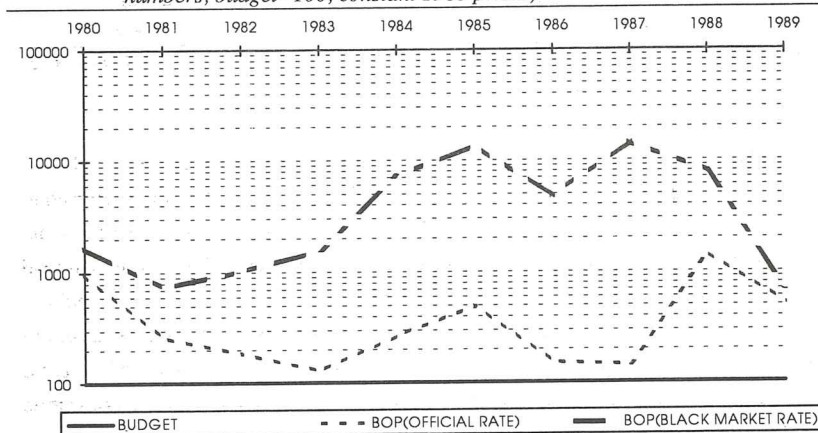
Additional evidence is provided by *Figure 4.6*. According to the figure, the net flow of total external resources from all sources during the 1980-89 period amounted to about 4.7 billion 1980 US dollars, i.e. 1.3 billion more than the amount of net aid reported by balance of payments statistics or approximately 800 million more than total investment. The external resources referred to in the figure include long- and medium-term loans from socialist and other non-DAC countries. These funds were analyzed in Chapter 2, but note that the figures presented in that chapter corresponded to gross disbursements while the figures used here are net of the interest and amortization effectively paid. The immediate conclusion is that consumption was financed by external resources though we can say nothing about the role of aid in this respect. Note, finally, that the accumulation of unpaid interest and amortization on the foreign debt was an additional 'source' of finance. Had Nicaragua paid its entire debt service

the net inflow of external resources would have contracted by more than 50 percent of its actual value.

4.4. Aid and the Fiscal Balance

Now let us relate foreign aid to the evolution of different components of the budget of the central government of Nicaragua. We begin by looking at government expenditure and then continue with how this was financed. Pertinent data were provided by the *Ministerio de Finanzas* and given in millions of current córdobas.⁹ We have converted these figures to constant prices using the 1980 GDP deflator. Foreign aid had to be defined according to the concepts used in public finance statistics. Closer examination of these statistics raises some questions about their reliability as a source of information about fiscal responses to aid. On the one hand, even though loans and grants are reported separately, no distinction is made between concessional and non-concessional borrowing. Thus, we have had to assume that all loans were given on concessional terms. On the other hand, we found that the amount of grants stated in the budget greatly diverged from that reported by balance of payments statistics. This is illustrated by Figure 4.7.

Figure 4.7: The Accounting Bias of Grants, 1980-1989
(balance of payments (BOP) figures compared with budget figures, index numbers, budget=100, constant 1980 prices)



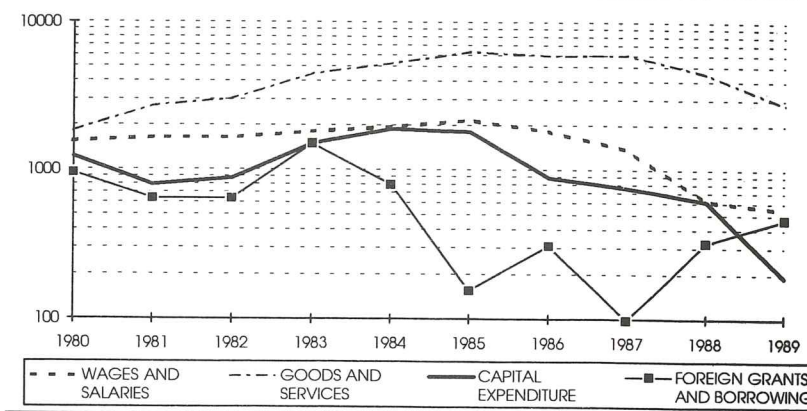
Sources: Banco Central and Ministerio de Finanzas.

⁹ No detailed budget information was available for the 1983-90 period.

Index numbers with budget figures as a base are used in the figure to compare budget and balance of payments figures. The data from these two sources were made compatible by using the real official exchange rate and, alternatively, the real black market rate when converting balance of payments figures to córdobas. The discrepancies shown in the figure are extremely large, more than 1,000 percent, in the case of black market conversion. It could be argued that this is due to the fact that the *Banco Central* converts foreign grants at the official rate when crediting the government account; but note that the discrepancies are larger than expected even in the official conversion case. Only in two instances --1983 and 1987-- did balance of payment figures come close to those of the budget.

Alternative uses of public resources are shown in Figure 4.8, namely wages and salaries, goods and services, current transfers and capital expenditures. Current transfers are composed of subsidies, expenditure on education, etc., while capital formation accounts for the major part of capital expenditure.

Figure 4.8: Foreign Aid and Public Expenditure, 1980-1989
(millions of constant 1980 córdobas)



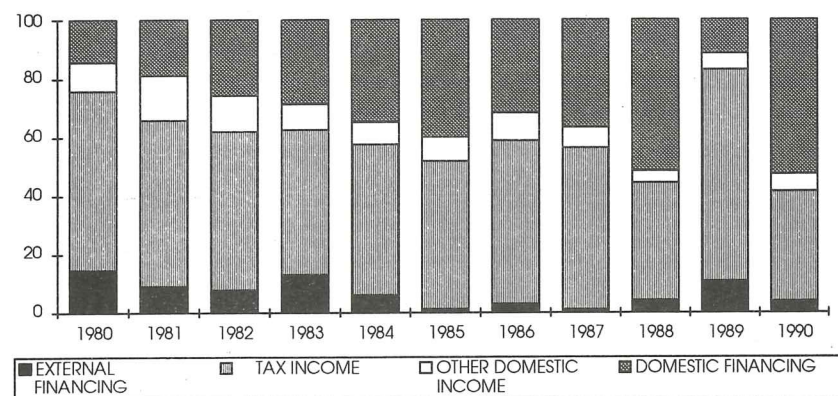
Source: Ministerio de Finanzas.

The interdependence between capital expenditure and foreign aid is apparent in the chart, at least for the 1980-87 period. The variables indeed move in the same direction and they often experience changes of similar magnitudes. This suggests that aid was used mainly for development purposes, i.e. that a major part of the development projects were not financed by tax revenues. Instead, typical current expenditures, such as the consumption of goods and services and the bureaucracy payroll, seem not to be

affected by changes in aid. In this case, the conclusion would be that the behavior of these expenditure categories was highly dependent on the extent of domestic financial constraints.

We now turn to the composition of the budget by source of financing. This is shown in Figure 4.9. As reflected in the figure, external and domestic resources were not competing sources in the government budget. The contribution of aid to total financing was 7 percent on the average. It was below the 20 percent level during the entire 1980-90 period.

Figure 4.9: Sources of Budget Financing, 1980-1990
(percent of total central government expenditure)



Source: Ministerio de Finanzas.

Clearly, a more sophisticated approach is required to determine whether aid displaced tax income (fungibility). At the present level of analysis, we can only verify the importance of the interplay between alternative sources of domestic financing, i.e. between taxes and borrowing. Moreover, even if aid actually displayed fungibility with respect to taxes, this did not translate into any sizeable impact on tax income. Note that the contribution of external resources to budget financing reached its highest levels in the early 1980s, precisely when the Sandinista government was carrying out a very expansionary economic policy and capital formation largely relied on long-term public investment projects. The contribution contracted markedly in the late 1980s and this was also consistent with the shift in public investment policy from massive additions to capital stock to short-run and small-scale projects and capital maintenance. Again, the

analysis tends to reinforce the view that taxes were allocated to finance consumption and aid to finance capital formation.

4.5. Aid Allocation and Capacity Utilization

In this section we attempt to relate the efficiency of aid to Nicaragua to the manner in which aid resources were transferred. This is not an easy task since hypotheses about the issue are scarce in the literature and we are faced with conceptual problems.¹⁰ Moreover, the data available to us were not classified according to adequate criteria or were given at too aggregate levels. Hence, the analysis in this section should be seen as a first approximation to the problem.

It has been customary in aid studies to distinguish between project aid and program aid. The former is commonly associated with the financing of specific investment projects while the latter relates to the funds allocated to support the recipient country's overall development objectives. From a macro perspective, the distinction may be useful because it allows for closer analysis of the different mechanisms through which the effect of aid is transmitted to the whole economy. Generally speaking, project aid is expected to increase the country's productive capacity whereas program aid (or non-project aid as it is also called) is expected to relieve constraints on capacity utilization. This is the case where support is given to imports of intermediate and raw materials or to capital maintenance. Alternatively, program aid may be shaped to facilitate the implementation of adjustment programs. This is the case where it takes the form of balance of payments support, budgetary support or debt relief. Finally, it can be designed to support social policies. Food aid and emergency aid are typical examples of this.

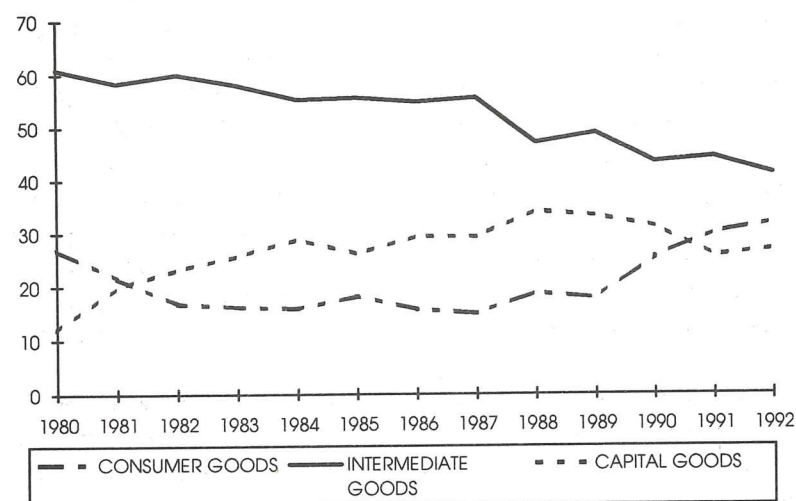
There is, of course, no clear dividing line between project and program support but rather a set of more or less 'projectized' forms of aid. One of the most notorious mixed cases is sector aid. This category includes aid aimed at strengthening an entire economic sector (agriculture, industry, etc.) or a geographic region, as well as aid aimed at supporting a specific development policy, for instance export promotion. In the ensuing discussion, we abstract from these mixed forms and concentrate on the two ends of the aid spectrum, that is, program aid and project aid. An additional aid category is technical cooperation. (This was considered in Chapter 2.)

In a recent study on Swedish import support to Tanzania it was concluded that the observed decline in the share of recurrent imports (consumer goods and intermediate goods) in total imports was associated with 'the economy's increased dependence on aid

¹⁰ White (1994).

to finance imports and the character of the aid provided --i.e. mainly investment support in the form of project aid.¹¹ The authors argue that since the aid-induced growth of investment creates new capacity, the potential demand for recurrent imports necessarily increases. More consumer and intermediate goods are actually required to keep capacity utilization at its initial level when the stock of capital is increased. However, with declining exports and the major part of aid funds tied to the financing of capital goods imports, the country is unable to expand the volume of its recurrent imports. Consequently, the share of the latter falls, suggesting that capacity was created at the expense of capacity utilization. Obviously, it is detrimental to the objective of efficient resource allocation as well as the objective of self-reliance.

Figure 4.10: Composition of Imports by Use, 1980-1992
(percent of total imports)



Sources: Banco Central and Ministerio de Economía.

Figure 4.10 shows the evolution of the composition of Nicaragua's imports during the 1980s. This is similar to that observed in Tanzania.¹² The share of recurrent imports, particularly of intermediate goods, declines while the share of capital goods increases. This, together with the sharp fall in exports and the consequent stagnation of

¹¹ Doriye, White and Wuyts (1993), p. 52.

¹² Ibid.

total import volumes during the same period, suggests that capacity creation was accompanied by lower capacity utilization. Evidence from other studies tends to confirm this conclusion.¹³ The relevant question, however, is to what extent aid contributed to crowding out the share of recurrent imports and therefore to lower capacity utilization.

A first approximation to the question is given in Table 4.1 where total aid is broken down by aid-category and related to corresponding imports. Note that in the present case aid was defined in its broadest sense, as including grants and all medium- and long-term loans from official sources. A striking observation which can be made in the table is the weight of program aid relative to total aid. This was more than 70 percent for loans and more than 50 percent for grants. Our data base did not allow for the breakdown of project aid by use. Nevertheless, it seems reasonable to assume that the largest part of the *project-tied funds* was used to finance imports of capital goods. Indeed, more than 70 percent of the funds classified in that category were provided by multilateral creditors and DAC countries which are very reluctant to finance local costs.

Table 4.1: Grants and Loans by Use, All Sources, 1980-1989
(millions of current US dollars and percentages)

	Percent of Total		Percent of Corresponding Imports		
	Grants	Loans	Grants	Loans	Total aid
Technical cooperation	21.7	0.2			
Investment projects	14.3	17.7	10.6	35.8	46.4
Program aid	55.0	71.1			
Machinery and equipment	4.7	22.6	3.5	45.8	49.3
Raw and intermediate materials	11.5	21.5	6.9	35.4	42.3
Oil	10.5	12.2	14.4	45.8	60.7
Consumer goods	9.5	11.8	19.0	64.6	83.6
Food aid	19.9	0.0	72.2	0.5	72.7
Balance of payments support	4.2	14.1			
Emergency aid	3.8	0.0			
Total	100.0	100.0	15.6	52.0	67.6

Memo: 1980-1989 averages

Imports of goods	785.9	Import-related aid	531.0
Imports of services	129.7	Export of services	41.8
Profits and other payments	4.4	Private transfers and interest received	12.2
Debt service paid	90.0	Exports	359.7
		Balance of payments support	81.7
Total	1,010.0		1,026.4

Sources: Ministerio de Cooperación Externa and Ministerio de Finanzas.

¹³ Medel Mendieta (1988) and Dijkstra (1992).

By the same token, we were unable to separate that part of program aid which was expended locally, but there are strong indications that *aid-financed expenditures* in machinery, equipment and intermediate materials, inclusive of oil actually were *import expenditures*. As a matter of fact, the aid from the socialist countries mainly consisted of goods produced in those countries and it was usually given in the form of program aid. According to our data, the participation of those countries in the program aid categories machinery, equipment and raw materials was 80 percent, while their share in the imports of capital goods for the industrial sector amounted to 90 percent.

The arguments presented above provide the rationale for the computations which are presented in the last three columns of the table. The figures there reflect percentage shares of each individual aid category within a certain import category. The share of 'investment projects' in imports and that of 'program: machinery and equipment', for instance, are equal to the ratio of these aid categories to the imports of capital goods. The table sheds light on two central aspects of foreign aid to Nicaragua. First, it shows that aid financed more than 95 percent of the imports of capital goods. This gives additional support to the notion that the investment boom of the 1980s was entirely fueled by foreign aid. Second, the table confirms the assumption that the possibility of expanding recurrent imports, mainly imports of raw materials and intermediates, was highly dependent on export performance. Indeed, only 42 percent of those imports were financed by aid funds. The remaining 58 percent, about 170 million US dollars per year, had to be financed by export proceeds. As shown in the table, these amounted to 360 million US dollars per year or 50 percent of total imports. The overall impression is that the allocation of foreign aid to Nicaragua has been the decisive factor behind the growth of the country's productive capacity, but that at the same time it has largely contributed to the creation of 'import bottlenecks' in relation to the objective of higher capacity utilization.

There are potential solutions to that problem, but none of them are simple to implement. Consider, for instance, the policy option of redirecting production to exports in order to increase both the import capacity of the country and the present level of capacity utilization. The option may look attractive, but it demands the adaptation of the production sectors to the competitive conditions of export markets which, in turn, requires the modernization of infrastructure, new investment and, not least, the implementation of a consistent economic policy. As we know, Nicaragua's present economic situation is far from fitting this scenario. Another possible solution would be to reallocate aid funds from investment projects to import and maintenance support. The latter would include the financing of spare parts and current supplies and would aim at facilitating the functioning of existing capacity. There are obstacles to reallocating aid funds in this way, but we leave their analysis to Chapter 7.

4.6. Conclusions

The present chapter started by examining whether foreign aid may have caused 'Dutch disease' in Nicaragua. The evidence presented is not completely conclusive and aid was presumably not the most important determinant of the money supply and the price level, i.e. of the appreciation of the córdoba in real terms in the official market for foreign exchange. Still, our data indicate that it may have had a role to play in the process.

Aid has also had to contribute to closing the trade gap in the Nicaraguan economy, i.e. aid has allowed foreign goods to enter the country to a much larger extent than would otherwise have been possible --making Nicaragua more aid-dependent in the process. Foreign aid has also had to act as a substitute for domestic savings, which became negative from 1984. This means that foreign savings, including aid, have had to finance the entire capital formation and possibly some public consumption as well, although an examination of aid in relation to the government budget tends to indicate that domestic tax revenues were the main source of this consumption.

Breaking down foreign aid into program and project aid reveals that the former was more important than the latter and that aid played a very important role in financing machinery and equipment, but that this appears to have created production capacity but impaired capacity utilization.

Chapter 5. STABILIZATION POLICIES AND FOREIGN AID

The present chapter reviews the Nicaraguan experience of stabilization and adjustment policies, focusing on one of the most controversial issues in the present aid debate, namely, the role of aid in macroeconomic stabilization.

The chapter begins with a brief discussion of how the need for macroeconomic stabilization arose in the 1980s. It continues with an analysis of the 1988-90 period, when Nicaragua faced enormous domestic and external imbalances and implemented IMF-style stabilization policies, however, without support from the large multilateral creditors. Finally, the analysis focuses on the 1991-93 period, when Nicaragua was applying rigorous fiscal and monetary measures under the direct supervision of both the IMF and the World Bank.

After six years of stabilization efforts, Nicaragua remains highly dependent on foreign assistance, not only to achieve economic growth, but also to ensure economic stabilization. The origins of this failure can be traced back to the economic mismanagement and the civil war of the 1982-87 period, as described in Chapter 3. This failure, however, cannot be attributed exclusively to the reluctance on the part of the Sandinista government to stabilize and adjust. In 1988-89, the multilateral credit institutions missed a golden opportunity to support this government's efforts toward stabilization. This, we will argue, was an important factor behind both the aggravation of the economic crisis in subsequent years and the present situation of increased aid dependency.

5.1. The Need for Stabilization: The Dismal 1980s

When the Sandinistas took over the government of Nicaragua in 1979, they inherited a poor and run-down economy which they set out to reconstruct. A large public sector was built up, a land reform was carried out and the State obtained a complete monopoly over the banking system and over foreign trade. Redistribution and social policies were given a prominent place on the list of priorities. The first two years --1980 and 1981-- were fruitful ones. GDP grew and the country gained access to international financial markets. However, with the advent of the Reagan administration in the United States in 1981, the increasingly radical Sandinistas suddenly found themselves cut off from their main export outlet. At the same time, the doors of the main international financial institutions were closing.

The response to these measures, which put the traditionally weak Nicaraguan balance of payments under severe strain, was to introduce a number of regulations and controls which, in turn, created severe distortions in the price system, not least with

respect to the price of foreign currency. An exceedingly complicated multiple exchange rate system was created. The córdoba was increasingly overvalued and the available foreign exchange was allocated according to administrative criteria. In agriculture, a system known as 'technological tables' was introduced which listed the inputs to be employed. These tables then served as the basis for allocating credit to agriculture, with the result that the access to credit became virtually free. The labor market was petrified via a rigid classification system of job categories. Wages were set by administrative decisions.¹

After 1983, GDP began to fall and the deficit on the foreign trade account mounted rapidly. The government budget deficit increased and the rate of inflation began to accelerate. At the same time, the activities of the *Contras* put the country back into a war situation. By 1985, it was clear that the Nicaraguan economy was in a state of severe macroeconomic imbalance. Stabilization efforts, including devaluation of the córdoba and increased fiscal discipline, failed, on the one hand, because they did not go far enough and, on the other, because the entire system of regulations, controls and subsidies essentially remained unchanged.

The macroeconomic situation continued to deteriorate. Inflation got completely out of hand, reaching a peak of 33,600 percent in 1988, with a fiscal deficit of about 28 percent of GDP, and the foreign trade situation turned dismal. A currency crisis was building up. Finally, it reached a point where drastic measures had to be enforced in order to re-establish a balance and to get the economy back on the path to growth. To this end, a stabilization and liberalization program was introduced in February 1988 which included monetary reform, simplification of the exchange rate system, with only two rates, reorganization (*compactación*) of the public sector to reduce government employment, and some price liberalization.

The stabilization package was plagued with difficulties, however. In particular, it was not clear whether fighting inflation or increasing production was the primary objective, and after the damage inflicted by Hurricane Joan, the Sandinista government in November 1988 reintroduced price controls and extended credit at negative interest rates.²

This was the situation which prevailed when Swedish assistance to support these stabilization efforts first began.

¹ The Sandinista policies are well described in Weeks (1985), Booth (1985), Gibson (1987), Medel Mendieta (1988), Aguilar (1989) and Martínez Cuenca (1990).

² Aguilar (1989), p. 12.

5.2. The 1988-89 Stabilization Efforts: International Isolation and Swedish Support

In January 1989, SIDA commissioned a team of economists, headed by Lance Taylor from MIT, to prepare a study on Nicaragua's economic problems and policy options. The mission visited Managua and helped the Sandinista government to design a rigorous stabilization program aimed at controlling hyperinflation, attaining relative price realignment and restoring confidence in the financial system. The second phase of the stabilization package proposed by the Taylor report started in March 1989, furthering the austerity measures introduced in early 1988. The mission's general assessment was that 'the new measures would almost certainly call forth an IMF standby loan plus additional international support, under normal political circumstances'.³ Analysis of the stabilization package indeed shows that it was fairly orthodox in both its objectives and instruments. It included price liberalization, strong devaluations and massive cuts in central government expenditures. In other words, it replicated most of the macroeconomic elements which usually constitute the basis for an IMF arrangement.

Regrettably, the normalization of the 'political circumstances', a prerequisite for international support as stated by the Taylor report, was not yet achieved in 1989. In June that year, the Swedish government sponsored an international donor conference in Stockholm for the purpose of procuring international support for Nicaragua's efforts toward economic stabilization. Only the Nordic countries and Spain, however, were willing to supply cash contributions on that occasion. The main multilateral creditors, i.e. the World Bank, the Inter-American Development Bank (IDB) and the IMF, refused renewed lending to Managua, in spite of the fact that 'the [Nicaraguan] authorities ... [were] ... fully justified in requesting such assistance, on the basis of the steps they took ... [in 1988] and during the first quarter of 1989'.⁴ A similar conclusion was drawn by the SIDA-sponsored monitoring group led by Albert Fishlow from Berkeley at the end of 1989: 'Nicaragua has already accomplished much in its economic reforms and more than some other countries receiving credits from these institutions [the IMF, the IDB and the World Bank].'⁵

³ Taylor et al. (1989), p. 14.

⁴ Ibid., p. 12.

⁵ Fishlow et al. (1990), p. 15.

Table 5.1: Nicaragua: Selected Economic and Social Indicators, 1987-1989

	1987	1988	1989
Non-financial public sector ^a			
Current expenditures ^{a b}	40.8	41.5	30.7
Overall deficit ^{a c}	-18.0	-28.5	-8.2
Credit to private sector ^a	38.3	63.4	47.6
Credit to public sector ^a	12.9	19.6	14.1
Means of payment ^{a d}	28.2	16.6	7.5
Quasi money ^{a d}	3.6	1.2	1.1
Real exchange rate ^e	3,395.0	167.0	100.0
Inflation ^f	912.0	14,316.0	4,770.0
Real wages	61.2	42.1	27.6
Open unemployment	5.8	6.0	8.4
Underemployment	23.1	26.5	31.0

a) percent of GDP b) interest payments excluded c) before grants d) average monthly ratio between aggregate and annual GDP e) córdobas per US\$ f) percent per annum

Sources: IMF and Banco Central.

The data displayed in Table 5.1 substantiate the above statements. Note, for instance, the reductions in total current expenditures and domestic credit achieved between 1987 and 1989, as well as the subsequent reduction of monetary variables and the inflation rate. The main price alignment measures included a major devaluation of the córdoba and a more flexible public sector pricing policy. The implementation of the stabilization program had high social costs. This is reflected in the table as increased unemployment and underemployment rates and rapidly deteriorating real wages. The Nicaraguan delegation returned from Stockholm with only 35 million US dollars, far less than the volume of liquid foreign resources needed to implement the stabilization program. This, among other factors, made the program fragile and inconsistent. In other words, the international reluctance to provide liquid resources to Nicaragua significantly contributed to undermining the 1989 stabilization efforts.

A quick review of Nicaragua's external debt and balance of payments indicators for 1989 may enhance our understanding of the situation. As Table 5.2 shows, interest and amortization payments amounted to about 200 percent of exports, and the total outstanding debt was more than six times the size of GDP. Clearly, servicing a debt of this magnitude was impossible. Under the given circumstances, only a heavy commitment of international financial resources over a sustained period would have been able to reconcile the short-term objective of attaining internal and external balance with the medium-term objective of economic recovery.

Table 5.2: Summary of Balance of Payments, Debt and Debt Service Payments, 1989
(millions of current US dollars)

Balance of Payments		Debt	
<i>Gross financing requirements</i>		<i>Medium and long-term</i>	
Trade balance	334	Bilateral	5,154
Other items (net)	-7	Multilateral	976
Interest payments	212	Commercial banks	1,306
Amortization payments	387	Supplier credits	108
Total	926	Others	65
<i>Sources</i>		<i>Short term</i>	
Private capital	-159		525
Official grants	169		
Public & publicly-guaranteed long term capital	286		
Total	296		
<i>Current financial gap</i>		<i>Commercial debt</i>	
Net change in reserves	68		134
Change in arrears	562		
Total	630	Total outstanding	8,268
<i>Accumulated arrears</i>		<i>Interest arrears</i>	
Interest	1,330		
	1,330		
Principal	1,758	Total outstanding	9,598
Total financial gap by December 1989	3,718	including arrears	
<i>Memo</i>			
GDP	1,400		
Exports	311		

Sources: World Bank and Banco Central.

An IMF report from 1989 shares this view.⁶ The report indeed recognized that the Nicaraguan government had been relatively successful in reducing the internal imbalance by employing adequate policy instruments, but it pointed out that the persistence of large deficits on the current account and the accumulation of external payment arrears posed formidable obstacles to full stabilization, meaning complete inflation control and a stable foreign exchange market. As shown in the table, in 1989 the deficit on the current account was 630 million US dollars --more than 40 percent of GDP. The accumulation of external payments arrears amounted to 3,700 million US dollars --the equivalent of 12 years' exports.

The Fishlow mission had already stressed the importance of the issue: 'For all the progress the Nicaraguan government has made internally, therefore, the external prospects look quite bleak and represent a *principal* obstacle to a serious program of

⁶ IMF (1989).

economic restructuring and domestic political concertation.⁷ The Taylor report, in turn, pointed out that the likelihood of curbing inflation and resuming growth was highly dependent on dismantling the 'effective blockade of multilateral loans imposed in the past several years ... [on Nicaragua] by the United States'.⁸

Both missions concluded that re-establishing relations with multilateral credit institutions was a prerequisite to economic stabilization. However, a necessary condition for this was that bilateral donors provide financial assistance for clearing the arrears to the World Bank and the IDB.⁹ As Nicaragua's recent history shows, this depended not only on Nicaragua's ability to establish an adequate track record with respect to policy implementation --in fact it was already established in 1989-- but on the outcome of the 1990 elections.

5.3. The 1990-91 Transition Period: Political Normalization and International Support

Without a doubt, the victory of the US-backed candidates in the 1990 elections normalized the political circumstances for Nicaragua. In April 1990, the new government headed by Violeta Chamorro took office and, in June that same year, the *Contra* army was disarmed and demobilized. At the same time, the United States lifted the trade embargo, normalized relations and actively supported the organization of the donor conference in Rome in June 1990. About 600 million US dollars in grants and soft loans were committed on that occasion. In the meantime, an IBRD/IDB/IMF mission visited Nicaragua and prepared a report on the financial needs of the country.¹⁰ The report was to be presented to the donor members of the Consultative Group. Not surprisingly, the mission concluded that major relief of Nicaragua's bilateral official debt was necessary and that additional resources should be committed to repaying the World Bank and the Inter-American Development Bank.

Seventeen bilateral donor representatives attended the Consultative Group meeting in Paris in December 1990 and agreed on a plan for clearing Nicaragua's arrears with the World Bank and the IDB. The plan envisaged direct arrears clearance, balance of payments support and bridge financing for a total amount of roughly 313 million US dollars. Subject to the execution of the plan, fresh financial resources were to be provided by both the IDB and the World Bank. The former declared Nicaragua

⁷ Fishlow et al. (1990), p. 15 (italics ours).

⁸ Taylor et al. (1989), p. 14.

⁹ About 380 million US dollars in 1991. As evidenced in Table 5.2, the weight of the multilateral debt relative to total debt was not too high (15 percent). The weight increases considerably, however, (to 25 percent) when only the creditors that were expected to be net providers, i.e. the DAC countries, are taken into account.

¹⁰ IBRD/IDB (1990).

eligible for a Trade and Finance Adjustment Loan of 110 million US dollars, and the latter for an Economic Recovery Credit amounting to 110 million US dollars. The IMF, in turn, announced continued financial support to technical assistance and talks concerning Nicaragua's request for a 40 million SDR stand-by arrangement which was approved by the Fund in September 1991.

Three months later, the Paris Club creditors agreed to reschedule Nicaragua's officially guaranteed bilateral debt, granted a 50 percent reduction on arrears of this debt over the next three years, and left open the possibility of reducing the debt stock. At the same time, Mexico, Venezuela and Colombia agreed to reschedule Nicaragua's outstanding obligations to these countries on exceptional terms.¹¹ Earlier in 1990, the United States government had pledged more than 500 million US dollars in support over a two-year period. At the Paris meeting, it showed willingness to write off at least a portion of Nicaragua's debt. This took place a year later in the form of a 260 million US dollar debt reduction.

Coordinating efforts to assist a developing country in achieving macroeconomic stability and external viability normally is no simple operation, and the task does not become any easier when the stock of the external debt is equivalent to eight times the GDP and 25 times the value of exports, as was the case in Nicaragua by 1991. Add to this the already mentioned fact that external payment arrears represented eight times the value of exports and that there were no indications of resuming growth, and you get a picture of the daunting task the Consultative Group had taken upon itself when it met in Paris.

Evaluated in this light, the outcome of the Paris meeting did not fall short of expectations. Indeed, it confirmed the need for a far-sighted external cooperation strategy to cope with Nicaragua's acute economic problems and, what is more important, it produced coordinated short-term actions which, on the whole, were consistent with that perception. A comparison of these achievements with the meager results obtained in Stockholm two years prior, however, raises some doubts about the ability of both the international donor community and the multilateral credit institutions to make consistent aid-coordination efforts with respect to medium- and long-term development objectives.

Several analysts and policy-makers have expressed their concern over this issue in the past. However, it has most frequently been addressed from the point of view of

¹¹ The terms included a forty-year repayment period, three percent interest, and a six-year grace period. The agreements covered debts of 1,300 million US dollars. Rescheduling the debt to Eastern European countries was also very favorable to Nicaragua. In fact, it was equivalent to a 100 percent reduction in present value terms.

bilateral aid, especially project support.¹² Little attention has been paid to the obstacles to coordinating financing programs and debt renegotiations, particularly the political pressures. As we have already pointed out, Nicaragua's experience with the multilateral credit institutions during 1988-90 provides a good example of such problems. The Swedish delegation was clear in its terms when referring to this issue at the second Paris meeting in May 1991. The delegation indeed appreciated 'the fact that a number of countries have come forward in this first truly multilateral effort to mount the assistance Nicaragua clearly needs.'¹³ At the same time, however, it stressed the fact that 'Sweden in 1989 invited the International Financial Institutions and a number of donor countries to a meeting in Stockholm to find a way of dealing with the already then precarious economic situation in Nicaragua. However, little was done to share the burden.'¹⁴

It is worth noting here that these critical remarks were accompanied by the decision to make effective a special contribution of 10 million US dollars for arrears payments and to reallocate a part of Sweden's 1991-93 official development assistance to Nicaragua from project support to balance of payments support. These decisions, together with the fact that Sweden has supported Nicaragua continuously since 1979, suggest that Swedish aid policy was able to combine the issues of consistency, continuity and adaptability to rapid changes in the recipient country's political and economic environment.

5.4. The 1991-94 Structural Adjustment Program: Economic Stagnation and Renewed Aid Dependency

By the end of 1991, Nicaragua was implementing a comprehensive stabilization program directed by the IMF and the World Bank. In this section we present a short description of the progress made in the implementation of the program between 1991 and 1993 and assess the nature of the obstacles to economic recovery. The purpose is twofold: on the one hand, to provide some insight into the critical situation the country finds itself in at the present time, and, on the other, to point to the key role of Nicaragua's foreign debt in terms of future policy discussions.

An evaluation of the stabilization efforts during the first 100 days of the Chamorro government is found in the background paper prepared by the World Bank and the IDB for the Paris meeting.¹⁵ It was recognized in the paper that the government had 'taken many positive measures to stabilize the economy', but it was also stressed

¹² See, for instance, Cassen et al. (1986).

¹³ UD (1991).

¹⁴ Ibid.

¹⁵ IBRD/IDB (1990).

that the government needed to improve the design and execution of the program. Special emphasis was placed on stronger devaluations, a more restrictive credit policy, additional cuts in public expenditure and more progress in the privatization program.

One year later, Nicaragua's major austerity efforts, though praised in words, were still considered insufficient. An IMF staff document, for instance, appraised the economic program initiated in March 1991 in positive terms but called for a major reduction in the overall fiscal deficit and a tighter credit policy.¹⁶ Similar statements were made by the World Bank in September 1991, on the occasion of the first disbursement of the Economic Recovery Credit (ECR).¹⁷ Six months later, the Fund insisted on further restraint in current expenditure despite having recognized that 'the rate of inflation [had] been reduced dramatically; the international reserve position of the Central Bank of Nicaragua [had] improved; and public finances [had] been strengthened markedly ... [but] ... *real GDP ... continued to decline*'.¹⁸ It did so for the following 18 months, indicating that something was going wrong.

The inconsistency of the stabilization efforts in relation to the behavior of relevant economic variables is presented in Table 5.3. What the table actually suggests is that the probability of Nicaragua moving from merely implementing stabilization policies to actually achieving economic recovery and growth was considerably reduced during the same period. Note, in particular, the efforts to restrain domestic credit and public expenditure. Apparently, these efforts had no positive impact on the balance of payments situation or on the evolution of GDP and consumption. This, combined with declining exports, stagnating investment and alarming inflationary pressures at the end of the period, increase the uncertainty about the ability of current adjustment policies to ensure economic stability.

At the end of 1993, the stabilization issue became a matter of real concern for both the Nicaraguan policy makers and the World Bank. It was clear that further adjustment would prove difficult to accomplish, not only because of the increasing social costs it would entail --cf. the penultimate panel of Table 5.3-- but also because of declining cash inflows. As shown in the table, the 1991 flow of external liquid resources to Nicaragua in the form of concessional loans or grants amounted to 511 million US dollars. A marked decline in aid flows was recorded during the following two-year period. To a certain extent, this can be attributed to discontinued or delayed US support to the adjustment program. However, there are reasons to believe that the decline in foreign aid will be permanent and that Nicaragua will not be able to count on

¹⁶ IMF (1991).

¹⁷ World Bank (1991).

¹⁸ IMF (1992) (italics ours).

exceptional amounts of foreign aid from DAC countries in the future. The main reasons are the increasing scarcity of public resources in industrialized countries and the urgent need for supporting economic growth in other regions, especially Eastern Europe.

Table 5.3: Stabilization Efforts, Economic Performance and External Finance, 1991-1993

	1991	1992	1993
<i>Policy variables</i>			
Domestic net credit ^a	100.0	67.8	59.9
Total expenditures ^b	26.9	28.1	25.7
Public budget deficit ^b	7.2	7.3	6.1
Nominal exchange rate ^a	100.0	116.0	142.0
Interest rate ^c	19.4	20.3	20.0
Import tax rate ^d	43.2	15.3	12.3
<i>Economic performance</i>			
Real GDP ^e	-0.2	0.4	-0.7
Manufacturing GDP ^e	6.4	-5.1	-1.6
Private investment ^e	-2.1	-4.1	2.7
Private consumption ^e	33.5	-1.2	-7.8
Inflation ^f	865.6	11.0	25.9
Resource balance ^g	-492.4	-586.0	-458.1
Change in net international reserves ^g	-13.4	4.9	5.0
Exports ^e	-17.6	-18.1	9.0
<i>Social indicators</i>			
Real wages ^a	100.0	132.0	89.5
Labor under-utilization ^h	53.5	49.1	51.3
<i>External financial flows</i>			
ODF cash ^g	511.1	395.0	242.0
ODF tied to specific projects ^g	302.9	316.8	370.0
Arrears clearance ^g	0.0	306.9	0.0

a) base 1991=100 b) % of GDP c) lending rate (%) d) average of nominal rates (%) e) growth rate f) % per annum g) millions of US dollars h) according to ECLAC methodology.

Sources: Banco Central, World Bank and ECLAC (various issues).

This would impose a constraint on donors for maintaining support to countries such as Nicaragua which have already received massive financial assistance --including arrears clearance --but failed to resume economic growth. The phenomenon is often described in impressionistic terms as a 'disease': so-called donor fatigue. If this donor fatigue exists for Nicaragua, the likelihood of the country experiencing major economic imbalances, similar to those which induced the inflation explosion of 1988-89, may increase in the short run.

Again, analysis of the external balance of payments provides insight into the problem. Comparison of Tables 5.4 and 5.2 indicates that the massive debt accumulated during the 1980s continued to increase during the 1990-93 period despite efforts made

through the Paris Club and bilateral negotiations, and despite significant increases in grants and concessional loans. Accumulated interest arrears contributed to a large extent to the increasing debt in the 1990s.¹⁹ Decreasing exports and the subsequent deterioration of the current account of the balance of payments also contributed to widening the financial gap. Between 1989 and 1993 the gap was increased by 75 percent from 3.7 billion to 6.4 billion US dollars.

Table 5.4: Summary of Balance of Payments, Debt and Debt Service Payments, 1993
(millions of current US dollars)

(millions of current US dollars)		Debt	
Balance of Payments			
<i>Gross financing requirements</i>			
Resource balance	458		
Other items (net)	5		
Interest payments	422		
Amortization payments	666		
Total	1,551		
<i>Sources</i>			
Private capital	51		
Official grants	385		
Public and publicly-guaranteed long term capital	301		
Total	737		
<i>Current financial gap</i>			
Net change in reserves	5		
Change in arrears	809		
Total	814	Total outstanding	8,049
<i>Accumulated arrears</i>			
Interest	3,386	Interest arrears	3,386
Principal	3,055	Total outstanding including arrears	11,355
Total financial gap by December 1993	6,441		
<i>Memo</i>			
GDP	1,825		
Exports	243		

Sources: Banco Central and IBRD.

In sum, what has certainly been demonstrated is that four years of stabilization and structural adjustment efforts have not improved Nicaragua's payment capacity. The latter is, and will be, for a long time to come, heavily swamped by Nicaragua's debt service obligations. This, together with the fact that both foreign aid and exports are likely to decline or stagnate in the next few years, forces us to conclude that further restructuring, including debt forgiveness, remains a *sine qua non* for resuming economic growth and a condition for attaining self-reliance in the long run.

¹⁹ These amounted to 2 billion US dollars in 1993.

5.5. The Options Ahead

In this study, we define self-reliance as the opposite of foreign-aid dependency and the latter as a country's inability to finance investment and import requirements through normal commercial channels.²⁰ As demonstrated before, Nicaragua is a perfect example of this kind of dependency. Massive aid has not helped Nicaragua to gain access to private financial markets. As a result, the country remains completely dependent on foreign aid not only for building up its productive capacity but also for the implementation of stabilization and structural adjustment measures. This is also true in the case where the application of these measures improves the productivity of investment and the allocation of resources. Hence, a central question for Nicaraguan policy-makers in the coming years is how to mobilize additional external resources from the international donor community in order to sustain economic recovery and not merely stabilization.

One strategic option is to intensify stabilization and structural adjustment efforts in the hope that donors will channel their scarce aid funds to the country showing the best policy performance. Statements to this effect are frequent in World Bank reports. However, as we have argued earlier, it is not consistent with the lessons drawn from Nicaragua's experience in the late 1980s. Another option is to ease adjustment efforts, for instance, by implementing a less rigorous credit policy, and to renegotiate with the donors the reallocation of available funds to investment projects. This, however, may jeopardize the agreements with the multilateral credit institutions, increase the expectations of devaluation, and ultimately lead to hyperinflation.²¹

The two policy options described above are likely to increase pressures on bilateral donors in the short and medium term. On the one hand, bilateral donors trying to give program assistance based on policies fully consistent with the prescriptions of the multilateral credit institutions risk getting caught in a vicious circle. They are requested to maintain financial support to the adjustment program. But as the program

²⁰ Cf. Cassen et al. (1986), p. 30.

²¹ A 'third alternative' is that the donor, while adhering to the conditions set by the IMF and the World Bank, does not withhold aid when the recipient country does not have a successful track record according to said conditions. Sweden conditioned its aid to Nicaragua for the first time in 1992, on the occasion of the 1993/94 agreement. The following conditions for the utilization of the Swedish contribution (295 million Swedish kronor) were stated in the agreement: a) 'Nicaragua shall implement the economic recovery programme'; b) 'Any amendments made to the economic recovery programme shall be accepted by Sweden'; c) 'An agreement on financial support shall exist between Nicaragua and the World Bank's International Development Association and the International Monetary Fund'; and d) 'The contribution shall be channelled through market mechanisms, and due consideration to budget process and countervalue funds shall be paid by Nicaragua' (SIDA, 1992-d.). From April 1993 onward, no agreement with the International Monetary Fund exists though discussions on an Extended Structural Adjustment Facility (ESAF) arrangement are under way. Sweden has, however, disbursed 135 million Swedish kronor as balance of payments support, including debt relief, between July 1993 and June 1994.

fails to create the conditions conducive to economic recovery and output growth, internal and external imbalances tend to amplify. This ultimately leads to a renewed balance of payments crisis and so forth. On the other hand, bilateral donors can respond in two ways when the recipient country's policy deviates from the prescriptions of multilateral credit institutions, or when relations with those institutions are interrupted. They can try to initiate a policy dialogue with the recipient in order to help implement an alternative policy package. This corresponds well to our description of the Swedish aid policy during the 1988-89 period, and we will return to this option in the final chapter. Alternatively, the donor may take the decision, but not the responsibility, of supporting inadequate macroeconomic policies. This is the case where aid is concentrated on project support and the donor consciously avoids playing any active role in the design and management of macroeconomic policies. This is perhaps an accurate description of Swedish aid policy with respect to Nicaragua between 1985 and 1988 (cf. Chapter 7).

To sum up, foreign aid to Nicaragua completely failed to promote economic self-reliance during the 1988-93 period. Worse still, both the donors and Nicaragua have been involved in ever-increasing debt negotiations, policy-conditioned aid and recessive adjustments which unintentionally perpetuate the present situation of extreme aid-dependency. Viewed from the donor perspective, this is perhaps a disappointing conclusion. From the recipient perspective, it is a dramatic one both because of the impressive efforts made to stabilize the economy and because of the high social costs of adjustment.

5.6. Conclusions

Swedish assistance to Nicaragua showed a remarkable ability to contribute to the macroeconomic stabilization effort in Nicaragua as soon as this process was undertaken at the end of the 1980s. A policy dialogue was begun in 1989 when two Swedish-sponsored technical assistance missions were instrumental in the formulation and monitoring of the stabilization program, after a shaky Nicaraguan start in 1988. In line with this, financial assistance was offered for the resulting program which, by and large, followed the orthodox IMF/World Bank recipe: devaluation, fiscal austerity, price liberalization, etc.

The very institutions advocating this type of policy, however, failed to provide financial support for the Nicaraguan effort. As a result, stabilization proved impossible, and the catastrophic debt situation went unresolved. Political factors prevented stabilization from gathering momentum.

An opportunity had been lost. Once Nicaragua experienced a change of government in 1990, an agreement could be reached with the IMF and the World Bank, and the United States put an end to its trade boycott. A year later, a stabilization program supervised by the international financial institutions was in full swing. This, however, proved to be too late. If one is to judge from the standard macroeconomic indicators, then the program has not been successful, and even if substantial rescheduling of Nicaragua's foreign debt has taken place, the latter continues to increase. Exports are weak and donor fatigue is beginning to show, with drastic reductions of the aid inflow in 1992 and 1993. Nicaragua is completely aid-dependent not only for growth but also for carrying out its stabilization and adjustment program. There is simply no way of getting Nicaragua back on a growth path without working on further renegotiation of the country's foreign debt, and this, clearly, includes debt forgiveness. The time has come for initiation of another policy dialogue between Nicaragua and its donors. To contribute to the initiation of such a dialogue is an important task that lies ahead of Swedish development cooperation with the country.

Chapter 6. MICROECONOMIC EFFICIENCY OF SWEDISH PROJECTS AND PROGRAMS

The present chapter is concerned with the microeconomic effects of Swedish aid to Nicaragua. Two key issues are addressed: (1) whether the projects and programs supported were designed to attain the goals set by the Swedish government for its development assistance policy, and (2) whether the assistance rendered by Sweden to Nicaragua between 1979 and 1993 was efficient in that said assistance went to well-designed, well-managed projects and project goals were actually met. Due to time constraints, we have employed evaluations already made of the Swedish projects and programs in Nicaragua.

The chapter explores the following areas: mining, forestry, rural cooperatives, energy, import support and, finally, research. Some kind of evaluation is available for all these sectors.¹ Unfortunately, this is not the case for support to the social and health sectors. Consequently, these sectors are not included in the discussion.² (Luckily, these sectors represent only 7 percent of total assistance between 1979/80 and 1992/93.) Two (very small) programs, which are not considered here but which are worthy of mention, are the cultural program and the women's program. The former was initiated as early as in 1982 and is still in operation.³ The women's program started in 1985 as a part of the projects already under way in the production sectors. At present, it includes direct cooperation with diverse women's organizations.⁴ We have also omitted the 'miscellaneous' category, most of which deals with support to NGOs and emergency relief. No systematic information with respect to the former is available to allow us to make any generalizations. As for emergency relief, such relief is given under exceptional circumstances which do not conform to 'normal' economic evaluation procedure.

6.1. Mining

A sizeable part of the Swedish support to production projects in Nicaragua has been devoted to the mining sector: 333 million Swedish kronor at constant 1985 prices (around 36 percent of the assistance to Nicaragua's production sectors or 15 percent of

¹ See Metell (1994), sections A and B, for an overview of evaluations commissioned by SIDA and SAREC.

² One exception is the social and health components of the mining program. Cf. below.

³ Support has been given to the *Museo Nacional de Nicaragua*, the *Biblioteca Nacional Rubén Darío*, the *Teatro Nacional Rubén Darío* and the restoration of *Convento San Francisco*.

⁴ 'The objective [was] to integrate women in mainstream development cooperation' (Carl Tham quoted in Østergaard, [1993]). From 1988 onward, there is a specific agreement on 'Funding of Development Projects for Women'. The program was evaluated in 1993 (ibid.).

total Swedish assistance to Nicaragua) between 1979/80 and 1992/93. The sector has received Swedish assistance since 1981, when jointly-financed gold prospecting was first undertaken at El Limón and La Libertad, the principal aim of which was to secure continued production at the existing mines, since the known ore reserves were too small to guarantee such production. Behind this, however, was the need for foreign exchange.⁵ Gold mining is an inherently enclave-like activity which is not likely to have any development effects other than those generated by the inflow of foreign currency. The effects in terms of employment, backward and forward linkages, etc., tend to be small. With the possible exception of training for a small group of workers, what matters is simply the potential contribution to growth and economic independence via the use of foreign exchange earnings.

The afore-mentioned prospecting activities also led to Swedish involvement in both the rehabilitation and the development of existing mines. One of the central components of these activities was the construction of a central mineral laboratory in Managua. In 1984, the assistance was extended to investments and maintenance of current production, which meant that Swedish cooperation spanned the entire range from prospecting to production, including training.

Mining cooperation efforts were first evaluated in 1985.⁶ This evaluation, which was technical rather than economic, concluded that prospecting had indeed been very successful, but that channels for the transfer of know-how and on-the-job training were sorely lacking. A continuation of the project (prospecting, training, further development of the laboratory with a view to handling other minerals and metals) was recommended on the grounds of its importance in terms of foreign exchange that could be employed to diversify the domestic industrial structure. One of the central problems entailed striking a healthy balance between prospecting and production activities, and the evaluators stressed that prospecting should not be carried out until the necessary degree of skill and knowledge had been acquired. They further suggested that the program could also be expanded to include metals and minerals other than gold which could serve as a base for future local industrial production. The laboratory referred to above would then have to be developed to handle these aspects as well.

SIDA drew the following conclusions. The support to the mining sector had been successful in that production would have been discontinued had it not been for Swedish support. On the other hand, it was deemed unfeasible to calculate the economic viability of the projects due to the messy exchange rate situation.⁷ It was recommended that

⁵ SIDA (1981-c), (1982-c).

⁶ SWECO (1986).

⁷ SIDA (1986-c).

Swedish support should continue, particularly because Nicaragua was experiencing an economic crisis. However, in order to forestall dependence on Swedish support in the longer run, it was also recommended that the mining companies themselves should be allowed to retain some of the foreign exchange they generated through their exports. In light of the Nicaraguan reality, a large share of the program budget for 1986/87-87/88 was reserved for inputs and spare parts, although it was recognized that this was a 'doubtful' measure.

In 1987, a follow-up study of the mining activities was conducted.⁸ This was far less favorable than the evaluation carried out two years prior. The study revealed that some 40 percent of the Swedish support to El Limón and La Libertad had gone to activities related to current production. This was not without problems, however, since cost accounting and cost control procedures were deficient. As a result, neither the mine management nor the *Instituto Nicaragüense de Minas* (INMINE), the institution responsible for all mines in the country, had any idea of the real cost of the operations or their profitability. For example, when the investment part of the Swedish assistance was entered on the balance sheet, it was converted into local currency at the official exchange rate of 70 córdobas per Swedish krona instead of at the unofficial rate of 8,500 --an enormous undervaluation. By the same token, revenue calculations were highly unrealistic. It was thus recommended that strict business practices be followed to increase competitiveness and, in turn, foreign exchange earnings. The follow-up study also suggested that, as part of that endeavor, the mines should be permitted to retain a higher percentage of their foreign exchange earnings than the 25 percent they (INMINE) were permitted at the time.

Subsequent to the 1987 follow-up, Swedish support to the mining sector began to be phased out.⁹ During this process, the economic deficiencies of the program became more visible. Sizeable losses were sustained, caused not least by the dubious exchange rate policy which discriminated strongly against the export sector. Thus, in terms of profitability, the mining projects constituted a failure. Viewed from an economic angle, similar conclusions may be drawn. Calculations in terms of foreign exchange balance pointed to an unacceptably low relation between inflows and outflows. In the best case, the two balanced each other out.¹⁰ Thus, mining hardly became the generator of foreign exchange hoped for at the outset.

It was calculated that Swedish support to the mining sector could be phased out over a five-year period. It was envisaged that INMINE would begin cooperation with

⁸ PROSPECTOR International (1987), (1988).

⁹ SIDA (1989-a)

¹⁰ Swartling (1988-a), (1989-b), SIDA (1989-c), de Vylder (1989).

foreign expertise on a commercial basis already after year one. The company was deemed to be ripe for this after having been reorganized. It was entitled to 75 percent of the foreign exchange it generated, and a more realistic exchange rate policy was introduced in 1988. The Swedish contribution during the phasing-out period was to be confined to the financing of investment and personnel, while all current costs were to be absorbed by INMINE itself. Second, the transfer of knowledge was to be carried out in a systematic fashion in all the areas where personnel support was provided. Finally, measures were to be taken to increase the living standard of the population in the mining areas. Swedish support to the mining sector was terminated on 30 June 1992, when the prevailing agreement expired.¹¹

To conclude, the support to the mining project, which was relevant from the point of view of growth and independence, turned out to be a failure in terms of efficiency. The evaluation undertaken in 1985 did not look into the economic aspects, but the follow-up study, two years later, clearly revealed that the project, the relevance of which was intimately linked to its ability to increase production and generate foreign exchange, was not professionally run, leading to substantial losses. This was partly the result of the government's macroeconomic policies, notably with respect to foreign exchange, but no attempts were made either by INMINE or SIDA to determine whether the project was in fact a viable one once a more realistic (shadow) exchange rate was employed.

6.2. Forestry Development

The second largest recipient of Swedish project assistance has been the forestry sector, which received 282 million Swedish kronor at constant 1985 prices (31 percent of the aid to the production sectors or almost 13 percent of total assistance) between 1979/80 and 1992/93. SIDA support to the forestry sector began early, as import support during the overall reconstruction effort. Its expansion was a 'natural' component when, in 1981, it was decided that Swedish assistance to Nicaragua was to increase, for at least two reasons: Nicaragua's potential in the area and the long history of forestry in Sweden.

¹¹ Some social assistance projects were also set up in connection with the mining scheme. The first one aimed at strengthening civil society by increasing the grassroots influence in the identification of the needs of the population of the two mining villages. According to the evaluators, in 1992, virtually all the goals of the project had been met, however over a longer period than envisaged (Ramos Gross and Sevilla [1992]; cf. also Pérez [1991]). The second one, at El Limón, aimed at the construction of stoves which, however, broke down and were not repaired for lack of material, and latrines, which were forced on the users without sufficient information and education. Hence, their use and spread were hampered (Medina S. [1992]).

The 1982 goal envisaged a broad support program designed to contribute to economic growth.¹²

The support to forestry has rested on four main pillars, all of which can be viewed as potentially efficiency-enhancing and hence conducive to growth: planning and institutional support, development of forest resources (planting, inventories, etc.), development of the forestry industry and, finally, education and training. The relative importance of these components has changed over time. Between 1982 and 1986, the focus was on industrial rehabilitation and a master forestry plan was designed. During 1986-90, assistance was reoriented to support operations that would yield incomes quickly, and between 1990 and 1992 capacity-building received priority (management, production, institutional support).¹³

In 1985, an evaluation was made of the forestry development program.¹⁴ It was concluded that the program had been important in terms of its impact on the attitudes of the Nicaraguan authorities. Awareness had spread concerning the importance of conserving and developing the country's forest resources. However, the program left few measurable results. An attempted cost-benefit analysis was not completed for lack of data.

Nevertheless, five main conclusions could be drawn. The formulation of the national forestry development plan had been quite successful and the plan covered all the main aspects of forestry. The support to cutting and processing had facilitated imports of, above all, spare parts, which presumably had increased the production of plywood and sawn timber by up to 50 percent over previous years where assistance was non-existent. These positive effects, however, had to be weighed against three negative ones. A laboratory for wood technology had been built in a less than cost-effective fashion. The utilization of a new 'saw-doctoring' school in Matagalpa was much lower than expected, at a time when the need for training and repairs remained high. Finally, forest planting, one of the most important parts of the project, proved to be the weakest area.

Thus, after four years, the forestry program showed mixed results in terms of efficiency. Nevertheless, given the circumstances, the *Contra* war in particular, the overall impression of the evaluators was a positive one:

This Evaluation has found that, given the limitations and restrictions on the programme imposed by the war and significant shortcomings in the Government's

¹² SIDA (1981-d).

¹³ Scandinavian Project Managers (1993), pp. 14-15.

¹⁴ Goppers et al. (1986).

economic policy, SIDA-supported forestry activities have progressed reasonably well. Furthermore, the individual consultants and authorities involved, both Nicaraguan and foreign, are managing the programme competently.¹⁵

The evaluators recommended that financial assistance should focus, to a larger extent, on rehabilitation and enhancement of production capacity, including the private sector, to ensure the generation of export incomes in the longer run. It was pointed out, however, that for such incomes to materialize, an adjustment of the completely unrealistic exchange rate was necessary. The evaluators also stressed the need for planting new trees to meet the household demand for firewood.

Already prior to this evaluation, in October 1985, a switch had been made from a long-run orientation to a short-run one. This was confirmed once the evaluation had been made available. Around one-third of the funds for the forestry sector were earmarked for measures that would contribute to increasing production in the short run.¹⁶

A second evaluation was made in 1992, when the program launched in 1982 had been running for a full decade.¹⁷ This evaluation makes explicit reference to the four 'pillars' of support. Institutional support had only been given during the most recent two-year period and without any long-run orientation. SIDA had also financed both strategic and operational inventories. The former had been particularly important. However, Nicaraguan inventory-taking capacity remained weak. The planting programs had not met with success, due to a lack of suitable areas, on the one hand, and a confused property rights situation, on the other. A pilot farm forestry program begun in 1987 to involve the farming population and support the use of forest resources by the private sector appeared as relevant but was completely dependent on outside finance and thus needed explicit government backing for survival. The educational component had also met with considerable success and had filled a perceived need. However, the forest technician school in Estelí displayed various deficiencies and needed continued financial and material support. Training and recruitment of teachers was seen as crucial for the future of the school without Swedish support.

The most resource-demanding aid component was the support to the forestry industry, and its results, in terms of production, stood out as a failure in relation to the costs. Much of the equipment bought was never installed and capacity remained low.

¹⁵ Ibid., p. 1.

¹⁶ Scandinavian Project Managers (1992), pp. 8, 11.

¹⁷ Scandinavian Project Managers (1993).

Apparently, the reasons were to be found in the lack of interest on the part of the present government in continued industrial rehabilitation and development.¹⁸

The conclusions drawn by the 1992 evaluation team were that forestry was a relevant area for support, given Nicaraguan potential, on the one hand, and Swedish experience, on the other. The long-run action plans, rehabilitation efforts and education program constituted a solid foundation for assistance, and the emphasis on institutional support during the 1990-92 period was in line with these efforts. However, the switch in 1986 to focusing on short-run increases of output was perceived as unfortunate, since the Nicaraguan forestry sector at that time was 'not in a state in which it could significantly contribute to resolving the country's financial problems'.¹⁹ It would have been better to concentrate on the long-run development of institutions.

Thus, in summary, the growth-oriented support to forestry displays a mixed picture in terms of efficiency. Both evaluations stressed that the long-run components of the program were basically sound, and during the first four years it appeared to have functioned reasonably well, although in the distorted setting caused by the economic policies of the Nicaraguan government. The reorientation in 1986, on the other hand, stands out as a questionable political decision, taken under the pressure of acute circumstances, which served to deviate the support to forestry from its long-run goals, and the results, in terms of output, were not obtained in a cost-effective way.

6.3. Rural Cooperatives

Third in importance among the production sectors is rural cooperatives which received 151 million Swedish kronor in constant 1985 prices (17 percent of Swedish assistance to the production sectors or almost 7 percent of total aid) between 1979/80 and 1992/93.

The first agreement regarding assistance to agricultural cooperatives in Nicaragua was signed in 1984 between the Swedish Co-operative Centre (SCC) and the *Unión Nacional de Agricultores y Ganaderos* (UNAG). The objective was to strengthen the services provided to the UNAG cooperatives, in particular with respect to sales of produce and distribution of inputs and basic consumer goods, with a view to improving the living conditions of small- and medium-sized farmers. The following year, the project received emergency funds from SIDA in order to enable those farmers who had been most affected by the *Contra* war to remain on their farms. It was hoped that this would contribute to stemming the increased migration of poor farmers to urban areas and alleviate the concomitant reduction of food availability. Thus, the goal of the project was mainly of an emergency nature, although, it can also be looked upon in

¹⁸ SIDA (1988-a).

¹⁹ Scandinavian Project Managers (1993), p. 4.

terms of distribution and growth (the latter via savings of foreign exchange to be employed for other purposes). The main component in this package was the financing of purchases of farm inputs through the newly-founded *Empresa de Cooperativas de Productores Agropecuarios* (ECODEPA), 'the economic arm of the UNAG'.²⁰

The ECODEPA project was evaluated as early as 1986, only one year after its inception.²¹ This evaluation, which was based entirely on qualitative data for lack of quantitative information, concluded that to a great extent the goals of the project had been met. Cooperative development had been strengthened; the farmers appeared eager to participate, and cooperative ideas had started to take root among them. However, this was not manifested financially. The base of ECODEPA was the cooperative farm shops, the *tiendas campesinas*, to which few members had made any significant financial contributions.

Around the time of the evaluation, some 200,000 peasants had already left abandoned their land, in part, because of the *Contra* war, but also for economic reasons such as the distortions of the price mechanism. The ECODEPA project had helped the rural population to remain in the countryside through its positive impact on the standard of living and the priority it gave to the zones most affected by the war. ECODEPA had facilitated the distribution of goods to these areas, and the project had also contributed to peace, by reducing the social base from which *Contras* could be recruited.

The lack of quantitative data made it impossible to determine to what extent agricultural production had changed, but the farmers and cooperative officials interviewed indicated that the inputs distributed through the *tiendas campesinas* had made production much easier for them.²² According to the evaluators, increased availability of consumer goods presumably served as an incentive to produce and sell more crops. The number of families that had benefited from the ECODEPA project was estimated at around 135,000.

Thus, the main conclusion was that, by and large, the project had achieved its goals. This, however, did not mean that its efficiency could not stand to be improved. The pricing policy of the farm shops entailed a heavy subsidy to the buyers, since the goods were sold at far below their market value. Also, within the cooperative system itself, credit was the most common form of transaction. Finally, the system of book- and record-keeping left a lot to be desired. At no level in the system was there a

²⁰ Bynke, Guerrero and de Vylder (1986), pp. 1-2.

²¹ Bynke, Guerrero and de Vylder (1986).

²² Until October 1986, more than 88 percent of the total funds spent on ECODEPA had been devoted to purchases of imported goods (56.4 percent to inputs and the rest to consumer goods) (ibid., p. 19). Thus, the project was mainly one of import support.

satisfactory system of accounts and control. According to the evaluation, this was the main weakness of the ECODEPA project.

The evaluation team recommended continued support to the ECODEPA project and also indicated that this project ought to be extended so as to cover the entire country. In 1987, the project was incorporated into the regular SIDA country framework. It was no longer seen as an emergency relief measure but as a long-term undertaking.

In 1989, a second evaluation was carried out.²³ The team points out that the ECODEPA project had been successful in reaching the target population, although not to the extent envisaged at the time the project was launched. Some 204,000 rural families had been reached, or 89 percent of the projected figure, which must be considered as a major achievement given the war and the extremely difficult economic conditions prevailing in the country. More than half the stores set up were located in war zones. Again, it proved impossible to obtain any quantitative information with respect to the impact of the program on agricultural production, but there was 'a widespread belief that the project ... [had] been strongly influential in slowing the deterioration of the agricultural sector, and in allowing a significant percentage of the rural population to remain on their farms.'²⁴ Broad sectors of the rural population, including both small- and medium-sized farmers, had been reached in a way which had directly contributed to improving their living conditions.

Efficiency cannot be measured only in terms of goal attainment, however. There is also a cost component to consider, and this cost in the case of ECODEPA appeared to be relatively high both in economic and human terms. Clearly, ECODEPA would never have survived without foreign subsidies. Its financial viability was low, due, among other things, to deficient practices. Thus, credits were given at zero interest in a hyperinflationary situation and imported goods were sold at prices far below their real (scarcity) value. The artificial exchange rate employed in the past was a third factor. The organization was a long way from being self-financed.

To a certain extent, the losses incurred could be justified by the fact that the ECODEPA project was an emergency relief project during the first years of its existence. However, the evaluation team felt that in 1989 it was

precisely the time for a review of the project's thrust and priorities. The Mission's overall conclusion is that the catastrophic conditions which the country has faced are now changing, and that it is time to reorient the project from one of providing

²³ Jackson et al. (1989).

²⁴ Ibid., p. 1.

emergency relief aid to one of development assistance directed towards measurable improvements in socio-economic indicators and economic self-sufficiency. Therefore, ECODEPA's economic activities must in the future be organized along the lines of economic feasibility and capital accumulation. The cooperative aspects of grassroots group action and democratic control need to be emphasized, and the entire movement needs to consolidate its hard-won achievements as a spokesperson for the producers of the agricultural sector.²⁵

The 1989 evaluation clearly had an impact on Swedish support to the ECODEPA project. The importance of financial consolidation of ECODEPA was highlighted and the Swedish side also stressed the importance of ECODEPA maintaining an independent position *vis-à-vis* the 'politicized' UNAG. Talks with the new Nicaraguan government confirmed the willingness of the latter to give priority to aid directed at strengthening a politically-independent cooperative movement. The target groups were slightly respecified. The primary beneficiaries would be the small peasant household, with special priority given to the women (a sector which had been neglected hitherto), while the medium-sized farmers would constitute a secondary target group. SIDA also stressed the necessity of making a clear distinction between the commercial part of ECODEPA activities and the parts aiming at economic development and of ensuring that the former would not continue to be subsidized as it had in the past.

The change of government in 1990 forced ECODEPA to reorient its activities dramatically. Expansion took place in three directions: coffee exports, purchases and storing of sesame seed and importation and distribution of agricultural chemicals. The number of products for sale through the *tiendas campesinas* was reduced considerably with future concentration on agricultural inputs. The stores were converted into local cooperatives which were free to buy from the source of their choice.

This had repercussions on Swedish assistance as well. In 1991, SIDA received a request from the Swedish Co-operative Centre for 77 million kronor, to be employed for continued support to the ECODEPA project.²⁶ To appraise the proposal, SIDA hired two consultants who pointed out the economic weakness of the project, the overstaffing, the inflated level of wages and salaries and the low cost-consciousness, with operating costs running as high as 40 percent of the gross sales value.²⁷ The SCC document had to be revised in order to incorporate the macroeconomic changes that had taken place after the change of government and had created a completely new situation in the market

²⁵ Ibid., pp. 1-2.

²⁶ SIDA (1991-b).

²⁷ Baumeister and de Vylder (1991).

where ECODEPA was active. The problem of high operating costs and low profitability on all levels of the ECODEPA system had to be tackled and the support had to be designed in such a way as to reach the target groups.

As a result of the appraisal, SIDA asked the SCC and ECODEPA to come back with a new proposal for a maximum of 25 million Swedish kronor for a transition period of 12 months, taking three conditions into consideration: clear results for the target groups (the small- and medium-sized farmers) in terms of production and/or economic situation, profitable operations in the long run for the cooperatives (SIDA support was not to be forthcoming to purely commercial activities other than during a transitory period) and, finally, more resources to education and to the integration of women in cooperative activities.²⁸

The new proposal was submitted to a desk appraisal which suggested that the project be trimmed to some 2.5 million US dollars.²⁹ In particular, it was emphasized that the partial withdrawal of the state from state enterprises, subsidized credits and extension services required that ECODEPA become a competitive and economically viable enterprise. Accordingly, it was recommended that all commercial activities be financed locally and only those (non-commercial) activities that served to enhance the social and democratic principles of the cooperative and benefited the target groups continue to be supported by development assistance. The objective was to see ECODEPA become financially self-sufficient by 1993/94 with the subsidies to the purely commercial activities being removed one year earlier.

Before embarking on yet another phase of financing for the ECODEPA project, SIDA determined that an evaluation of the project would have to be made, not least to find out whether the project would be able, in the future, to continue its operations without recourse to foreign assistance --especially the commercially-oriented ones.³⁰ The 1993 evaluation team concluded that ECODEPA had managed to restructure its commercial activities in a relatively short time. The market shares obtained with respect to coffee exports, sesame seeds and imported chemical inputs for agriculture had given the organization a clear possibility of becoming profitable in the future. At the time of the evaluation, however, ECODEPA was still not financially sound, but reductions in terms of staff and number of *tiendas campesinas* and the introduction of a systematic accounting system on all levels were seen as steps in the right direction.

According to the evaluation team, this process should be able to continue without further Swedish support. Regular loans from development banks should provide the

²⁸ SIDA (1991-b), p. 2.

²⁹ Interconsult Sweden (1991).

³⁰ Lewin et al. (1993).

necessary financing. The evaluation team also recommended that the distribution of regular consumer goods through the *tiendas campesinas* be discontinued, since this was a loss-generating activity. The parts of the ECODEPA program which were considered to have a high 'development content', and which were hence eligible for further Swedish financial assistance, were the new credit program (informal credit to peasants through the stores) and the likewise newly-launched program to increase the participation of women in ECODEPA activities.

Presumably as a result of the evaluation, the support to ECODEPA, including the parts recommended for continued assistance, came to an end on 30 June 1993.

To sum up, the first years of emergency assistance to the farmers living in zones affected by the war were successful since this assistance enabled a significant part of the rural population to remain on their farms. By the beginning of the 1990s, however, the situation had changed entirely. ECODEPA had been transformed into an organization which had to work in a much more market-oriented environment as an exporter of coffee and sesame and an importer of agricultural inputs. The need for distributing basic goods to the peasant population had by then disappeared. ECODEPA did not manage to make this transition in a cost-effective way but was sustaining large losses.³¹ The need to become economically viable was clear, and this could not be accomplished through foreign financial assistance, but by trimming the operating costs. In this situation, it was logical that Swedish support should come to an end.

6.4. Energy

Cooperation in the field of energy was initiated in 1981 and continues today. Altogether, the energy sector has received 131 million Swedish kronor in constant 1985 prices (14 percent of the assistance to the production sectors, or 6.5 percent of total assistance) between 1979/80 and 1992/93. Assistance has focused on three major projects: the construction of small hydroelectric plants, production of briquettes from cotton stalks and extensive rehabilitation of Planta Nicaragua, a fuel oil-fired condensing power plant which accounts for around one-third of the electricity production of the country. The main objectives of this assistance have been to make Nicaragua less dependent on imported fuels for energy and to make more efficient use of actual imports, in order to save foreign exchange and to contribute to independence and growth.

The hydroelectric program was part of a larger Central American program which aimed at developing domestic energy sources.³² A study carried out by a Swedish

³¹ Cf. Haglund (1993-a), (1993-b).

³² SWECO (1990).

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³² SWECO (1990).

consultancy firm had indicated that building larger plants would be more cost-effective. Still, it was decided to go for the smaller plants, the argument being that the latter were to be located in small rural areas, so as to increase utilization of local resources, such as small-scale industries, with a view to increasing the living standard of the population and curbing rural-to-urban migration. Moreover, some of the equipment could be made locally.

The program got off to a slow start.³³ A number of preliminary studies and profitability studies were conducted in 1984, before the *Instituto Nicaragüense de Energía* (INE) presented a program for Swedish funding of planning, feasibility studies and construction of 20 small hydroelectric plants. A review was made in 1985 to secure the necessary information for making the funding decision.³⁴ The reviewer suggested that the support to further studies be limited and that funds instead be devoted to the construction of some of the projected plants.

The decision to go ahead with the project was taken in 1987. However, project implementation was delayed considerably, as a result of three factors: drawn-out negotiations when purchasing consultancy services, cuts in the national investment budget beginning in 1987 and the security problem connected with *Contra* warfare.³⁵ In 1988, a sector review was undertaken which concluded that Nicaragua should concentrate its efforts on geothermal power and large hydroelectric plants, and that the small hydroelectric plant program should be phased out since it appeared to be less viable economically. At the beginning of 1989, the project ground to a halt as the difficult financial situation made it imperative for the government to cut all investment funding. Swedish decisions to also finance the local construction costs in 1989 and 1990, however, made it possible to finish the task. In the end, only two working plants were completed. These should produce annual paybacks of 11 and 23 percent, respectively, of the foreign funds over a thirty-year period.³⁶ However, no economic evaluation of the small hydroelectric plant project as a whole has been made thus far.

The second part of the energy support consisted of assistance from SIDA and SAREC to INE to manufacture briquettes out of cotton stalks. This project, which began in 1982, was incorporated into the country budget from 1986/87 onward. The program was reported to show satisfactory progress up to 1988, when a technical evaluation was made which questioned the entire orientation of the experimental activities that had been carried out.³⁷ The consultant argued that the critical part was

³³ SIDA (1984).

³⁴ Aastrup (1985).

³⁵ SIDA (1988-a).

³⁶ SWECO (1990).

³⁷ Claret (1988).

devising a machine for harvesting the stalks; that, unfortunately, the solution that was finally arrived at did not fit the technical level prevailing in Nicaragua, and that the amount of cotton cultivated per hectare was too small for the machine. According to the evaluator, the result was that 'the machine was not suitable to do any work at all.'³⁸ The outcome of the evaluation was that the harvesting part of the project was handed over to the consultant that made the evaluation. Nothing came out of this transfer, however. The consultant finally left the project and INE decided to shelve the harvest of cotton stalks. The briquette plant itself, however, remains operational.

The third area of support entailed rehabilitation of Planta Nicaragua. This decision was taken in 1988.³⁹ The reasons were, on the one hand, a desire to support the economic policy of the government and, on the other, and presumably more importantly, the desire to maintain the level of production and contribute to the inflow of foreign exchange. This project survived the 1988 sector review and was also given high priority for the future. No external evaluation of the project has been made but, according to the SIDA Infrastructure Division, the rehabilitation work has been successful.⁴⁰ It is worth noting here that the operation of Planta Nicaragua is essential to the power supply of the country. It is the biggest single unit in the Nicaraguan grid. According to estimations made by the Infrastructure Division, after rehabilitation, the availability of blocks 1 and 2 is expected to increase from 60 to 90 percent. Electricity production in turn would be increased by 40 percent. In 1992, the training component of the project was assessed.⁴¹ The consultant concluded that this had functioned mainly as basic training, including some theoretical subjects, and that the personnel felt more confident after the course, but that the course had not been sufficient to meet the needs of the operating and maintenance staff.

Clearly, the main objective of Swedish support to the Nicaraguan energy sector was to enhance growth and save foreign exchange, but the extent to which this has been accomplished varies. Only two of the projected 20 small hydroelectric plants were completed. These appear to be able to pay back their costs, but it should be noted that no economic evaluation has been made of the project in its entirety. The cotton briquette project failed as well. The rehabilitation project has not undergone proper economic evaluation, but it appears to have worked fairly well. The training component is progressing well and can be further developed in the future.

³⁸ Ibid., p. 8.

³⁹ SIDA (1988-a).

⁴⁰ SIDA (1992-c), on the information provided by both the Swedish consultancy firm ÅF-Energikonsult and the Nicaraguan counterpart (INE).

⁴¹ Körner (1992).

Beside the projects mentioned above, SIDA has provided support to the formulation of INE's long-term expansion plan, in particular, the Master Plan for the Río Viejo, which includes general studies of the power potential of the river and feasibility studies of hydropower plants in Río Viejo. More recently, a program concerning institutional strengthening has been included in Swedish energy cooperation with Nicaragua. The program was designed jointly by INE and Sydkraft International in November 1992. Its objective is to transform INE into a business-oriented unit.

6.5. Import Support

Swedish aid to Nicaragua in 1980/81 and 1981/82 consisted, for the most part, of import support.⁴² This was defined to include the purchase of commodities such as medicines, spare parts and forestry machinery. The preparation of the program was deficient, as SIDA worked on the assumption that the Nicaraguan authorities were capable of handling the purchasing themselves. However, this turned out not to be the case. It appears that in the end Nicaragua paid more than what was necessary for the goods and services purchased.⁴³ During the following years, project and program assistance was substituted for commodity assistance. It was aimed at precisely those sectors that had hitherto benefited from import support, and SIDA played a more active role in the purchasing process.

A second change of focus took place in 1985/86 when import support was reintroduced. A total of 30 million Swedish kronor was devoted to such support that year, and 40 million in 1986/87.⁴⁴ The idea was to provide a flexible instrument which could be employed at short notice. At first all import support was tied to purchases in Sweden, the argument being that Sweden could provide the required goods on competitive terms. Between 1979/80 and 1992/93, 440 million Swedish kronor, in constant 1985 prices, were disbursed as import support. This corresponds to 20 percent of the total assistance to Nicaragua during the period. In addition, Sweden provided balance of payments support which could be used for financing imports, but also for credit mechanisms and debt reduction operations. Total balance of payments support amounted to 175 million, or 8 percent of total assistance. An additional 265 million were to be disbursed during the calendar years 1993 and 1994.⁴⁵

Import support could be seen as a potential contributor to three of the objectives of Swedish foreign assistance. Relaxation of the foreign exchange constraint would

⁴² Some Swedish consultancy services in the forestry sector and in tax administration were also included in the support.

⁴³ De Vylder (1987-a), pp. 8-9.

⁴⁴ Ibid., p. 9.

⁴⁵ SIDA (1992-d).

constitute an efficient source of support both to growth and independence. Concentrating the import support on inputs that could be used for generating export revenues or for reducing the need for imports, in a situation of extreme scarcity of foreign exchange, would be instrumental for growth. Compensating the effects of the United States trade boycott which had begun in 1985 would strengthen political independence. Finally, overcoming the threat to Nicaragua's economic and political independence would also help to overcome the threat to democratic development.⁴⁶

The allocation of import support was based on a tentative 'want list' from the Nicaraguan government, with room, however, for change and improvisation. Allocations were decided sector by sector and at the beginning mainly the chemical industry, fertilizer production and transports were favored. Problems arose with respect to the concrete formulation of wants, as a result of a general lack of knowledge as to what the Swedish market had to offer. This dilemma was resolved, however, by a visit from SIDA officials to Nicaragua.

In March 1987, Swedish import support to Nicaragua was made the subject of a 'mini-evaluation',⁴⁷ which concluded that 'by and large' this support had 'met the set goals'.⁴⁸ One exception was pointed out, however: fertilizer imports, which in 1986/87 accounted for 37.5 percent of the total. Nicaragua's need for fertilizer was determined by the *Ministerio de Ganadería y Agricultura* in an arbitrary way and the strong overvaluation of the córdoba in combination with domestic price distortions made fertilizer artificially cheap in Nicaragua: '... today, Nicaragua appears to have what is maybe the cheapest fertilizer in the world.'⁴⁹

In 1987/88, a revolving fund (FOPEX - cf. below) was created under the auspices of the *Ministerio de Economía y Comercio*, the purpose of which was to support the export of manufactures. In 1988, following the mini-evaluation, it was also proposed that the import support program be prepared more thoroughly, since support of this kind was likely to increase in subsequent years. Above all, the 'user' ministries were to be drawn into the planning process to a larger extent than hitherto, and SIDA also suggested that the possibility of transferring unused funds from the sector programs to the import support program be considered. However, no concrete changes were stipulated in the agreement with the new Nicaraguan government.

As a result of the balance of payments situation, import support remained the most important support item in quantitative terms. Looking to the future, SIDA took into account domestic political change and probable changes in international (notably

⁴⁶ De Vylder (1987-a), p. 8.

⁴⁷ De Vylder (1987-a).

⁴⁸ Ibid., 'Sammanfattning av slutsatser och rekommendationer'.

⁴⁹ Ibid., p. 13.

US) assistance to Nicaragua and increased the support to the social sectors, beginning in 1991/92.⁵⁰ In practice, however, the share of commodity support was increased, from 33 percent in 1988/89 to 47 percent in 1991/92, partly at the direct expense of support to the sector programs and partly as a result of an increase in the country budget for 1991/92.⁵¹

A 1990 study pointed to serious flaws in the system based on administrative allocation of credits and to the lack of macroeconomic analysis of the impact of import support.⁵² The Nicaraguan government, however, judged that it would not be possible to liberalize allocation immediately due to the grave economic situation in the country. SIDA also expressed the desire to continue to give support to the same sectors as before, regardless of what happened with the allocation system in the short term. The necessity of ensuring the actual payment of counterpart funds in córdobas (cf. Appendix) was pointed out by the Swedes. (Such funds represent a reallocation of resources from the private to the public sector, but no net addition to resources.) Furthermore, the Swedes expressed their support for decentralization of import support allocation to the Nicaraguan banking system.

In 1991 and 1992, a team led by Gabriel Palma from Cambridge University conducted a major evaluation of Swedish import support to Nicaragua.⁵³ Palma begins by examining the five different recipient channels employed for allocating import support. The most important channel, the *Fondo de Promoción de Exportaciones* (FOPEX), was established in 1987 to ensure inputs for non-traditional export products. However, its success, as of 1991, was questionable. The net increase in exports due to FOPEX activities was 'not very impressive', according to Palma, 'and it could actually be negative.'⁵⁴ Furthermore, the rate of repayment of loans from the institution was low (with less than one-fourth of the loans due for repayment being serviced during the first quarter of 1991) and the list of projects under consideration contained a number of dubious, extremely risky ventures.

The *Fondo de Apoyo a las Importaciones* (FAIM), controlled by the *Fondo Nacional de Inversiones* (FNI), lends foreign exchange for imports to firms producing manufactures for the domestic market, including inputs for the export industry. FAIM had a far better repayment record than FOPEX (with close to three-quarters being recovered). Its main problem seemed to be that it worked via financial intermediaries, mainly *Banco Nicaragüense de Industria y Comercio* (BANIC), who were paid

⁵⁰ SIDA (1988-b), (1989-b).

⁵¹ EuroConsult (1990), p. 5.

⁵² EuroConsult (1990).

⁵³ Palma (1992).

⁵⁴ Ibid., p. 54.

relatively low commissions and who hence preferred to refer their customers to other funds, leaving the high-risk ventures to FAIM. FAIM, in turn, had serious problems assessing the financial situation of loan applicants, due to poor accounting practices. Also, smaller firms were discriminated against, since the commission in this case was not high enough to cover handling costs. Together, this meant that the demand for FAIM loans was low and that around 80 percent of the applications were approved.

FOPEX and FAIM together (in 1991) received around three-fourths of Swedish import support. The remainder was distributed among the energy, transport and health sectors. The energy sector funds were handled by the *Instituto Nicaragüense de Energía* and were used to purchase imported inputs. This part of the import support program stood out as a highly successful one in the sense that virtually all the funds had been used. More important, however, was that the INE was one of the most efficient public corporations which, in spite of having to work with fixed rates, was able to turn an operating deficit of 0.6 percent of GDP in 1987 into an operating surplus of the same size in 1990.

In the transport sector, the government-operated *Empresa Nacional de Buses* (ENABUS) received loans for buying new bus engines. This company, however, was not run efficiently. Low set rates (far below those of the private companies) prevented the company from paying its debts to the government and to the financial sector. The company was heavily subsidized in the 1980s but subsidies had been cut drastically by the time of the evaluation.

In the health sector, the recipient of Swedish import support is COFARME, a semi-independent state company importing medicines and inputs for the manufacture of medicines. The aid received by this company was not properly recorded, which in turn made it completely impossible to trace what happened with the funds. Apparently, this complete lack of records made it possible to resell significant parts of what had been received in the black market.

In all, judged from the point of view of the efficiency of the support-receiving channels, the 1987/88-90/91 import support program can hardly be qualified as a success, with the exception of the energy sector and, possibly, but by no means certainly, the FAIM loans to manufacturing. Palma concludes

that at present [April 1992] there is not enough *financially sound* demand for Swedish import-support funds - at least not in the way they are currently offered, and at the interest rates at which they are charged (with the added problem that

BANIC does its best to redirect any existing demand somewhere else, aiming at a larger commission).⁵⁵

This conclusion leaves the question of counterpart funds. Both the Swedes and the Nicaraguans appear to have failed to approach this question systematically. In the reform package implemented by the Sandinista government at the beginning of 1989, counterpart funds were given an important role as a means of financing the fiscal deficit of the government.⁵⁶ Before March 1991, FAIM counterpart funds were transferred from the *Banco Central* to the *Ministerio de Finanzas* as soon as a loan was given to a FAIM customer, i.e. before the counterpart funds were created, strictly speaking. Thereafter, however, their use was plagued by an administrative conflict between the Bank and the Ministry, where the Bank rightly argued that spending the funds immediately⁵⁷ would be tantamount to spending money borrowed from the *Banco Central* and consequently inflationary. As demonstrated in the Appendix to the present chapter, this may have been the case, although not necessarily. In addition, the Bank contended that the counterpart funds were bank funds that were only lent to the *Ministerio de Finanzas*.

A second problem with the counterpart funds was that they were not properly recorded in the budget --which was clearly against the law. As a result, it was virtually impossible to obtain correct information with respect to both their magnitude and their use. 'Obviously, at best, there is invitation to uncertainty and inefficiency, and at worst, to corruption (which everybody agrees is widespread at the moment in some sectors of the government).'⁵⁸

Palma recommended that import support should be given much lower priority in the future. His recommendation is based on the change in the situation with respect to foreign exchange which improved dramatically in 1990 and 1991. After the change of government and the reorientation of economic policy in 1990, the Bush administration in the United States provided over 300 million US dollars in assistance during the first year of the Chamorro government --a sum of the same order as the country's total export value-- and, in addition, renewed trade with Nicaragua. In 1991, United States aid of a similar magnitude was obtained.⁵⁹ The córdoba was devalued by 400 percent.⁶⁰

⁵⁵ Ibid., p. 104.

⁵⁶ Ibid., pp. 42-43.

⁵⁷ That is, before repayment of the FAIM loans by the borrowers, which is when the counterpart funds are created.

⁵⁸ Palma (1992), pp. 77-78. Palma also concludes in his summary that 'Practically none of these funds have reached their intended objectives' (ibid., p. 6). However, this conclusion bears no relation to the analysis in the main text of his report.

⁵⁹ Ibid., pp. 82, 95.

The black market and official rates of exchange converged. Positive real interest rates were introduced and credit restrictions were imposed on both the private and the public sector. As a result, the supply of foreign currency increased. Nicaraguan capital abroad was repatriated and remittances from Nicaraguan workers in the United States increased as did the inflow of official assistance. At the same time, the demand for dollars was reduced. A recession followed the new stabilization plan, capital flight was reduced and the extent of speculative dollar holdings was reduced, much as a result of the increased confidence in the domestic financial system once real interest rates turned positive.

Relaxation of the foreign exchange constraint meant that import support was no longer as vital to the Nicaraguan economy in 1991 as during the foreign exchange-starved 1980s. The limited absorption capacity of the Nicaraguan economy made it furthermore difficult to spend productively even the funds already made available by foreign donors. A large proportion remained unused in 1991.⁶¹ However, in 1992, the external constraint was tightened once again. Exports fell by 20 percent and grants by 55 percent while imports increased by 10 percent. The service account worsened as a result of increased interest payments. The government responded by allowing debt payment arrears to accumulate, thus undermining the confidence that had been gained after the normalization of the external debt in 1991.⁶² Thus, the basis for Palma's conclusion that import support should be placed well down on the list of Swedish priorities for Nicaragua appears to be weak. Rather, the question of future import support must be discussed in an overall macroeconomic context (cf. Chapter 8).

6.6. Research

Swedish research cooperation with Nicaragua began on a small scale even prior to the fall of the Somoza regime, with the funding of a group of Nicaraguan social scientists exiled in Costa Rica in 1978/79 and 1979/80. After the change of political regime, an agreement was signed between the Swedish and Nicaraguan governments in 1981.⁶³ Between 1979/80 and 1992/93 a total of almost 89 million Swedish kronor in constant 1985 prices (equal to 4 percent of total Swedish assistance to Nicaragua) had been spent on research assistance. The main objective has been to create research capacity in the long run in areas defined as priorities by the Nicaraguan government. A subsidiary goal was to contribute to the creation of scientific results of relevance for solving national problems. Both these goals point towards the growth objective.

⁶⁰ Aguilar (1992-a), p. 13.

⁶¹ Palma (1992), p. 86.

⁶² Aguilar (1993), pp. 6-7.

⁶³ Ganuza (1988), p. 77.

After five years, a survey was made of the research system in Nicaragua.⁶⁴ The study highlights that what has been accomplished must be viewed in light of the difficult setting:

The lack of a research tradition, the 'brain drain' after 1979, the de facto situation of war which has reigned in the country for the past several years and a catastrophic economic situation have strongly limited the possibility of creating propitious conditions for research in the country. Empirical research, directly connected to the productive needs of the economy, is given maximum priority. The basic sciences have been practically neglected. Agricultural and social sciences predominate [...] Research structures, such as laboratories, scientific equipment, chemicals, libraries and documentation centres are deficient, unequally distributed and underutilized, in so far as they exist. Human resources, in the form of researchers with higher education (Master's or Ph.D degree), are very limited. The country lacks a national research policy or an institutional body that centralizes responsibility for such a policy. Local financing of research activities is very limited.⁶⁵

The research cooperation which took place between 1980 and 1986 concentrated on the training of Nicaraguan researchers in a 'sandwich' model: training in a Swedish research center combined with training and field work in Nicaragua, with visits by Swedes to the research sites. Support had taken place in four areas. Within the agricultural sciences and rural development only one project was supported: plant husbandry of red beans, initiated in 1982, in cooperation with the University of Agricultural Sciences at Ultuna. The main result was the creation of a group of ten active researchers, some of whom were working on master's theses within the project framework. In addition, useful findings were generated by the project.

In the field of medicine and health, four projects received support: microbiology and parasitology, social medicine, occupational medicine and mental health. A number of pilot projects were carried out on infectious and parasitic diseases. In social medicine, a project on health conditions was launched in the mining community of El Limón; in occupational medicine, two studies were planned but not yet started at the time of the evaluation. Finally, a mental health program was in the planning stages. All these efforts involved cooperation between Swedish and Nicaraguan institutions.

⁶⁴ Ganuza (1988).

⁶⁵ Ibid., p. 81. The overall research situation in Nicaragua at the time of this evaluation is described in Vilas (1988).

Within the sector encompassing the natural sciences, technology and industrialization, a geological profile and mineralogical and geochemical studies were projected. Solar map and solar drying studies were under way and the cotton stalks energy project involved a research component as well. Drying and crystallization projects were initiated in chemical engineering and a project on medicinal plants was being implemented, however, of 'doubtful relevance from the medical point of view'.⁶⁶

Finally, SAREC supported research on ethnohistory, semiotics and economic development carried out on the Atlantic coast under the auspices of the *Centro de Investigaciones y Documentación de la Costa Atlántica* (CIDCA). This research, which had been funded since 1981, was made the subject of a special evaluation.⁶⁷ The evaluation concluded that basic and empirical research had been successfully combined, that contacts had been created between foreign and Nicaraguan researchers and that the research undertaken had been of relevance for the practical problems facing the population in the research area. It stated, however, that the majority of the researchers were foreigners, that more rigorous theoretical and methodological approaches were called for and that publishing activities were deficient. Continued support to the center was deemed necessary to allow it to reach a minimum 'critical mass'.

When the five-year review was carried out, the majority of the projects had not yet been completed. Many had barely gotten off the ground. In those areas where activities had been under way for a few years, some progress could be witnessed, although it was still too early to venture an educated guess as to whether the long-run goal with respect to research capacity would be met.

In 1990, research cooperation in the agricultural sciences, which had expanded by that time, was evaluated.⁶⁸ Research activities had been concentrated on cereals, notably basic foodstuffs, with the aim of increasing research and teaching competence through post-graduate studies at Ultuna in combination with research in Nicaragua. Unfortunately, the evaluation does not leave any clear impression with respect to the effectiveness of the program, which, nevertheless, was seen as relevant for Nicaraguan agriculture. Some communication problems between the Swedish and Nicaraguan parties were identified and the plots used for trials were not ideal. The period required for training in Sweden to be efficient was longer than what had been forecast when the project was first launched.

Two years later, an evaluation was made of SAREC's support to forestry and agroforestry research.⁶⁹ Three Nicaraguan institutions were involved and the *Centro*

⁶⁶ Ganuza (1988), p. 94.

⁶⁷ Long (1987).

⁶⁸ Larsen Petersen (1990).

⁶⁹ Ståhl (1992).

Agronómico Tropical de Investigación y Enseñanza (CATIE) in Costa Rica functioned as project leader and coordinator. The evaluator stated that the research at CATIE was high according to international standards but that the planning of the Nicaraguan projects rested on an overly optimistic appreciation of the existing research capacity in Nicaragua. A large number of the studies carried out were made in the form of papers by students at the bachelor's or master's level. (A number of Nicaraguan students received training at the master's level at CATIE.) Also, a certain amount of efforts were duplicated on the Nicaraguan side. The evaluator recommended that the support to CATIE be separated from that going to the three Nicaraguan institutions, that the training program should be extended to involve the doctoral level as well and that research not be limited to biological aspects but cover social science aspects as well.

Two later evaluations and a study of the entire Nicaraguan system for higher education and research are available, all of which were completed at the beginning of 1994. One of these concerns the engineering projects: drying and crystallization and also process engineering.⁷⁰ The evaluator concluded that the project had generated remarkable improvement of both human and physical capital at the Nicaraguan institution and had hence contributed toward the long-term objective. The publication record was good, with results finding their way into international professional journals, and the degree of applicability (agro-industrial methods) was high. The equipment employed was well maintained, three Nicaraguans had received technological licentiate degrees in Sweden and the project had contributed to the establishment of a bachelor's degree program at the *Universidad Nacional de Ingeniería*. Support for another six-year period was recommended to consolidate the achievements made to date.

The second evaluation concerns the geosciences.⁷¹ The geoscience effort started in connection with the gold mining project supported by SIDA. SAREC provided the pertinent research funds between 1981 and 1991 and, after SIDA's mining support came to an end in 1992, a second phase was begun with cooperation between a Swedish and a Nicaraguan university. The latter involved reorientation from mineral prospecting and gold recovery to geophysics. During the first phase, INMINE displayed little interest in research, which meant that the latter was dominated by the Swedish experts. Nevertheless, the training of Nicaraguan geologists and mining engineers in Sweden led to two doctorates and three licentiate degrees. In the second, ongoing phase, the Nicaraguan research role has been increased and post-graduate training in Sweden continues. A geoscience center has been established within the *Universidad Nacional Autónoma de Nicaragua*. As emerges from the evaluation, the publication record has

⁷⁰ Lieberknecht (1994).

⁷¹ Gaál (1994).

been good, with a shift from internal reports to 'normal' publication outlets. Thus, progress has been satisfactory so far, but the project remains a fragile one, mainly because of the uncertain working conditions of the Nicaraguan scientists in a situation where little domestic financial support is forthcoming. Accordingly, the evaluation recommended further SAREC funding.

Given the wider perspective of the study of Nicaragua's higher education and research system its conclusions differ from those of the evaluations of the individual projects.⁷² The basic contention is that SAREC's support to research in Nicaragua has been unique in terms of impact:

SAREC's support stands out as probably the most widespread, longstanding and in many ways effective support for research capacity building in Nicaragua. Not only has Swedish cooperation provided opportunities for postgraduate training for a relatively large number of the faculty that makes up the small national scientific community. It has also helped to develop a significant number of research projects and some research programmes, it has provided equipment and access to international scientific information, it has promoted research cooperation and thus produced a visible impact on the building of national research capacity.⁷³

On the other hand, the evaluators complained that the support had not been sufficiently focused, that it had been spread too thinly, and that it had targeted research areas, rather than institutions and, as such, had failed to pay sufficient attention to the strengthening of institutional capacity. Some of the projects appeared to be less essential from the point of view of Nicaragua's development priorities. In other cases, the research groups had been formed just because of the availability of funding. SAREC had also been known to stress the sandwich model of training too unilaterally. Finally, SAREC's support could have been better coordinated with that of SIDA and other donor agencies.

The evaluators suggested that SAREC's support, which at the time of the evaluation consisted of eighteen projects, should be confined to fewer areas. These should be based on their relevance for the country's development. In this process, better coordination with SIDA support should be attempted, attention should focus on institutional support and the administration of funds should be simplified. The projects in engineering and geoscience should be phased out, not because they are unsatisfactory but because they bear little relation to Nicaragua's development objectives and for

⁷² Brunner and Edwards (1994).

⁷³ *Ibid.*, pp. 69-70.

reasons of administrative expedience. SAREC's support should concentrate on a core program encompassing four different areas: public health in cooperation with *Universidad Nacional Autónoma de Nicaragua* (UNAN) in León, natural resource management together with three Nicaraguan institutions, social sciences at the *Universidad Centroamericana* and, finally, support to the ongoing university reform in Nicaragua.

Summing up, SAREC's support to research in Nicaragua has worked well in one sense, but not in another. It has financed a number of projects and programs which have produced output in terms of research results and high-caliber training. However, the support provided has not always been clearly in keeping with the development objectives of the country and has been spread out among too many institutions and projects. The capacity-building aspects have been somewhat overlooked. These factors have, in turn, tended to lower the efficiency of the assistance.

6.7. Conclusions

No coherent picture emerges when one attempts to summarize the experience of Swedish assistance to Nicaragua in terms of microeconomic efficiency, i.e. in terms of aid's contribution to the attainment of the official goals of Swedish cooperation with developing countries. All the projects and programs examined bear a clear relation to these goals, notably that of economic growth. The extent to which the programs have been efficient given the goals, however, varies considerably from program to program and it is difficult to arrive at any generalizations in this regard.

The support to the mining sector by and large stands out as a failure from the efficiency point of view. Gold mining was undertaken almost exclusively in order to increase output and save foreign exchange, but the project turned out to be an inefficient venture, due not least to the policy of the Nicaraguan government of severely overvaluing the domestic currency.

The forestry sector presents more of a mixed picture. Basically, the long-run output-concentrated orientation appears as sound, but the decision to switch to support for short-run output maximization was not a well-informed one. This output could only be obtained at a high cost.

The support to rural cooperatives during its initial phase was an emergency measure designed to stem the tide of rural poor from war zones into urban areas. This effort was successful. The support no doubt made it possible for many to remain in the countryside. At the beginning of the 1990s, however, with the end of the *Contra* hostilities, the rationale for the program had largely been lost. Besides, ECODEPA

failed to adapt to the changing circumstances in an efficient manner. Hence, Sweden pulled out of the program in 1993 --a correct decision.

The energy sector experienced severe difficulties when it came to meeting the quantitative targets set for the mini-hydropower plants, but the two plants actually constructed appear to be financially viable. No economic evaluation of the whole project has been made, however. The briquette project failed and was shelved by the Nicaraguans themselves. Finally, there are indications that the rehabilitation of Planta Nicaragua has been efficient for the most part and that the training program has worked relatively well.

Import support during the 1987/88-90/91 period can hardly be labeled a success story, with the exception of the energy sector and possibly, but not certainly, some of the support to manufacturing. At the beginning of the 1990s there were not enough financially sound projects to support. The creation and use of counterpart funds also stands out as a moot point. It is not clear how large these funds are or how they have been used. They have not been properly recorded in the government budget and they may also be inflationary.

Finally, the research assistance rendered by SAREC also presents a mixed picture. With only minor exceptions, what has actually been done has been done fairly well given the circumstances. However, concentration has been lacking. The funds and the efforts have been spread too thinly and the capacity-building aspect has not been stressed sufficiently.

APPENDIX: THE GENERATION OF COUNTERPART FUNDS

Two of the major problems in connection with import support are the extent to which counterpart funds are being generated and whether or not the creation of such funds is conducive to inflation. Counterpart funds are generated

when aid-financed commodities are sold to the public and the proceeds [in domestic currency] deposited in accounts that are usually owned by the recipient government. Such accounts are later used to finance development projects that have been agreed between the aid donor and the host government.⁷⁴

Assuming that output cannot change in the short term, import support will have three different effects on the price level. In the first place, it will bring goods into the economy. This tends to lower the price level. Second, if receiving import support means that imports that would otherwise have been undertaken are suppressed, the net reserves of foreign exchange will increase, and since these reserves form part of the money supply, this will exert upward pressure on the price level. Alternatively, in situations where foreign exchange is chronically scarce, as was the case in Nicaragua in the 1980s, imports are usually controlled by the government. This means that the net reserves of foreign exchange will not increase because the import support received will result in a net addition to imports. Finally, there is always the possibility that the Central Bank will use the counterpart funds to create additional money.

Ideally, this should not take place. When the government sells imported commodities or, for that matter, foreign currency that is used for imports, the purchasers have to pay for this in domestic currency. This means that either the cash holdings in the hands of the public or the bank deposits of the latter will decrease, with the consequence that the money supply will be reduced. (The domestic currency paid is deposited with the government and hence does not count as part of the money supply.) Later, the government will use the counterpart funds thus generated to pay for goods and services produced domestically. This increases the money supply, since the money spent will then be converted either into cash holdings or bank deposits in the hands of the public, but the transaction is not inflationary because this increase corresponds exactly to the previous decrease in the money supply.

⁷⁴ Roemer (1989), p. 795. The economics of counterpart funds is also discussed e.g. in Bruton and Hill (1991), Maxwell (1991) and Maxwell and Owens (1991). The Swedish principles for import support are contained in SIDA (1992-a).

The ideal sequence may not materialize, however. Instead, the chances are the initial reduction in the money supply will be compensated for by the Central Bank to avoid a credit squeeze during the period that elapses until the government spends the counterpart funds --without reducing credit to the public-- thus feeding inflation. This is likely to be the case especially when the time lapse between the creation of the counterpart funds and their spending is long. Hence, central bank policy is a crucial determinant of the outcome.

The above assumes that production of goods does not increase. This is not a realistic assumption, however. In the longer run, receiving import support should make it possible to expand output, at least in the situation where the economy has been constrained by a lack of foreign exchange. This would tend to decrease prices.

So far, the only study on counterpart funds generated by Swedish import support to Nicaragua is the one undertaken by Gabriel Palma. Palma attempted to examine the generation of counterpart funds by Swedish import support to Nicaragua and the extent to which this was conducive to inflation. However, he said nothing about the development effects of counterpart funds.⁷⁵ The FOPEX funds, which were given as loans to export firms, did not generate any counterpart funds in the traditional sense, since these loans had to be repaid in dollars and the repayments were used for new loans on a revolving basis.⁷⁶ The funds did give rise to increased government revenue in the form of import taxes and taxes connected with production of non-traded goods generated by the import support. These taxes, however, did not feed inflation, since they were generated out of production of goods and services. The only part of the FOPEX funds that could exert inflationary pressure were those shares of the loans to agriculture (a maximum of 30 percent) and fisheries (a maximum of 50 percent) that could be used for purchasing domestic inputs, because they would initially (before being repaid) act as credit to the private sector. Presumably, however (Palma gives no figures), these funds only accounted for a modest part of total FOPEX lending.

Strictly speaking, the FAIM funds were the only part of Swedish import support that generated counterpart funds. Once a FAIM loan was approved, the *Banco Central* provided the borrower with a loan for the equivalent amount in córdobas, which were, however, sterilized when they were used to purchase a letter of credit in dollars. Since the program operated on a córdoba loan basis, not on a dollar for cash basis, the counterpart funds (public funds) should not have been created until the loans were

⁷⁵ Palma (1992).

⁷⁶ Some of the export proceeds were employed to pay off Nicaragua's foreign debt. In these cases, the *Banco Central* had to pay the exporters in córdobas, hence increasing the money supply. However, since the net increase of exports generated by the FOPEX program appeared to have been small, the inflationary effect emanating from this should have been small.

repaid in córdobas. (Repayment appears to have been a relatively minor problem in the FAIM case.) Had the FAIM counterpart funds been created in this 'normal' way, i.e. when actual repayments from the borrowers took place, they would have amounted to 5.5 million córdobas (1.1 million US dollars) in September 1991. However, since up to March 1991 the FAIM counterpart funds were created as soon as the loans were made, the figure was higher. By September 1991, a total of 23.4 million córdobas (or almost 4.7 million US dollars) had been lent through FAIM.⁷⁷ Before March, the *Banco Central* transferred the counterpart funds automatically to the *Ministerio de Finanzas*. Thus, these funds were inflationary to the extent that they were spent before the loans were paid back. Since March, however, the *Banco Central* argued that only the funds actually paid back should be placed at the disposal of the Ministry.

To what extent the counterpart funds were actually inflationary is impossible to say, for lack of information concerning the timing of payments from the *Banco Central* to the *Ministerio de Finanzas* and the spending pattern of the Ministry. However, 23.4 million córdobas amounts to 3.2 percent of the narrowly-defined money supply (M1) in 1991,⁷⁸ so it could be that the FAIM counterpart funds did contribute to inflation - if spent rapidly. On the other hand, if the spending was delayed during the years of hyperinflation, the impact was small indeed.

The import support channeled through INE (energy) and INEBUS (transport) did not give rise to any counterpart funds until very recently, since these two institutions did not pay back any of the funds received from Sweden via the *Banco Central*. Finally, in the case of the health sector, the majority of the medicines were dispensed to users free of charge, i.e. no counterpart funds arose in this case either.

To conclude, whether the counterpart funds generated by Swedish support to Nicaragua contributed to inflation or not is an exceedingly difficult question to answer, given the information available. The import support given increased the availability of goods both through imports and through their contribution to domestic production. In a situation of extreme scarcity of foreign exchange, the imports made possible through the program undoubtedly constituted a net addition to imports and did not act as a substitute for imports that would otherwise have taken place. The only inflationary pressure that may have arisen must then have come from credit expansion by the *Banco Central*, notably via the transfer of FAIM counterpart funds to the *Ministerio de Finanzas* before actual repayment of FAIM loans. To what extent this has actually

taken place is impossible to say, however, without access to data with respect to the timing of spending.

⁷⁷ Palma (1992), p. 72.

⁷⁸ According to Corbo et al. (1993), Table 8, the money supply (M1) was 723 million córdobas in 1991.

Chapter 7. SWEDISH AID MANAGEMENT AND EFFECTIVENESS

The effectiveness of aid depends, in practice, not only on the recipient country's macro-economic environment and policy framework, or on the success or failure of individual projects, but also on the fulfilment of certain conditions which raise difficult political and administrative issues. One such condition is that donors be capable of conducting a policy dialogue with the recipient country's authorities and of maintaining closer working relations with the local executing institutions. This is crucial to the success of individual aid projects and programs and contributes to effective project implementation and monitoring. Another condition is that donors, as part of their natural concern to see their resources used effectively, take additional measures to ensure that aid is provided in appropriate forms.

This requires critical insight on the part of donors into the planning and management of aid by their own agencies. The effectiveness of aid is indeed significantly influenced by the organizational and conceptual framework in which donor agencies design and manage the allocation of available funds. This is true at both the micro and the macro level. At the micro level, the use of inadequate or inconsistent criteria in project selection, appraisal and evaluation threatens the achievement of specific project objectives. At the macro level, the lack of the knowledge and skills required to correctly interpret the changes in the economic and political climate of the recipient country makes it difficult for the agencies to anticipate emerging adverse economic trends, especially those that aid itself may induce. The agencies are therefore unable to modify aid to adjust to these changes, to draw right lesson from their own and others' experiences, and to offer something useful in the policy dialogue.¹ This may well contribute to the recipient's failure to meet its commitments and attain sustainability.

In the present chapter we discuss the effectiveness of Swedish aid to Nicaragua from this perspective. The focus is primarily on the decision-making process which takes place at SIDA, but some remarks are also made regarding the role of the Ministry for Foreign Affairs which carries the ultimate responsibility for all Swedish aid. The analysis is necessarily qualitative. Indeed, our main sources of information were official documents and interviews with representatives of the Swedish and Nicaraguan authorities and other donor agencies. Nevertheless, we were able to approach some

¹ The following statement by an ex-Assistant Director General of SIDA points in this direction: 'If the donor fails to appraise structural conditions sufficiently well before launching a project, he may find that the whole policy environment must be changed if the project is to have a chance of success' (Edgren [1986], p.53).

issues quantitatively and this enhanced our understanding of the decision-making process. For instance, our having broken down project aid by types of expenditure naturally shed more light on the interplay between Swedish enterprises and SIDA.

A final remark concerning methodology should be made here. We have approached SIDA's planning and evaluation process in the way proposed by Kim Forss.² Forss distinguishes four main steps in that process and links these steps to specific activities. The respective steps and activities are: 1) project planning, which includes idea and support memoranda; 2) monitoring implementation, which includes built-in project evaluations and quarterly reports; 3) impact assessment, which includes both project-specific and external evaluations, and 4) economic efficiency assessments, which are also based on these two activities. Supplementary activities in the four steps are weekly letters, annual reviews and the Memorandum on Development Cooperation which is submitted to the government.

7.1. Planning the Support

Swedish support to Nicaragua has gone through three distinct phases. Each phase corresponds to a well-defined period in the socio-economic history of post-Somoza Nicaragua. Between 1979 and 1982, Nicaragua was implementing its reconstruction plan. A large part of Swedish support in those years went to financing the national health program. During the second period (1983-88), Nicaragua embarked on ambitious investment projects which, as described in Chapter 4, were wholly financed by foreign resources. Sweden increased its aid commitments steadily during that period and, at the same time, decided to upgrade Nicaragua to the status of 'program country' and to create a Swedish Development Cooperation Office (DCO) in Managua.

Aid concentrated on a few large production projects in the forestry, mining, and energy sectors, but considerable aid resources were also channeled through diverse NGOs, in particular, the Swedish Co-operative Centre which administrated the rural cooperative project. The years immediately after 1988 witnessed a shift in the nature of Swedish aid. When the economic and political situation deteriorated, production projects were phased out and greater emphasis was attached to program aid, especially import support. The shift was accentuated in the following years. At present, most of the Swedish aid to Nicaragua is allocated to support the implementation of the adjustment program, either in the form of import and balance of payments support, or as support to the social sector.

² Forss (1985).

7.1.1 The Health Sector

On 20 July 1979, the same day the new government was able to enter the city, an official of the Swedish Ministry for Foreign Affairs arrived in Managua. During his four-day visit, he conducted a primary inventory of the damages caused by the civil war and reported on Nicaragua's most urgent needs.³ Fifteen days later, the Swedish government, in response to a formal request from the Sandinista government,⁴ decided on initial support of 25 million Swedish kronor (about 6 million US dollars).⁵ The first formal Swedish-Nicaraguan discussions on the allocation of Swedish aid were held in Managua, in August that same year. On that occasion, representatives of the Nicaraguan government presented a list of projects and programs, indicated the project to which the highest priority was assigned and suggested that only one of the projects enumerated be selected for Swedish support.⁶ The Swedish delegation reacted positively to that suggestion but instead of selecting the highest priority project it chose the next one on the list, i.e. the health sector project.⁷ The decision proved to be a wise one in terms of Swedish development assistance objectives. The highest priority Nicaraguan project indeed was the reconstruction of Managua center, a very costly and technically difficult project, with limited impact on the well-being of the low-income sectors.

An amount of approximately 68 million Swedish kronor was allocated to projects or activities within the health sector during the 1979-83 period. *Table 7.1* shows the approximate distribution of funds by specific project. Funds were provided in the form of import support.

Table 7.1: Health Sector Program by Project. Shares of Total Disbursements, 1979-1983
(percent, current prices)

Construction and equipment of the Subregional Hospital at Rivas	46.5
Completion of the Children's Hospital in Managua	22.1
Rehabilitation of 13 hospitals	13.2
Anti-malaria campaign	3.2
Medicine	3.1
Catering - 5 hospitals	2.9
School laboratories	2.9
Cold storage room	1.6
Others	4.5
Total	100.0

Source: SIDA.

³ UD (1979-a).

⁴ Nicaragua (1979-a).

⁵ To this should be added the 10 million Swedish kronor which had previously been allocated to humanitarian assistance through voluntary organizations.

⁶ Nicaragua (1979-b).

⁷ UD (1979-b).

None of the projects included in the table was ever evaluated. However, a memorandum from the Ministry for Foreign Affairs gives some indications of the status of the whole program as of May 1982.⁸ The author of the memorandum was very critical about the efficiency of the program. He stated two reasons for such criticism. One was that actual costs would greatly exceed anticipated costs, owing to delays in the construction of hospitals. The other reason was perhaps more serious. The author feared that 'the level of capacity utilization in the two hospitals [was] likely to be low because of the high costs associated with the maintenance of the hospitals' sophisticated equipment.⁹ Interestingly enough, SIDA's Health Division had already pointed to this risk in a report from 1980.¹⁰ The report indeed stated that Nicaragua's health sector should be one of the priority areas for future long-term cooperation, but it claimed that support should be shifted from the construction of large and costly hospitals to small-scale projects in rural and backward urban areas. A general conclusion was that 'we should not support those projects for which no evaluation of maintenance costs is available.'¹¹

Apparently, these recommendations and warnings had no effect on the project planning conducted by the SIDA Country Division. The health sector program started in 1979. It was supposed to last for two years, but, in 1984, SIDA was still providing financial support for the purchase of additional equipment for the Rivas hospital. SIDA recognized improved health as a primary objective of Swedish aid policy to Nicaragua from the very start. Still, the program was formally discontinued in 1983 at which time aid was concentrated on the production sectors. Moreover, no attempt was made to resume or reformulate the health sector program until 1991, when UNICEF requested SIDA to support the *Plan Quinquenal de Desarrollo Rural Integrado* (PQDRI), which combines actions in the fields of basic health, education, child welfare and agricultural production. Since 1992 SIDA has supported both this plan and the creation of 19 health districts referred to as *Sistemas Locales de Atención Integral en Salud* (SILAIS). It is worth mentioning that both the PQDRI and SILAIS are programs aimed at developing community health care systems involving low-cost health workers. This policy approach greatly diverges from that implemented with the support of SIDA in the early 1980s, but it largely resembles the one proposed by the SIDA Health Division in 1980.

Most of the statements in the Ministry for Foreign Affairs memorandum mentioned above are personal comments and reflections. Nevertheless, they are illustrative of what the Ministry thought about the prospects of Swedish aid to

⁸ UD (1982).

⁹ Ibid.

¹⁰ SIDA (1980).

¹¹ Ibid.

Nicaragua at the time. An example of this is the positive response to SIDA's proposal to increase the country budget from 40 million Swedish kronor in 1982/83 to 50 million in 1983/84. Two supporting arguments are stated in the memorandum. One concerns Nicaragua's absorption capacity, which is judged to be 'significant'. The other concerns the phasing-out of the health-sector program and the concentration of aid on the 'production sectors'. The latter was judged to fit better the requirements and objectives of 'the planned changes in our aid to Nicaragua'.¹² The reason for this is explained in a SIDA address to the government from 1982 which reads as follows: 'Swedish support to production sectors should be increased and the support to the health sector should be diminished [because] experience demonstrates that Nicaragua's ability to make good use of Swedish resources increases when those resources are delivered with the help of Swedish technicians and not simply to cover construction costs or to finance imports.'¹³ Just how far these expectations were from reality is one of the questions explored below.

7.1.2 The Forestry, Mining and Energy Projects

In the mid-1980s, Nicaragua's economic plans emphasized capital development projects. An official document from 1983 outlined the main economic objectives for the 1983-88 period and pointed out that 'one of the main concerns of government action [was to focus greater] attention [on] production sector and infrastructure projects [aimed at] the elimination of major internal and external bottlenecks'.¹⁴ On the whole, the document suggests a shift in emphasis from reconstruction and stabilization efforts to the intensification of 'the process of capitalization of the economy'. As mentioned in the previous section, Swedish aid underwent a similar transition in 1982-83 and this suggests that the transition was a *recipient-oriented* one in the sense that Sweden did not impose policy conditions on the Nicaraguan authorities.

Perhaps it is more important to ponder the reasons why SIDA gave first priority to the mining, forestry and energy sectors. Again, the 1982 SIDA Cooperation Memorandum sheds some light on the issue. The experience and competence of Swedish firms operating in the former sectors is a well-known fact. The memorandum makes reference to this when it argues that 'the concentration of aid on the mining, forestry and energy sectors will ensure large return flows'.¹⁵ According to SIDA's own estimates, these flows amounted to more than 60 percent of total aid to Nicaragua in

¹² UD (1982).

¹³ SIDA (1982-a).

¹⁴ Nicaragua (1983).

¹⁵ SIDA (1982-a).

1984. This evidently shows that SIDA's policy shift was consistent with Swedish economic *self-interest*, although, as the agency remarked, 'our assistance is not tied to the purchasing of goods and services in Sweden'.¹⁶ However, it raises the question as to whether SIDA's *strategic* choice of sectors, in the long run, was in keeping with Nicaragua's priorities and absorption capacity.

As early as July 1981, the SIDA Agriculture Division analyzed the prospects of *long-term* support to the forestry sector. A division memorandum pointed to the fact that 'Nicaraguan authorities have expressed their interest in Swedish support to the forestry sector' but recognize that 'it is difficult to gain insight into their [the Nicaraguan authorities] priorities and how they would like Swedish resources to be used'.¹⁷ However, the Agriculture Division did not consider this an impediment to 'continuing and increasing support to the forestry sector', or as a reason for delaying it. Instead, it proposed that a Swedish consultancy firm in direct contact with the Nicaraguans formulate specific project proposals and make preliminary cost estimations.

The work was completed in 1982. It resulted in five contracts between the Swedish consultancy firms Interforest/Swedeforest and the Nicaraguan forestry authorities (*Instituto Nicaragüense de Recursos Naturales y del Ambiente, IRENA*).¹⁸ A similar procedure was used in the case of the mining sector. The original proposal by the Nicaraguan mining authority (*Instituto Nicaragüense de Minas, INMINE*) was substantially modified by the Swedish state-owned company Sveriges Geologiska AB (SGAB).¹⁹ The latter, together with two representatives of SIDA's Industry Division, formulated the first version of the mining sector program in 1981.²⁰

The Country Division approved these two programs but it expressed its concern about the risk of SIDA getting involved in projects with over ambitious objectives: 'A general reflection about the consultancy studies of both the forestry and the mining sector is that the studies will certainly prove the need for very large-scale investments [...] and these, in turn, will require significant foreign credits.' In a more indirect way,

¹⁶ Ibid. 'Returns flows' play an ambiguous role in Swedish aid policy. Jacoby (1986), p. 90, explains this as follows: 'While the economic motives [for increased return flows] must have been very similar to those which once prompted government to suggest an expansion of tied aid, return flows was and has remained a neutral or even positive concept ... Business and industrial circles adopted the term with enthusiasm, as did labour market organisations', and concludes: 'The history of the evolution of Swedish aid practices during the 1970s and first half of the 1980s has largely been one of an increasing permeation of aid with commercial or economic interests, yet in forms which have not demanded any major shift in the principles guiding aid policy' (ibid., pp. 87-88).

¹⁷ SIDA (1981-a).

¹⁸ SIDA (1982-b).

¹⁹ The contract with INMINE was signed by the Swedish government agency SGU (Sveriges Geologiska Undersökning). SGU later handed over its responsibilities to SGAB.

²⁰ SIDA (1981-b).

the Country Division also expressed its concern about the operational capacity of the Nicaraguan counterparts in the forestry and mining sectors: 'It is [...] important to discuss with the Nicaraguans [IRENA and INMINE] whether they have the resources required to take advantage of all the information provided [by the studies] [...] and whether they are capable of managing these investments.'²¹ However, no evaluation of the absorption capacity of these institutions, i.e. their capacity to process and manage aid resources, was carried out, and no control of the availability of budgetary resources to finance recurrent costs or of foreign exchange to buy supplementary inputs was undertaken.

Contradictory statements were made concerning the duration of the projects. For instance, a letter from the Swedish Embassy in Managua addressed to the Ministry for Foreign Affairs was very positive with respect to the prospects of the mining sector program: 'As regards [the] mining [program], it is reasonable to assume that it will soon be able to repay its costs.'²² The program thus risked being phased out quickly and the embassy warned of the consequences: '[...] our aid to Nicaragua risks being rapidly decreased.'²³ The warning is understandable since the implementation of the mining sector program involved more than 50 percent of aid commitments, or about 3.2 million US dollars, at the time the letter was written. However, the rate at which the phasing-out of the mining program was to take place was clearly overestimated. Instead of being phased out, assistance to the Nicaraguan mining sector was increased. In 1988, this assistance amounted to 8.5 million US dollars which represented about 30 percent of total aid commitments that year.

The starting phase of the energy project differed from that of the mining and forestry projects in two ways. On the one hand, the project document which accompanied the Nicaraguan request for Swedish support was a highly structured one.²⁴ It contained time plans, pre-feasibility studies and detailed descriptions of the financial requirements concerning two subprojects, one focusing on energy conservation activities and another on the development of small hydroelectric plants (SHP). On the other hand, the project was originally developed by Nicaraguan authorities (*Instituto Nicaragüense de Energía, INE*) with the assistance of foreign experts. Besides, it was designed as an integrating element of the National Master Plan for Electric Development and the Central American Energy Program which were prepared with the technical assistance of the UNDP in the mid-1970s.

²¹ SIDA (1982-c).

²² UD (1983).

²³ Ibid.

²⁴ Nicaragua (1981).

SIDA reacted both swiftly and positively to the Nicaraguan request. Two and a half million Swedish kronor were allocated to the SHP project in 1981/82. This almost matched the amount required by INE. The motives behind the decision are found in a letter addressed by the SIDA Country Division to the Industry Division.²⁵ They are illustrative of the central ideas which govern SIDA's planning system. It was stated that 'the project was interesting from the point of view of the Swedish resource base.' Note again the importance of *Swedish self-interest* in SIDA's decision-making process. The 'Swedish resource base' in the present case was SWECO which had already started a similar project in Jamaica.²⁶ The Country Division further argued that, 'it seems that this project can be managed in the same manner that the forestry and the mining projects are presently managed, that is, with very limited practical involvement from SIDA'. The question here is whether this statement implied recognition of SIDA's limited *project management capacity*, in the sense that internal resources were not available to fund specific project-management activities by the agency itself, or the assumption that consultancy firms in general are more *cost-effective* than SIDA in project management. To our knowledge, no systematic investigation of this last issue has been undertaken to date.

The Country Division finally stated: 'It is true that the implementation of the project is not tied to the utilization of Swedish consultants but the fact is that we need to incorporate the project into the cooperation planning as soon as possible, and this implies that we should not go outside Sweden [resort to foreign consultants].'²⁷ Here, the Country Division pointed to a problem which is a constant source of concern at all decision-making levels: the possibility of *delays in the disbursement of available funds*. The issue is continuously addressed in the correspondence between SIDA headquarters, the DCO, the Embassy and the Ministry for Foreign Affairs. Moreover, it is often referred to as an indicator of SIDA's overall performance and efficiency.²⁸ It partly explains why SIDA officers react with anxiety and tend to improvise when the recipient country's absorption capacity is abruptly reduced by external factors, or when aid

²⁵ SIDA (1981-c).

²⁶ 'Swedish resource base' is a euphemism for 'Swedish self-interest' in SIDA's terminology. Jacoby (1986), p. 90, was somewhat sarcastic when referring to it: 'Now there was official sanction for proving the efficiency of Swedish industry, expertise and know-how at the service of development. Better utilization of the Swedish "resource base" became the new catchword.'

²⁷ SIDA (1981-c).

²⁸ SIDA's annual accounting reports (SIDAs ekonomiska årsrapporter) for instance, relate improved performance to an increase in the ratio of disbursed to committed funds (utnyttjandegrad) or, conversely, a decrease in the amounts that are carried over to the next budget year (reservationer).

commitments are suddenly increased by large amounts because of political decisions. The case of the import support program is illustrative of this.²⁹

7.1.3 Import Support

By 1985, Nicaragua's economic, political and military situation was rapidly deteriorating. The *Contra* war was intensifying and larger human and material resources were being allocated for defense and for the support of thousands of people displaced from the war zones. This had an adverse effect on the execution of Swedish projects. The Development Cooperation Office reported major delays due to of serious manpower shortages and lack of construction materials. Difficulties in financing recurrent costs because of budget constraints were also pointed out.³⁰ The DCO report concluded that Nicaragua's project execution capacity was very low and that it would remain so in the future. It further stated that this 'provides motives for increasing the weight of import support in the total support', and added: 'given the present circumstances, it should be regarded as normal that one-third of the country budget is used to support imports.' The report mentioned the difficulties which Nicaragua was facing in financing the importation of essential inputs because of extreme foreign exchange shortages.

However, the fact is the main concern was the potential under-utilization of the funds which were to be available in 1985/86. This issue was at the center of the discussions held by the heads of the sector divisions and the officers responsible for cooperation with Nicaragua during the 1985 aid-review meeting. It was clearly stated in the meeting that the main objective of the planning for 1985/86 should be to assure 'that the funds committed are disbursed in the course of the year'.³¹ No mention whatsoever is made in the formal proposal to the government. Instead, SIDA prompted this new emphasis on import support by referring exclusively to the 'precarious situation in the exchange market'.³²

Examination of the distribution of aid by program reveals that the funds allocated to import support actually represented one-third of the corresponding totals. This created a new problem. As much as 85 million Swedish kronor were to be disbursed between 1986 and 1988. At that time, however, the economic distortions caused by war

²⁹ Edgren (1986), p. 49, refers to the issue in the following terms: 'In some cases, the political decision-makers in Sweden voted larger country allocations than SIDA's technical departments could use in projects. SIDA solved this problem by allowing recipients to use increasing amounts of money for general imports. The share of general import support in country programmes increased from a few per cent in 1970 to 40 per cent by the end of the decade.'

³⁰ SIDA (1985-a).

³¹ 'Målet är att inte ha några reservationer inom landramen till Nicaragua' (SIDA [1985-b]).

³² SIDA (1986-a).

and faulty policies were clearer and more visible, and this evidently increased the risks for inefficient program implementation. A policy dialogue with the Nicaraguan authorities on the macroeconomic implications of the program was thus necessary, especially in relation to such issues as the functioning of the Nicaraguan foreign exchange market, the management of State enterprises and accounting procedures. This would, however, have taken time and therefore would have delayed both the implementation of the program and the disbursement of funds.³³

In fact, the first time that SIDA engaged an external consultant to conduct a study on Swedish import support to Nicaragua was in 1987.³⁴ The study was not intended to be a formal evaluation but rather a more or less complete review of the program (cf. Chapter 6). Notwithstanding, it contained valuable information and recommendations. A main conclusion was that, 'given the importance of import support in Swedish development cooperation with Nicaragua, the import support program should be prepared more carefully than hitherto'.³⁵ In addition, the consultant pointed out the lack of reliable information on the operations and efficiency of public enterprises and recommended that 'SIDA should urge the Nicaraguan counterpart to continuously deliver more complete and updated reports on the use of Swedish funds'.³⁶ Yet, in 1990, that information was imprecise or not available.³⁷ Critical remarks were also made regarding the inefficiency of foreign exchange and price policies. However, no macroeconomic evaluation of the program was commissioned until 1991 (cf. Chapter 6).

In 1987, the Swedish government decided to increase Nicaragua's budget from 125 to 160 million Swedish kronor. This created renewed pressure on both the Regional Department for Latin America (RELA) and the DCO in Managua. The following quotation from a letter addressed by the former to the latter is illustrative of such pressure:

We know that [Swedish] aid commitments are to be increased considerably in next year's budget [...] it is therefore necessary to accelerate the programming work in order to be able to present a proposal regarding the allocation of the new

³³ Odén (1986), p.104, was very clear when referring to this problem: 'The reasons for the difficulties encountered [in the implementation of import support programs] were not limited to the recipient end. With a rapidly increasing aid budget, SIDA's own capacity to prepare projects was also a bottleneck. It was initially assumed that import support needed much less effort on SIDA's part. Experience shows, however, that in order to succeed an import support programme often requires as much attention in the identification and preparatory phase as project aid.'

³⁴ De Vylder (1987-a).

³⁵ Ibid., 'Sammanfattning'.

³⁶ Ibid.

³⁷ EuroConsult (1990).

funds to the [Swedish] government in July 1987. We propose that the DCO immediately start discussions with the Ministerio de Cooperación Externa and ask for a preliminary proposal regarding the use of these funds.³⁸

Apparently, SIDA was willing to follow Nicaragua's priorities in the allocation of additional funds but, in reality, the Nicaraguan authorities had to define these priorities according to SIDA's own *priorities and timing*. RELA indeed indicated that a major part of the additional funds should be used for import support. This would evidently facilitate the rapid disbursement of funds. It further suggested that part of the import support should be allocated to the rural cooperative project. The remaining funds could be used to support cultural activities and other small projects. In a letter from April 1987, the *Ministerio de Cooperación Externa* communicated to SIDA 'the priorities of the Nicaraguan government concerning the allocation of additional Swedish financial resources'.³⁹ Not surprisingly, the allocation proposed by the ministry was almost the same as that proposed by RELA.

7.2. Project Monitoring and Impact Assessment

Generally speaking, SIDA's role in the implementation of the three industrial development projects described above was that of provider of funds. Apart from the continuous follow-up of payments, SIDA's *formal* monitoring work was confined to assistance to the Swedish consultancy firms and the Nicaraguan counterparts in contract negotiations. Judgements on the current efficiency of the projects and their possible economic impact are stated in SIDA's quarterly project review and annual sector review as well as in the agreed minutes of discussions with Nicaraguan representatives. These, however, are based primarily on the progress reports produced by the Swedish and/or Nicaraguan executing agencies. External evaluations of ongoing activities were also carried out, but they were mainly intended to provide background information on specific issues.

In addition to these formal activities, there was *informal* monitoring work which also served evaluation purposes. The informal monitoring work included inspections by DCO officers, visits by SIDA missions and close contact with the Swedish consultants and the Nicaraguan officers working in the project. The information generated by these activities appears in the correspondence between the DCO and the headquarters in the

³⁸ SIDA (1986-a). The *Ministerio de Cooperación Externa* is the Nicaraguan authority which coordinates and centralizes foreign aid. Note that the letter is from November 1986 and that 'programming' in this case means 'country programming'.

³⁹ Nicaragua (1987).

form of personal comments, suggestions and critical statements. These paint a lively picture of the internal and transactional environment of the projects.⁴⁰

The written documentation relating to the monitoring and implementation of the mining, forestry and energy projects spans more than a decade. Consequently, the information is abundant. Due to time and resource constraints, it was not feasible to structure this information within the framework of the present study. Accordingly, we had to limit ourselves to processing the material related to only one of the projects. We chose the mining project, the main reason being its size: more than 40 million US dollars at constant 1985 prices were allocated to this project between 1981 and 1992. This alone represents 36 percent of the funds allocated by SIDA to investment in development projects in Nicaragua, or 15 percent of Sweden's total ODA to Nicaragua 1979-93 (cf. Chapters 2 and 6). Another reason for our having selected this particular project is that no external evaluation of the project as a whole has been undertaken to date, despite its gradual phasing-out which started in 1991 when the new Nicaraguan government gave high priority to the privatization of public enterprises. SIDA plans to commission such an evaluation some time during 1994.⁴¹ The delay in doing so points to important shortcomings in SIDA's evaluation and monitoring system. In our opinion, this calls for closer examination. Hopefully, the following analysis will be of help. The issues examined below relate to shifts in the activity orientation of the program, increases in the funds allocated and, finally, effectiveness.⁴²

The mining sector program went through three phases. From 1981 to 1983, the main objective of the program was to identify Nicaragua's gold and silver reserves and to rehabilitate the gold production facilities in the mining districts of La Libertad and El Limón. The program continued to develop in this direction for the next two years. At the same time, it was extended to encompass a number of additional projects including the establishment of a new repair shop, the expansion of beneficiation plants, the development of open-pit mining, ore treatment studies and decentralized mine laboratories. Purchase of equipment and spare parts (import support) was also included in the budget revision for 1984. A total of 110 million Swedish kronor was disbursed during the 1981-85 period. As mentioned before, a major portion of these resources was allocated to prospecting work and consulting services on exploitation matters.

⁴⁰ According to Forss (1985), p. 333, the transactional environment includes 'the organizations, institutions and the people, [with whom] the project is interlinked'. The internal environment, in turn, refers to 'the nature of the technology, the scope and number of objectives, size, scale and geographic dispersion [...]'.
⁴¹ SIDA (1994).

⁴² We are grateful to Karin Metell, Stockholm University, for her help in the selection and organization of the written material related to the implementation and monitoring of the mining project.

Between 1986 and 1988, the main component of SIDA's program support to the mining sector was mineral extraction. A total of 141 million Swedish kronor was disbursed during the period. From 1989 to 1991, the main objective of the program was to improve both efficiency in production and the knowledge of mineral resources in order to prepare for phasing out Swedish support to the sector. Other components of the program during this period were the establishment of environmental controls at the mines and the implementation of social projects, such as the construction of housing units and school facilities in El Limón and La Libertad. The Swedish contribution to the mining sector continued in 1992 and 1993, however, this time as support to the new government's privatization schemes. *Table 7.2* provides the approximate distribution of allocated funds by activity and by type of inputs during the three phases.

Table 7.2: Mining Sector Program by Activity, 1983-1991
(percent of total)

Activity	1983-1984	1986-1988	1989-1991
Production	0.0	40.0	27.0
Prospecting	50.0	12.0	18.0
Training and research	12.0	5.0	7.0
Social	0.0	4.0	13.0
Technical assistance	38.0	39.0	35.0
Total	100.0	100.0	100.0

Source: SIDA.

By 1982, prospecting activities at El Limón and La Libertad were fully under way and the same was true for the construction of the central laboratory. The SIDA mission which visited Nicaragua in August that year evaluated the project's performance in positive terms.⁴³ A similar opinion was expressed by external experts who paid short visits to the mining areas.⁴⁴ SIDA agreed to initiate the second phase of the project to be executed during 1983 and 1984 and committed 43 million Swedish kronor to that end. A year later, SIDA's appraisal of the results of ongoing project activities remained unchanged: 'The high level of project activities achieved in 1982 has been maintained during 1983. The budget and the time schedule agreed upon in 1982 have mainly been followed and no major obstacle to the fulfilment of the project in 1984 has arisen.'⁴⁵

A substantial increase in the funds allocated to the project was also discussed. According to SIDA, what was discussed was 'an INMINE request for Swedish

⁴³ SIDA (1982-d).

⁴⁴ Stephansson (1982) and Sarap (1982).

⁴⁵ SIDA (1983-a).

financing of five additional subprojects⁴⁶ but, according to INMINE, the request was actually a response to a previous proposal by SIDA: '... the Swedish authorities [SIDA] have suggested that there are good prospects for increasing the support to the Nicaraguan mining sector in 1983/84. Accordingly, we propose that 26.5 million Swedish kronor be allocated [to five new subprojects].'⁴⁷ Apparently, prior discussions were held, but the fact is it took very little time for SIDA to decide on the 'Nicaraguan proposal'. The proposal indeed dated from 2-5 October while SIDA's approval was from 12 October.⁴⁸

Again, analysis of policy level decisions helps to establish a rationale for such an unplanned enhancement of project objectives and resources. The government's budget proposal for 1983/84 anticipated a contribution of 75 million Swedish kronor which represented an increase of 25 million Swedish kronor over 1982/83. In the opinion of the SIDA Industry Division, this justified further strengthening of the mining program:

The parliament in spring 1983 decided to significantly increase the country budget for 1983/84. Discussions of future and more long-term support for the mining sector have therefore started earlier. For the same reason, we must try to immediately identify projects which are compatible with both parties' views on future cooperation.⁴⁹

In the ensuing years, the project developed into an integrated exploration-exploitation project. An SGAB report from 1985 stated the reason for this: '... the early realization by the parties involved indicates that the problem did not only include the lack of ore reserves but that the whole mining industry was in a precarious situation.'⁵⁰ The report concluded that future efforts should be aimed at solving such problems as the lack of raw materials, deficiencies in service installations and the shortage of adequately educated manpower. As mentioned in Chapter 6, the consultant who evaluated the ore prospecting projects in 1985 arrived at the same conclusions and recommendations. These provided the basis for the 1986/88 cooperation agreement. The main features of the agreement were as follows: a) emphasis was shifted from mineral prospecting to rehabilitation of the mines and intensification of production; b) 40 million Swedish kronor per annum were to be channeled to the project, and c) the number of subprojects was increased from six to thirteen.

⁴⁶ Ibid.

⁴⁷ Ibid.

⁴⁸ SIDA (1983-b).

⁴⁹ Ibid.

⁵⁰ SGAB (1985).

With the 1986/88 agreement, the implementation of the project became more intricate and the problems of cooperation between INMINE, SGAB and SIDA became more apparent. At the same time, SIDA became increasingly concerned with the implications of the economic crisis and the *Contra* war for the mining sector. The Industry Division directed attention to some of the emerging problems:

It should be pointed out that the security situation may develop in such a way as to seriously affect some parts of the project [...] The possibilities of buying goods and services in the domestic market diminish [...] Though the mines are hard currency generators they have no preferential access to foreign exchange.⁵¹

The latter problem was especially damaging for the success and sustainability of the project and created a dilemma for SIDA. Contrary to what had been planned, the mines were to remain dependent on SIDA money to boost production in the foreseeable future. Thus, the risk of SIDA being directly involved in the management of the project seemed very real at the time. The Industry Division pointed out the possible consequences: 'An increase in SIDA's practical possibilities to monitor the project activities requires significant additional resources in the form of both supervision, time and consultancy services.'⁵²

This explains why SIDA suddenly became seriously concerned about the economic efficiency of the mining project. A letter from the Swedish Ambassador to the Minister of Mining in March 1987 clearly reflects this concern. The Ambassador stated:

SIDA recommends that INMINE, well in advance of the signing of next specific agreement, formulate a long-term strategy for the development of gold mining and prospecting [...] It should also formulate the criteria that have to be taken into account in order to guarantee the *economic efficiency* of the activities [...] It is now important to concentrate on the development of the mines, and their *effective operation* [...] This approach implies that the objectives of the Nicaraguan project receiving Swedish support must be *to maximize the production of gold, while minimizing reinvestment and operating costs*.⁵³

⁵¹ SIDA (1986-b).

⁵² SIDA (1986-c).

⁵³ UD (1987), (italics ours).

A number of measures were taken by SIDA in order to help INMINE tackle these problems. The measures, among other things, included: a) the appointment of consultancy firms to improve the management of the mining program, to implement a program for transfer of know-how, and to follow up on the project; b) the recruitment of a qualified expert in mining development to assist INMINE in elaborating an overall long-term development plan, and c) transfer of the main responsibility for the execution of the program to INMINE from July 1989 onward.⁵⁴ Clearly all these measures are helping to create a basis for the evaluation of the economic viability of the mines. However, as we will demonstrate shortly, the absence of a clear conception of this problem at the planning and designing stages of the project contributed largely to reducing the effectiveness of the whole support.

By the end of the 1980s, deteriorating economic conditions and the implementation of the economic stabilization program seriously affected SIDA's development projects (cf. Chapter 5). This is reflected in the correspondence between SIDA headquarters and the DCO in Managua. Price distortions, inflation and foreign exchange shortages are often pointed to as major impediments to the efficient implementation of the projects. The concern with macroeconomic issues and efficiency issues is also reflected in SIDA's formulation of general criteria and guidelines for evaluation. The appraisal mission on the forestry sector, for instance, had to consider among other aspects the monetary reforms, cuts in the national budget, and export constraints. It also had to evaluate the efficiency of the measures proposed to strengthen the competitiveness of the industrial component of the forestry project.⁵⁵

As mentioned earlier, a formal and comprehensive evaluation of the mining program was never undertaken. Instead, SIDA commissioned a number of studies on the effectiveness of the program in terms of increasing foreign exchange earnings.⁵⁶ Depending on the assumptions and methodology adopted, the studies concluded that Swedish support to the mining sector between 1982 and 1988 either equaled or surpassed the net foreign exchange earnings generated by the mines during that period. More disappointing, however, are the conclusions about the financial viability of the mines.

A research study related the problem to the existence of large distortions in the foreign exchange market. The results point to inefficient use of external resources.⁵⁷ The profitability estimates for the 1991-2000 period produced by an expert working for

⁵⁴ Until 1989, SGAB had full control over the implementation of the project. SGAB's organization was parallel to INMINE's and included not only mining engineers and geologists but also procurement officers, economists and accountants.

⁵⁵ SIDA (1992-f). See Chapter 6 for a description of the final report's conclusions.

⁵⁶ Swartling (1988-c), (1988-d), (1989), SIDA (1989-c), de Vylder (1989).

⁵⁷ Carlsson (1991).

the SGAB tend to corroborate this impression. Excluding from the analysis the costs of technical support, i.e. more than 30 percent of total assistance, gives a relatively low internal rate of return: 9 percent. For one of the components of the project, the rate was negative. This made the author conclude that 'the firm [*Empresa Minera el Limón*] has to reduce costs considerably, first of all, by cutting down employment by 200 persons.'⁵⁸ Some months after this was written, the DCO reported: 'To date, INMINE has laid off a large number of employees [501]. Still, it cannot show any evidence of significant results in such areas as reduction of stocks, purchasing procedures, consumption of materials and services, cost-efficiency related incentives, and utilization of production capacity.'⁵⁹

The above-mentioned research study wondered about 'the lessons learned from this project in terms of the role of economic analysis in project design and decision-making.'⁶⁰ The author filed valuable conclusions and recommendations with which we are in complete agreement. Some of these are reproduced here below:

In this project the objectives have been clearly stated. But the indicators and measures of objectives fulfillment have never been properly identified. This should have been done at the very early stages of the project and would later on have facilitated evaluations of project performance. The absence of a comprehensive evaluation, combined with the low frequency of impact and efficiency evaluations, has contributed to a situation where it has been difficult to form an opinion on whether the project has met its objectives or not [...] An economic analysis of the kind required by this project [...] would have been quite feasible to carry out: *ex ante* and as a part of the regular monitoring activities [...] A more conscious use of economic analysis could certainly have improved decision-making. As it were, the various analytical attempts probably created more confusion than guidance to the decision makers [...] the real causes behind the problems of the mines were basically external to the project and to a considerable extent of a political nature. *An analysis of the political economy of Nicaragua would therefore have been equally, if not even more important than traditional cost-benefit analysis.*⁶¹

⁵⁸ Svensson (1990), p. 50.

⁵⁹ SIDA (1991).

⁶⁰ Carlsson (1991), pp. 23-24.

⁶¹ Ibid. (italics ours).

It is worth noting here that studies of Nicaragua's macroeconomic and political problems have been available to SIDA from the very beginning of the support to Nicaragua. Actually, many of them have been commissioned by SIDA itself.⁶² An evaluation of these studies is beyond the scope of the present work. Nevertheless, it seems fitting to make some comments regarding the way SIDA has used them. It is true that the studies have frequently provided the basis for SIDA's general considerations and description of economic conditions in internal and external reports. However, their conclusions have seldom been utilized to identify alternative courses of action at the project planning level. Nor have the conclusions been incorporated into the decision-making process to bring about changes in project design and implementation or the termination of individual projects and programs.

With the launching of the structural adjustment program by the new government in 1991, the mining program entered a new phase. As stated in Chapter 5, one of the main recommendations of the initial IMF mission was to eliminate the overall deficit created by the budget. The World Bank followed suit and conditioned support on the dismantling of public enterprises, among them, the mining enterprises. This created new problems for SIDA. On the occasion of the 1990 deliberations, SIDA stipulated that a condition for continued Swedish support was an all-round rationalization of the mines. The problem now was to reconcile this objective with the ongoing privatization of the mines. According to the DCO, INMINE, the Nicaraguan government, and even the Swedish consultant who coordinated the support to the privatization program saw this program as a natural extension of the original mining program. Surprisingly enough, the SIDA Industry Division agreed: 'The primordial question is whether INMINE has qualified itself to secure continued Swedish support. If the answer is positive, the issue is to what extent and in what form and direction Swedish support should be extended in view of the eventual privatization.'⁶³ Evidently, the answer was positive. More than 25 million Swedish kronor were disbursed between June 1991 and December 1993. Of this, 5 million were allocated to support the privatization of the mines.

At the time we visited Nicaragua (January 1994), the privatization process was not as yet completed. Bids for the mines had been evaluated with the assistance of Swedish and national experts, but negotiations between the parties were very slow owing to uncertainties regarding property rights, indemnification to the former owners, participation of the employees in a joint venture project and last, but not least, disagreements on the real value of the companies to be privatized.

⁶² De Vylder (1981), (1985), (1987-a), (1987-b), Taylor et al. (1989), Fishlow et al. (1990), Aguilar (1989), (1992-a), (1992-b), (1993), Ocampo (1990), (1991), Corbo et al. (1993).

⁶³ SIDA (1991-a).

7.3. Some General Findings from SIDA Evaluations and Policy Documents

A background paper to this study identifies the main lessons that emerge from the 11 evaluations that SIDA has carried out in Nicaragua and provides an overview of SIDA's main policy and project documents, i.e. letters to the government and project support memoranda.⁶⁴ These are analyzed in relation to overall development objectives and project aims. The conclusions of the background study complement and enlarge the analysis in this chapter. They point to the existence of some general weaknesses in project design and monitoring as well as in the formulation of policy objectives. These can be summarized as follows:⁶⁵

Evaluations

Several evaluators have stressed the need for more clearly formulated aims and objectives, both at the project and subproject level, in order to facilitate the assessment of project results and of the fulfilment of project objectives.

The importance of maintaining a dialogue with the pertinent authorities has also been emphasized by the evaluators. Central issues in this dialogue are development and project aims, the financing of recurrent costs and project implementation.

Absence of or deficiencies in the financial accounts of the organizations and State enterprises that have benefited from SIDA assistance have repeatedly been pointed out as a matter of concern.

Most evaluations indicate the lack of statistical data as a main obstacle to the quantification of project aim fulfilment.

A final problem pointed out by the evaluations refers to the lack of resources for following up and taking decisions in the field. This could explain why some of the recommendations that were pointed out by earlier evaluations or by informal (monitoring) reports have never been implemented.

Letters to the Government and Project Support Memoranda

The general objectives of Swedish aid to Nicaragua were well described at the initial stage of Swedish assistance. These objectives have not been questioned or thoroughly revised over time. Instead, they have been used and cited as arguments for providing support to specific projects. The recent and important shift in Swedish support to Nicaragua is partly a result of dramatic changes in Nicaraguan political and economic conditions. This, however, has not lead to a clear reassessment of the overall

⁶⁴ Metell (1994).

⁶⁵ Ibid., pp. 24 and 36.

objectives, despite the fact that the change of content in Swedish development assistance called for such reformulation.

Objectives on a sectoral level have been reformulated on a regular basis, but often the reasons are not stated. On some occasions SIDA refers to requests from the Nicaraguan government in the letters to the government.

Operational targets for individual projects have been expressed very sporadically. This could be due to the fact that the overall responsibility for this lies with Nicaraguan counterpart and is therefore not well accounted for in project support memoranda. This reflects a serious shortcoming, given that these documents, to a large degree, form the basis for SIDA monitoring and evaluation procedures. Project evaluations have repeatedly pointed to this deficiency.

Evaluations commissioned by SIDA have, to a great extent, been used and referred to for assessments of continued support. Indeed, SIDA has, in project support memoranda, referred to nine of the eleven evaluations reviewed in the present report. Evaluations are often concordant with earlier project documentation, but to what degree the former have been used for decision-making is very hard to determine. It should also be pointed out that the evaluations performed by Nicaraguans of social projects in the mining sector have not been referred to explicitly, despite having been commissioned by SIDA. A small number of other documents, such as sectoral surveys (sektorgenomgångar) and other studies commissioned by SIDA have been referred to, but only minimally.

Lack of appraisal studies as foundations for project support decisions is very clear. A formal appraisal study is only referred to in one (1) case, as a basis for further support.

7.4. Conclusions

The effectiveness of Swedish aid to Nicaragua depends heavily on the functional links within the Swedish development cooperation system and between this system and outside organizations i.e. private enterprises providing consultancy services and the Nicaraguan executing agencies. In the case of SIDA, all these links are part of the process of identifying, selecting, monitoring and evaluating projects and programs. They, however, involve large quantities of routine reporting and consultation which is often governed more by administrative considerations than by matters of efficiency. This seriously interferes with the objective of promoting and improving the efficient use of Swedish aid resources by the Nicaraguan counterpart.

A conspicuous example of this is the undue attention paid to delays in the allocation of the pertinent funds to specific projects. This, in turn, is linked to the notion

that the rapid disbursement of aid funds is a reflection of SIDA's effectiveness. This creates continuous pressure on SIDA's organization and induces improvisation in the allocation of funds and in the preparation of the projects. As shown in this chapter, this was the case when the Ministry for Foreign Affairs and the Parliament in the 1980s decided on major increases in the Swedish aid commitments to Nicaragua. These decisions were promoted by SIDA itself but they were very demanding for the agency in terms of project planning.

SIDA conducts development cooperation with Nicaragua through several units: the Latin American Department, the sector divisions and the Development Cooperation Office in Managua. Activities are conducted close to the Ministry for Foreign Affairs and the Swedish Embassy in Nicaragua. These units and institutions do not constitute an integrated and comprehensive planning framework; instead, they each perform specific tasks and respond to specific problems. There is, however, a developed system of exchange of information and consultation which coordinates activities and integrates objectives in every phase of SIDA's project cycle. Our analysis has focused on some of these phases, namely the planning, monitoring and evaluation phases, and concentrated on only a few projects and programs. A generalization can be made. Apparently, SIDA departments and divisions are not sufficiently alert to each other. Suggestions, recommendations and warnings made by a given SIDA unit may well be disregarded by the other units. This is particularly true in the initial phase of the project cycle.

The concentration of aid on a small number of development projects which required large-scale investment was in keeping with the Sandinista strategy of enhancing the productive capacity of the country. This suggests that Swedish aid to Nicaragua was recipient-oriented. Closer examination of the arguments put forth by SIDA, however, indicates that the selection of specific projects was related to other, more selfish objectives, especially the intensive use of the Swedish resource base and the generation of large return flows.

Most of the aid resources were managed and administrated by Swedish consultancy firms working under contract with SIDA. As a result, the direct involvement of SIDA in the implementation of the projects, and therefore also the agency's operating costs, were considerably reduced. However, the effects of this policy on overall aid effectiveness cannot be measured at present. It is also impossible to draw any definite conclusions regarding the more specific issue of cost effectiveness. The decision to transfer the main responsibility for the management of aid resources from consultancy firms to Nicaraguan counterpart organizations has changed this situation, but it is also clear that ongoing and large-scale support to institution-building should have been provided long before.

The Nicaraguan experience illustrates how changes in the macroeconomic and political environment of the recipient country can be detrimental to development cooperation objectives. Anticipating such changes and subsequently tailoring project designs and schedules is clearly a difficult but necessary task. SIDA, however, made few efforts in this regard. In 1989, for instance, the mining and forestry programs were tailored to fit the new economic situation. Greater emphasis was attached to the economic efficiency of the respective activities and special attention was given to the macroeconomic constraints. These changes, however, came too late.

SIDA evaluations and policy documents were analyzed in a background report. The main implications are: more consideration should have been given to the formulation of objectives and more resources should have been devoted to monitoring work and policy dialogue. Project proposals should have been the subject of systematic appraisal and operational targets clearly identified.

Chapter 8. CONCLUSIONS

In this final chapter we will summarize our main findings and file some pertinent recommendations regarding the future of Swedish assistance to Nicaragua. The purpose of this exercise is not to prescribe a detailed plan of action. This is the task of the respective aid agencies. A too detailed analysis also risks losing sight of the important issues. Rather, what we hope to achieve is to point to some of the principal problems to be tackled, as well as the options available to the decision-makers who will shape the course of Swedish development cooperation in the future.

8.1. The Objectives of Swedish Assistance to Nicaragua; Some Statistical Facts

Chapter 1 reviewed, among other things, the objectives of foreign aid. Swedish assistance to Nicaragua is based on the five objectives of Swedish development cooperation in general: growth, equity, independence, democracy and environmental protection, with special emphasis on economic growth. Nicaragua is a poor country where incomes must improve. Distribution has not been singled out for special handling, since the distributional objective has been at the center of domestic economic policy. Growth is also seen as conducive to national independence and democracy.

Swedish assistance to Nicaragua has gone through three distinct phases: reconstruction after the civil war, 1979-82; support for production (mining, forestry, rural cooperatives, energy), until the late 1980s; and support to stabilization and structural adjustment efforts, from the late 1980s onward.

Chapter 1 also dealt briefly with different methodological issues and provided a summary view of the development process. Economic development, defined as a combination of growth, equity and poverty alleviation, is viewed as a result of three processes: growth of the labor force, capital formation and technological progress. These processes are accompanied by structural change: from low-productivity (primary) sectors to high-productivity (secondary and tertiary) sectors, in a policy framework which does not discriminate against production for the international market, which ensures that a macroeconomically stable situation prevails and which provides incentives that furnish correct information with respect to the relative scarcity of various factors and commodities.

A second methodological problem concerns the concept of efficiency, which is central to economics. Unfortunately, it is impossible to come up with a definition of efficiency which is both theoretically consistent and operational enough to serve as a guideline for the present study. Accordingly, we have adopted the official Swedish

development objectives, notably economic growth, as our yardstick with respect to what is desirable.

Chapter 2 presented the statistical picture of foreign aid to Nicaragua, with emphasis on the Swedish contribution. During most of the 1980s, the dominant source of assistance was the socialist countries of Eastern Europe, mainly the Soviet Union, which accounted for more than half of the total. This assistance, however, terminated completely with the fall of communism. Today, Nicaragua receives aid only from Western sources: mainly the DAC countries and the multilateral lending agencies. This shift from the ex-socialist countries to Western donors has also led to a parallel shift from loans to grants.

During the 1980s, program support, mainly import support, dominated the picture. However, the Nordic countries and the EC have concentrated far more on project aid, while the multilateral agencies have put most of their funds into emergency relief and food aid.

Swedish assistance to Nicaragua has always been provided in the form of grants. In real terms, a peak was reached in 1989. The Swedish share of Western assistance increased from around 10 percent in the early 1980s to a peak of almost 28 percent in 1989, falling to about 6 percent in 1991, when the United States reappeared on the scene as a donor country. Nicaragua accounts for only a minor part of total Swedish official development assistance: below 3 percent, or less than 5 percent of the funds administered by SIDA, which has handled over 90 percent of the total aid going to Nicaragua. Technical assistance appears to have represented some 15 percent of total Swedish aid to Nicaragua between 1979 and 1993.

8.2. External Constraints and Macroeconomic Policies

Three chapters were devoted to examination of the macroeconomic effects of Swedish assistance to Nicaragua. The analysis begins in *Chapter 3*, with an examination of the evolution of the Nicaraguan economy and Nicaraguan economic policy. The purpose of this exercise is to provide a background against which to set the analysis of aid. More specifically, it intends first to paint a picture of the environment in which economic policy --development policy as well as stabilization policy-- had to be made in the 1980s, and second, to examine some of the major policy elements themselves.

In terms of growth, the 1950s, the 1960s and the first half of the 1970s enjoyed relative success. Manufacturing, in particular, emerged as a rapidly developing sector. This, however, did not mean that growth was beneficial for the majority of the Nicaraguan population. Far from that. Nicaragua was run as a 'family enterprise' by the Somoza clan, with a concomitant concentration of income and wealth. No less than 70

percent of the population lived in absolute poverty in 1976 and social indicators convey a similar picture.

This situation did not improve during the latter half of the 1970s. The Sandinista insurrection against Somoza and the ensuing civil war made not only for great losses in terms of human lives and injuries but also for a fall in both GDP and the average standard of living. The rate of investment turned negative and the manufacturing sector began to shrink.

Thus, the Sandinista government took the helm at a difficult time. The first two years were relatively successful. The economy began to recover, but this recovery proved to be only temporary. Relations with the Reagan administration deteriorated rapidly, with the United States beginning its support to the *Contras*, instituting a trade embargo and vetoing economic assistance from the main multilateral sources. The total cost of the foregoing to the Nicaraguan economy amounted to almost half the per capita income of the country between 1979 and 1990, and as *Contra* activities turned to open warfare, hundreds of thousands of Nicaraguans were obliged to leave their homes.

The economic policy devised by the Sandinista government spelled disaster in many ways. However, in terms of social indicators and income distribution it was relatively successful. During the 1980s, life expectancy at birth increased, infant mortality was reduced, access to medical services and drinking water was improved and illiteracy was reduced dramatically. Viewed from a short-term perspective, foreign aid contributed indirectly to these achievements, by easing the tradeoff between spending on the social sectors and on the growth-generating ones. From a long-term perspective, it could be argued that foreign aid made it possible to continue the disastrous economic policies which over time were eroding the base for social spending as well. However, as demonstrated in our analysis of stabilization policies in Chapter 5, Swedish assistance constitutes at least a partial exception in this respect.

Against the success in terms of social indicators must be set the fact that private consumption fell dramatically in the 1980s. Most importantly, food production per capita fell by about 8 percent per annum, partly as a result of policies that were also supported by the donor community.

Turning directly to the economic policies of the Sandinistas, beginning with foreign trade, the Central American Common Market had, by and large, reached the end of the road at the beginning of the 1980s, and the countries in the region were beginning to turn to non-traditional products aiming at the international markets at large. This, in turn, required a change in trade policy as well, with currency devaluation as one of the main ingredients. The Sandinista government, however, failed grossly on this count. An exceedingly complicated multiple exchange rate system which discriminated strongly

against exports was devised and the córdoba was allowed to become severely overvalued. As a result, exports showed a distinct downward trend in the 1980s.

Fiscal and monetary policy left a lot to be desired as well. The share of government expenditure in GDP expanded rapidly until a peak of almost 60 percent, corresponding to an overall public deficit of 28 percent, was reached in 1984. This was largely the result of increased military expenditure in connection with the *Contra* war, but large investment projects and financing of increased consumption by low-income groups had their share in this as well. Spending on this scale could not help but have a major impact on the price level. Virtually the entire deficit was monetized, i.e. the printing press was employed to finance it. The result was hyperinflation.

The Nicaraguan economy increasingly failed to mobilize savings in the 1980s. Investment as a share of GDP more than doubled between 1980 and 1988, with public investment gradually replacing capital formation by the private sector. However, domestic savings were positive only in 1981-83. By 1984, they had turned negative and remained so for the rest of the decade. Capital formation became completely dependent on an inflow of foreign resources, with the result that a large foreign debt was rapidly built up. To this day, this debt continues to act as a tremendous obstacle to economic stabilization and growth in Nicaragua.

The experience of the Nicaraguan economy during the 1980s was an unfortunate one in virtually all respects except from the perspective of short-term social achievements. The capacity of the economy to generate growth was systematically eroded by two sets of factors. One was largely external: the systematic policy of the United States which aimed at the political destabilization of the Sandinista regime through the trade boycott, the obstruction of international lending and support to the *Contras*. The second component was domestic: a dismal set of economic policies which discriminated against exports, created hyperinflation and steered investment systematically away from the private sector towards inefficient public ventures which had to be financed with external funds.

8.3. Aid from a Macroeconomic Perspective: Foreign Trade and Capital Formation

In Chapter 4 the long-term effects of foreign aid were examined from a macroeconomic perspective. This entailed some methodological difficulties. Since it was impossible to separate the effects of Swedish assistance to Nicaragua from that of other donors, the conclusions apply to the effects of aid in general. Moreover, since it was also impossible to relate aid directly to economic growth, an indirect approach had to be

adopted, focusing on what in general terms appear to be some of the most important determinants of economic growth: exports, imports (of inputs) and capital formation.

One of the most widely discussed issues in the aid debate in recent years is whether an inflow of foreign aid is likely to produce 'Dutch disease' in the recipient economy, i.e. whether the inflow of funds serves to appreciate the real exchange rate to the point where the country's exports become non-competitive in international markets. The relevant comparison in this context is that of the inflow of aid, on the one hand, and the behavior of the *official* real exchange rate, on the other, since this was the rate that had to be used by exporters when converting their foreign earnings to córdobas. What resulted was appreciation of the córdoba when the amount of aid increased between 1980 and 1985 (before the government started to devalue the currency in an effort to stabilize the economy), i.e. the evidence is consistent with the Dutch disease hypothesis. However, it should also be borne in mind that the acceleration of inflation over the period as a result of the increased money supply is likely to have been the main culprit in the appreciation process, which of course does not preclude the aid inflow from having played a complementary role.

Turning to the import side, one of the most commonly advanced rationales for foreign aid is that it may serve to break up the foreign exchange bottleneck which serves to keep capital formation down since it allows investment goods and intermediates of foreign origin to be imported. There remains no doubt that aid allowed imports to increase, but this did not take place in a way which could be self-sustained over time. Weak export performance meant that the gap between imports and exports could not be closed. Instead, it widened, making the Nicaraguan economy more aid-dependent.

This was true in another sense as well. In models which highlight the lack of foreign exchange as an obstacle to capital formation, it is implicitly assumed that domestic savings do not constitute a binding constraint but are forthcoming more or less automatically to complement the inflow of foreign goods. This was not the case in Nicaragua, where, as we have already pointed out, domestic savings turned negative beginning in 1984. There, foreign funds had to bear the entire burden of capital formation.

We have also questioned whether the inflow of aid served to finance consumption, and public consumption in particular, along with investment. This, however, appears not to have been the case, at least not regularly. Rather, domestic taxes appear to have been used for consumption and aid funds for capital formation.

Finally, there is the question of whether aid was optimally allocated between investment in capacity-building and expenditure which served to increase the utilization of existing production capacity. This may not have been the case. Aid financed more

than 95 percent of the imports of capital goods, but only some 40 percent of the imports of intermediates and raw materials, i.e. it is very likely that the allocation of aid funds contributed to creating import bottlenecks on the utilization side.

Thus, it cannot be argued that foreign aid contributed to economic growth in Nicaragua --at least not in an unequivocal way or in a way which was conducive to self-sustained growth. Our evidence suggests that the aid inflow contributed to appreciation of the domestic currency in real terms (even though it was not the main factor) and hence to poor export performance. Aid made imported goods available to the economy and hence contributed to capital formation, but probably not to increased capacity utilization. Finally, as has already been pointed out, from 1984, foreign savings had to shoulder the entire burden of capital formation, meaning that aid acted as a substitute for domestic savings and hence that the country became aid-dependent.

8.4. Aid and Stabilization

The relation between aid and macroeconomic stabilization was dealt with in *Chapter 5*. The economic policies of the Sandinista government led to fundamental imbalances both externally and internally. The deficit on the current account of the balance of payments grew rapidly, the budget deficit soared until it reached a level of 28 percent of GDP in 1988 and the rate of inflation skyrocketed to an astounding peak of 33,600 percent the same year.

The stabilization efforts attempted in the mid-1980s had been conceived half-heartedly and had therefore failed. This was also the case with the package put forward in 1988. At this point, Nicaragua received Swedish-sponsored assistance in the form of two technical missions which helped to design and monitor a new stabilization scheme, along standard World Bank/IMF lines, with devaluation, price liberalization and fiscal discipline as main components. This was a far-sighted, innovative measure, and Sweden also arranged an international donor conference in Stockholm in 1989 which, however, failed to generate the funds necessary to guarantee the success of the program. The World Bank and the IMF refused lending to the Sandinista government in spite of the fact that the latter was already implementing the reforms these bodies normally call for.

It was not until the change of president and government in Nicaragua in 1990 that a World Bank/IMF-sponsored stabilization and adjustment program was launched and renegotiation of Nicaragua's external debt was initiated. By then, however, valuable time had been lost, and the program has not been overly successful. Credit and public expenditure have been restrained, the currency has been devalued, tariff rates have been decreased, and the rate of inflation has been reduced considerably in comparison with the hyperinflation years. However, the economy shows no signs of growth, the

manufacturing sector continues to shrink, export performance continues to be poor and private consumption is suffering.

Also, it is clear that further adjustment will be difficult. The inflow of aid has diminished since the massive infusion of United States assistance in 1990 and 1991. It could be that donor fatigue is beginning to set in, in light of the failure to get the engine of economic growth going. Not least, the external debt of Nicaragua has continued to grow in spite of the renegotiations through the Paris Club and elsewhere. The Nicaraguan economy is showing signs of major 'debt overhang', making it necessary to use export revenues to service the country's debt obligations instead of setting the economy on a growth path. By the same token, it is difficult to gain access to private international financial markets and international investors will not be attracted to the country as long as the economy continues to stagnate.

Thus, it is imperative to work out a solution with respect to Nicaragua's foreign debt, and this solution, of necessity, has to include debt forgiveness. As of now, Nicaragua is already entirely dependent on foreign assistance when it comes to securing stabilization, and as long as debt overhang continues, growth will be an impossibility. The time has come for another innovative Swedish initiative, that of initiating and coordinating a dialogue between Nicaragua and its donors.

8.5. Microeconomic Effects: Projects, Import Support and Research

In *Chapter 6*, our attention turned to the microeconomic facets of aid. Project aid has been given by Sweden to Nicaragua in four fields: mining, forestry, rural cooperatives and energy. In addition, import support has been given to a number of sectors and support for research projects and institutions has been channeled through SAREC. These efforts show somewhat mixed results from the point of view of efficiency. As far as can be told, all the projects and programs appear to have been relevant ones from the point of view of the objectives of Swedish development cooperation. However, given the limitations of the study, it has been impossible to determine whether projects or programs other than the ones actually undertaken would have made a greater contribution to Nicaragua's economic development.

Gold mining has absorbed 15 percent of total Swedish assistance to Nicaragua. The project, which aimed at generating badly needed foreign exchange, turned out to be an inefficient venture. The project was not professionally run and the increasing overvaluation of the domestic currency discriminated against gold exports. The end result was that the project did not generate more foreign exchange than what it used.

In the forestry sector, which has accounted for roughly 13 percent of Swedish assistance, the original emphasis was on developing production in the *long* run. Until

the mid-1980s, the program showed somewhat mixed results in terms of efficiency. At that time, a decision was taken to concentrate the support on an effort to increase output already in the *short* run to cope with immediate foreign exchange problems. This decision, however, is somewhat questionable, since the resulting production increases do not appear to have been obtained in a cost-effective way.

Rural cooperatives (7 percent of total aid) were funded --mostly in the form of import support-- as an emergency relief project in the mid-1980s, mainly because this support afforded a way of preventing the massive exodus from the countryside which resulted from the *Contra* war. This project, which centered on sales of agricultural inputs and consumer goods to small- and medium-sized farmers through a system of rural cooperative stores, appears to have met its objective, even though the efficiency of the project could have been greater. Once the *Contra* war came to an end, the original rationale for the project no longer existed. The cooperative organization made an effort to transform itself into a body to market agricultural produce and farm inputs in a market economy setting, but failed to do so in a cost-effective manner. The organization ran a loss when it should have been commercially viable. Accordingly, Swedish support came to an end in 1993.

Assistance in the energy sector has absorbed 6.5 percent of total Swedish aid. What has come out of this assistance is difficult to say. Three different projects were supported. The first one envisaged the construction of twenty small hydroelectric plants. Of these, only two were completed. These appear to be financially viable, but no effort has been made to evaluate the entire project in economic terms. The second project, which aimed at making briquettes from cotton stalks, must be considered a failure. It is not clear whether the original technical solution to the harvest problem would have worked. This part of the project was transferred to new management, but failed to develop and was therefore shelved by the Nicaraguans. The plant itself, however, remains operational. The third component, rehabilitation of the country's largest fuel oil-fired power plant, worked reasonably well. However, no economic evaluation of the project has been undertaken.

Under the heading of import support we find 20 percent of total Swedish assistance to Nicaragua. Here as well belongs a large share of the balance of payments support (which amounted to 8 percent of the total). Little of this effort can be said to be successful. The assistance to manufactured exports has been directed mainly to high-risk ventures by the Nicaraguan counterpart, with the result that borrowers have found it difficult to pay back their loans and the interest on them. Support to transport went to a company entirely dependent on government subsidies for viability, and in the health sector the funds were not even properly recorded. On the other hand, the support to the energy sector has gone to what appears to be one of the most efficient state-controlled

enterprises in the country. Finally, the internal Nicaraguan administration of the funds allocated for imports in the manufacturing sector has created a situation where it is doubtful whether the funds reach financially sound companies.

Import support in principle also creates counterpart funds in domestic currency when the goods are sold in the recipient country. However, to what extent this has taken place in Nicaragua and what the economic effects of this have been remains extremely unclear. Recording procedures leave a lot to be desired and it is difficult to see how and when the funds have been spent.

Finally, the research support provided by SAREC has accounted for about 4 percent of total Swedish assistance to Nicaragua. This support has been reasonably effective, given the current status of the individual projects and programs. The main criticism is that this support tends to be too dispersed rather than focusing on fewer institutions, which would have a greater impact in terms of capacity- and institution-building.

The overall microeconomic picture of Swedish assistance to Nicaragua is mixed and unfortunately not too bright. In terms of cost-effectiveness, it appears as if at least 40-50 percent of total Swedish aid to the country has not been particularly successful, for reasons stated above: the *Contra* war, the macroeconomic policies conditioning the implementation of aid programs (notably the exchange rate policy), incompetent management on the Nicaraguan side (not least, deficient accounting procedures but also goal structures not conducive to efficiency), and the absence of economic analysis prior to decision-making, not to mention internal tension within the projects.

8.6. Aid Management

Chapter 7 was devoted to examination of the management aspects of Swedish aid to Nicaragua. The focus was on SIDA procedures, since SIDA has handled more than 90 percent of the funds going to the country. Both the planning and monitoring and impact assessment procedures were discussed. Due to the time constraints of the study, our discussion of monitoring procedures focused on the largest project, namely the mining program.

SIDA cannot be analyzed in isolation. The Swedish development cooperation system consists of a number of political and administrative bodies which interact in the preparation, decision-making, implementation and evaluation involved in the various projects and programs. This process has not always worked efficiently, but administrative expedience has often carried the day. Thus, excessive attention has been paid to delays in the disbursement of funds, based on the erroneous idea that rapid disbursement is a good indicator of SIDA's efficiency. The same philosophy has led to

haste with respect to allocation in certain instances, which in turn has resulted in precipitated project planning and strain on SIDA's administrative routines. The lack of systematic economic project appraisal and evaluation, as noted in Chapters 6 and 7, is a sign of this.

The assistance to Nicaragua also points to coordination problems of various kinds, both between SIDA and other political or administrative participants in the process, and within SIDA itself. In both instances it is clear that the individual organizations or units tend to concentrate too much on their own immediate tasks and to pay too little attention to the overall framework. They react mainly to their own problems when they themselves perceive them, whereas warnings and observations from other organizations or units tend to go unheeded, especially during the initial phases of a project.

It is also worth asking to what extent the selection of projects was actually guided by Swedish development cooperation objectives and the development strategy of the Nicaraguan government. Considerations such as employment of the Swedish resource base and generation of large return flows appear to have been given far too much weight, which naturally raises the question of the extent to which aid resources were efficiently allocated between sectors and projects.

Another moot point is whether SIDA's extensive use of consultancy firms in the management and administration of aid resources during part of the period under review was cost-effective. (It did, however, contribute to keeping SIDA's own administration costs down.) The alternative, which was used at a later stage, was to transfer the management responsibility to Nicaraguan counterpart organizations. As seen in Chapter 6, however, the effects of this were dubious at times. This clearly indicates the desirability of providing training and technical support for the counterparts throughout the life of a project or program.

Finally, the case of Nicaragua eloquently illustrates the difficulty of operating in an environment which is characterized by abrupt political shifts and changes in macroeconomic policy. Special attention must be given to the potential impact of these changes on projects and programs in good time, but this was precisely what SIDA failed to do. By the time project objectives and activities were adjusted to fit the new economic conditions, it was already too late.

8.7. Recommendations

As demonstrated in Chapters 6 and 7 of the present study, Swedish assistance to Nicaragua has not been overly successful at the microeconomic level, with some exceptions. This is true both with respect to the outcome of the projects and with respect to the aid management associated with them. Systematic *ex ante* project

evaluation, based on proper cost-benefit techniques, has been lacking, and attempts made at later stages have often failed for lack of proper data or been undertaken too late to change the course of an unsuccessful project. Frequently, *ex post* evaluations have been lacking as well. This is true not least for the health sector, where none of the projects carried out has undergone any formal evaluation. It also appears as unfortunate that the criteria for choosing projects include such items as the Swedish resource base and the generation of large return flows. Finally, once a project is in operation, far too much emphasis has been placed on avoiding delays in disbursement. Import support and balance of payments support have displayed a number of deficiencies as well, mainly when it comes to management on the recipient side and the creation of counterpart funds.

Given the experience accumulated in project and program assistance, the obvious question is whether it is meaningful to pursue this type of assistance in the future. This question can be answered in at least two different ways: 1) Yes, it is, provided that the forms under which this assistance is given are changed, and 2) No, it would be better to concentrate elsewhere.

Let us begin with the first option. What changes are necessary? First, on the Nicaraguan side, the question of institutional strengthening appears to be the most important issue. Much of what has gone wrong with project and program support has been the result of insufficient absorption capacity on the Nicaraguan side. Alternatively, long delays in the use of the committed funds arise, delays which are perceived as unacceptable on the Swedish side and hence result in improvisation or premature payments which simply tend to reduce the cost-effectiveness of the assistance.

The Swedish Development Cooperation Office in Managua is well aware of this problem:

Nicaragua still receives large aid sums from many different donors, but the ability to plan their use --a task for the MCE [*Ministerio de Cooperación Externa*] and the economic cabinet which these institutions fail to master-- and the capacity to implement projects and programs is very limited. The lack of coordination between ministries and other authorities is striking, and so is the absence of a real counterpart with a reasonably clear strategy or plan for the development of the sector it administers. In relation to the absorption capacity it may therefore be stated that the country receives too much aid at present.¹

¹ SIDA (1993), p. 1.

This problem can be solved only in the long run by education, all the way from primary school to specialist training for example in the area of public administration. Thus, there is a case for directing foreign assistance to these areas.

The weakness in project and program assistance is not exclusively on the Nicaraguan side, however, but as we found in Chapter 7, Swedish practices leave a few things to be desired as well when it comes to project selection, evaluation and management. This is not the place to make any detailed recommendations about what should be done, particularly because our findings may apply to a larger segment of Swedish development cooperation than that which concerns Nicaragua. Rather, the message is to look systematically into the entire project or program cycle, from the conception stage to the time the project or program is completed, to determine whether the patterns detected in the case of Nicaragua are regular and, if so, to devise ways to correct them.

Project and program assistance does not operate in a vacuum. Even if both the absorption capacity problem and the Swedish assistance management problem are resolved, this does not necessarily guarantee that project and program assistance will be effective. Effectiveness also requires that the recipient country carry out an economic policy which does not produce major macroeconomic imbalances and thus does not hamper growth. In certain situations the macroeconomic constraints facing aid may be so severe as to render project or program assistance partly or totally ineffective. This was clearly the case in Nicaragua during the 1980s, when the domestic currency was grossly overvalued, the price system conveyed very little information with respect to scarcity relations and administrative procedures substituted the market in the allocation of resources. Under such circumstances it is very difficult to make projects and programs work.

Altogether, the macroeconomic picture of Nicaragua which has emerged during the course of the Sandinista administration in the 1980s and the subsequent Chamorro government in the 1990s is not a happy one. Per capita income has been falling for the past ten years --an achievement matched by few countries. At the same time, Nicaragua suffers from persistent macroeconomic imbalances. This is not to suggest that there are no positive signs in sight. The rate of inflation has decreased considerably compared to the hyperinflation years, 1988-90, although it remains to be seen whether this is temporary or permanent, and increased price stability appears to have been bought at the price of a continued overvaluation of the domestic currency. The budget situation has improved as well, as a result of foreign aid and reduced military expenditures.

Against this, however, we must set a number of highly negative factors, most of which are connected with international transactions. Exports have failed to pick up and their value remains far below that of imports. As a result of this and the payment of

interest on the foreign debt, the current account of the balance of payments continues to be in deficit. The external debt continues to increase as a result of new borrowing and accumulation of arrears on existing stock. Export earnings do not suffice to pay even the interest on this debt.

Nicaragua is a country which is completely dependent today on foreign aid, not only for financing its current account deficit and budget deficit, but also for financing (shrinking) domestic investment, since domestic savings are negative. In addition, the investment climate remains disastrous. The liberalization of imports coupled with the overvaluation of the córdoba makes it difficult for producers both to compete with imported goods and to expand exports. Credit can only be obtained at high real rates of interest. What all this means is that no recovery, let alone expansion, is in sight for the Nicaraguan economy. Above all, debt overhang has mortgaged the future severely. It is simply impossible for Nicaragua to meet its debt obligations in the medium-term. The country, in principle, is bankrupt.

This brings us to the second possible answer to whether it is meaningful for Sweden to continue to concentrate on project and program assistance to Nicaragua: No, because macroeconomic conditions are not conducive to aid effectiveness and efficient allocation of aid among and within different sectors. The primary objective must be to contribute to an appropriate macroeconomic policy. To see that this is so, we only have to remember how aid interacts with stabilization and structural adjustment policies on the macroeconomic level under the present circumstances.

We may then start with the current account deficit on the balance of payments. One of the central objectives of the present stabilization policy package is to reduce this deficit, but the international donor community, which is pushing hard for this in its negotiations with Nicaragua, simultaneously provides balance of payments support to the country, which allows it to continue to run a deficit. Thus, the assistance becomes counter-productive. At the same time, the inflow of foreign exchange allows Nicaragua to continue to have an overvalued domestic currency, which in turn keeps exports down. In addition, we see increasing liberalization of imports, which means that the balance of trade is being squeezed both from the export and the import side. The foreign debt continues to mount, the deficit on the service account increases because of interest payments on the debt, and this, when added to the trade deficit, produces an even larger current account deficit, which mainly has to be covered through aid.

Thus, the economy does not stabilize, and this lack of stabilization makes it difficult to get the wheels turning. This, in turn, combines with the recessive fiscal and monetary policies which also form part of the stabilization package to create an atmosphere which is not conducive to investment, and least from the private (domestic

or foreign) sector. On top of all this, there is the political uncertainty, with elections coming up in 1996, which could easily get inflation going again.

It is difficult to argue that continuing to concentrate aid on conventional projects and programs makes much sense under these circumstances. On the contrary, such concentration could easily result in aid malpractice in the form of *projectitis*: projects, each one by definition small in relation to the economy as a whole, and which hence affect only a minor part of the latter, are employed to solve problems they cannot handle. The binding constraint on the development process is to be found on the *macroeconomic* level, and here, aid mainly contributes to perpetuating a situation which combines imbalances and stagnation. The time has come to change this. The 'heavy' components of Swedish project assistance to Nicaragua (mining, energy, rural cooperatives and forestry) have either been phased out or reduced in recent years, i.e. most of what we have analyzed in the present work is history, and the new ventures in such fields as health, local development and the judicial system do not demand as much in terms of funding. Accordingly, some 85 million Swedish kronor from the country program have had to be carried over from 1992/93 to 1993/94.² Thus, now is a good time to make a change.

The next question is to what? Today, when the country's debt is seen in relation to national income, Nicaragua is the most heavily indebted country in the world.³ It should be fairly clear from the foregoing that debt reduction in the form of rescheduling and debt forgiveness are key elements when it comes to tracing out a viable economic development strategy for Nicaragua. The purpose here is not to suggest what this strategy should look like, but to indicate where foreign assistance could be effective, and the foreign debt is central in this respect.⁴ *Nicaragua's foreign debt must be reduced to a level where a credible commitment to service it can be made.* Otherwise, economic development will be blocked.

Unless something can be done about the debt situation and the aid dependency associated with it, Nicaragua will face enormous difficulties when it comes to getting growth going in the economy. As long as several times the total export revenues is required to service the debt, it goes without saying that nothing will be available for investment purposes. This, in turn, means that foreign aid will have to both service the debt and finance investment, for lack of domestic savings.

In the case of Sweden, this means practicing active multilateralism working for coordinated debt forgiveness among the international donor community, notably in the

² Ibid., pp. 1-2.

³ SIDA (1992-b), p. 28.

⁴ A possible starting point for work along these lines is found in SIDA (1992-b), which contains various proposals to relieve the debt of the poorest and most indebted countries in the Third World.

Paris Club, to the extent that this is possible,⁵ but also re-employing Swedish funds in the second-hand debt market through such mechanisms as, for example, debt-for-nature swaps, as in the case of Swedish assistance to Costa Rica (which would have the positive side effect of yielding a contribution to the environmental objective of Swedish development cooperation). Sweden initiated an innovative donor policy dialogue once in Nicaragua, in 1989. Today it has the opportunity to do so for the second time.

⁵ Cf. the suggestions in SIDA (1992-e).

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ANNEX 3: TERMS OF REFERENCE

Review of Swedish Development Co-operation with Nicaragua

1. BACKGROUND

The new government report of forms of management and co-operation in overseas aid (SOU 1993:1) proposes the elaboration of country profiles and country studies as an essential tool for the management of aid to individual countries.

Over the period 1982/83-1992/93, Swedish aid payments to Nicaragua have amounted to 2.5 billion SEK (about 2.8 billion SEK in constant January 1992 prices). No comprehensive analysis has been made of Swedish aid to Nicaragua which takes account of other donors' experience or places emphasis on the results achieved by Swedish aid.

This is the background to SASDA's intention to carry out a review of Swedish aid to Nicaragua over the period 1982/83-1992/93.

2. OBJECTIVE

The review will :

- a) analyse the effect and effectiveness in the sense of appropriateness to the objectives set (or 'external' effectiveness) of the aid given;
- b) analyse its cost-effectiveness (or 'internal' efficiency);
- c) make recommendations to improve its effectiveness and efficiency in development co-operation with Nicaragua in the future.
- d) make proposals for the methodology to be employed in analysing and following up the effectiveness and efficiency of aid in other country studies.

3. CONTENTS

The study should provide answers to the following questions:

- a) What has Sweden supported in Nicaragua?
- b) Why has Sweden supported Nicaragua in this way?
- c) What results have been achieved?
- d) Is Swedish development co-operation with Nicaragua reasonable in relation to the country's structure of production, economic policy and political conditions?
- e) Has Swedish aid been cost-effective?
- f) What have other donors done in Nicaragua and what do they intend to do in future?

- g) What should Sweden do in the future?

3.1. What Has Sweden Supported in Nicaragua?

The analysis will be based on a comprehensive time-series of Swedish aid to Nicaragua, broken down as follows:

- 1) by authority (Ministry for Foreign Affairs, SIDA, BITS, SAREC, SwedeCorp);
- 2) by channel (bilateral co-operation, multilateral co-operation, NGOs, companies);
- 3) by final product (sectors: direct production, social sector, services, imports, public-sector management, policy);
- 4) by macroeconomic function (external consultants, local costs, imports, credit, debt operations);
- 5) by final recipient (public sector, private sector).

The analysis will also highlight information about commitments, payments, carry-over of funds and types of grant. It will be supplemented by a short description of the contributions made.

3.2. Why Has Sweden Supported Nicaragua in This Way?

The study will examine:

- 1) applications from recipients;
- 2) policy considerations by the responsible authorities and the government;
- 3) discussions between donors and recipients;
- 4) decisions; and
- 5) communication of decisions to the recipients with special emphasis on comments or observations about content and execution.

3.3. What Results Have Been Achieved?

This part of the study will analyse, summarise and draw conclusions from:

- 1) evaluations carried out by Sweden;
- 2) evaluations made by other donors;
- 3) evaluations made by Nicaragua;

More detailed consideration will also be given to contributions which are of particular importance in Swedish aid to Nicaragua.

The review will analyse the macroeconomic effects of Swedish aid and the effects of total aid on Nicaragua. Analysis will focus on the effects on growth and distribution

in general, on selected sectors (of interest for Swedish aid), and on aspects of fungibility or additionality (effects on savings, public expenditure and investment). The 'crowding-out' and 'crowding-in' effects will be examined if possible.

The management of aid flows will be analysed with regard to the recipients' economic policy, financial programmes and budgetary process (rates of exchange, equivalent value in local currency and incorporation in the state budget). It assumes that effective aid demands that the recipient takes steps to implement different co-operation programmes and makes the hypothesis that good macroeconomic management of the flow of aid is a condition of effectiveness.

Has Sweden applied the concept of conditionality? If so, what requirements does it set? Report and follow up on conditionality.

3.4. Is Swedish Development Co-operation with Nicaragua Rational?

The reasonableness of Swedish contribution will be considered with respect to:

- 1) the recipients' resource base and economic strategies as reported in policy documents (development plans and analyses);
- 2) the recipients' priorities as shown by analysis of Nicaraguas national budgets (current outlay and investment plans);
- 3) public expenditures review;
- 4) analyses made by the World Bank, IMF and possibly other donors;
- 5) analyses carried out or commissioned by Sweden;
- 6) the democracy objective of the recipients.

3.5. Has Swedish Aid Been Cost-effective?

The review will include a broad analysis of administrative costs per aid project to Nicaragua.

3.6. Aid from Other Donors

Development co-operation with other donors will be covered, analysed by channel, product, macroeconomic function and recipient.

3.7. What Should Sweden Do in the Future?

Working from points 1-5 above, the review will make recommendations for the future orientation of development co-operation.

Particular attention should be paid to the recipient country's strategic planning documents for the future, the World Bank's and IMF's future-oriented analyses and estimates of the need for financing.

4. RESPONSIBILITY FOR EXECUTION OF THE REVIEW

The study will be carried out by Mats Lundahl at the Department of International Economics and Geography, Stockholm School of Economics, who will be responsible for planning and for discussions with SASDA. He will also be responsible for recruitment of research assistants to work on the project.

5. TIMETABLE

The study will begin on 15 September 1993 and the final report be presented to SASDA on 30 June 1994. SASDA and Mats Lundahl will agree a date for interim reports as the review proceeds.

6. INTERIM REPORTING

Lundahl will present his final report in English with a summary in Swedish (c. 20 pages) to SASDA on 30 June 1994 at the latest. A preliminary report will be presented during April 1994. The report may be published in a series of SASDA reports by agreement with the author.

The final report will be in WordPerfect 5.1 or 5.2 in printed form and on diskette.