

Nicaragua

Status Index (Democracy: 6.65 / Market economy: 5.11) 6.88		Management Index 5.08	
HDI	0.690	Population	5.3 mn
GDP per capita (\$, PPP)	3,262	Population growth¹	2.5 %
Unemployment rate	N/A	Women in Parliament	20.7 %
UN Education Index	0.74	Poverty²	45.1 %
		Gini Index	43.1 (2001)
Source: UNDP: Human Development Report 2005. Figures for 2003 unless otherwise indicated. ¹ Annual growth between 1975 and 2003. ² Population living below \$ 1 (1990-2003)			

A. Executive summary

Nicaragua is the second poorest country in the Western Hemisphere. Only Haiti shows poorer performance in economic prosperity. While Nicaragua has experienced marked economic losses since the end of the Somoza dynasty, the human development of Nicaraguans has shown steady increases since the Nicaraguan Revolution (1978-1979). These increases have been considerably strong since the end of Sandinista rule in 1990.

The findings of this report specifically concern the developments in Nicaragua since the assumption of office by Enrique Bolaños. The report concludes that serious political, economic and social problems continue to exist in Nicaragua despite three peaceful transfers of power through elections and successes in achieving economic stability. Although these problems do not pose a threat to the formal existence of democracy and a market economy, they constitute serious constraints for the proper functioning of these institutions. The management of transformation by the political elite shows severe malfunctions.

The poor performance of political elites is mainly due to an odd power sharing agreement between the juntas of the two strongest parties. Although the Liberals and Sandinistas publicly claim to be pitted against one another, the pacto político between their respective leaders, Arnaldo Alemán and Daniel Ortega, has resulted in the apportionment of decisive positions in state institutions among the two encampments. This deliberate and voluntary action by both juntas has prevented possibly well-intentioned political elites from furthering policies designed to increase democracy and transparency in the political system, depoliticize institutions and improve the enforcement the rule of law.

In January 2002, Enrique Bolaños assumed the office of president as the winning candidate of the Liberal Party. The centerpiece of Bolaños' election campaign and first year in office was the fight against corruption. This campaign placed him at direct odds with his powerful predecessor and fellow party member, Alemán

(1997–2002). In December 2003, Alemán was convicted on charges of corruption after a severe parliamentary crisis concerning the revocation of Alemán's parliamentary immunity.

Despite popular support, President Bolaños incurred considerable expenses for this success. The caucus of the Liberal Party remains in favor of Alemán and advocates a revocation of Alemán's conviction and a second run for president in 2006. Only nine members formed a new caucus in support for Bolaños. The loss of the majority in Parliament restricted his ability to enforce programs aimed at governance improvements and economic reforms. The fragile situation between the executive and the legislative branches has caused severe frictions and standstills in the political process. In early 2005, President Bolaños was at the brink of declaring a state of emergency.

All this did not help the situation of ordinary Nicaraguans. Their living conditions and freedom of choice did not improve significantly during the evaluation period. Annual per capita growth of GDP has been below 1%, and unemployment and malnutrition have both remained high. Half the population lives below the national poverty line. Development, measured against the HDI, remains far below the Latin American average but has improved considerably during the evaluation period, mainly due to improvements in education

B. History and characteristics of transformation

Nicaragua declared its independence from Spanish rule in 1821. It finally achieved independence after the end of the Central American Federation in 1838, but this did not end foreign influence and domination. Although Spanish rule only had covered the Pacific side of the country, Great Britain did not give up its occupation (1678-1894) of territories on the Caribbean coast after Nicaragua's independence was declared.

The predominant foreign influence has been and continues to be the United States. In order to counterbalance British influence, Nicaraguan officials turned to the United States for protection from foreign intervention in return for exclusive transit rights across Nicaragua in 1849. During the civil war between Liberals from the northern town of Leon and Conservatives from the town of Granada on Lake Nicaragua (1854-1855), the Liberals called on American William Walker to bring troops to their aid. After the surrender of the Conservatives, William Walker assumed power and control of the Nicaraguan army. This led to the 'National War,' (1856-1857) in which Conservatives and Liberals, aided by Central American forces, jointly fought Walker. The National War can be considered a

unique occurrence in Nicaraguan politics. Evolving from civil war, cooperation in the war against Walker enabled Nicaraguans to overcome a symptomatic

bipartisanship in the country's politics.

American influence remained strong even after the decision to dig a canal across the Central American isthmus was made in favor of Panama instead of Nicaragua. Tensions between Liberals and Conservatives tightened again, and various uprisings between 1909 and 1912 provoked American military intervention in favor of conservative candidates. American military presence lasted until 1933, but armed conflicts persisted. The considerable death toll inflicted on American troops by the rebel forces of Augusto César Sandino induced the United States to withdraw.

Despite the withdrawal of American troops, the United States still had a strong influence on Nicaraguan politics during the following four decades, backing the autocratic governments under different members of the Somoza family. Gross human rights violations by the National Guard in response to mounting opposition within the country and guerilla attacks by the Sandinista National Liberation Front (FSLN) disposed the Carter administration to end American support for the Somoza kleptocracy.

During the Nicaraguan Revolution, Anastasio Somoza Debayle waged a full-blown war against opposition forces. Loosing American support and military aid, facing a severe economic crisis and a further strengthened FSLN, Somoza left the country for Miami on July 17, 1979, to go into exile. Three days later, the multiparty exile government entered Managua, culminating the Nicaraguan Revolution. Approximately 50,000 Nicaraguans had died during the insurrection.

Within one year of the end of the revolution, the FSLN had consolidated its leadership of the new government, of the military and police force as well as of organized interest groups. Although most Nicaraguans were in favor of the revolution, the emerging dominance of Sandinistas provoked dissent. When Ronald Reagan took office in 1981, the situation worsened for the new government. The new American administration suspended all aid to Nicaragua and instead funded counterrevolutionary Contras, former National Guard members in exile, to overthrow the government. Nicaragua came to be a location of Cold War confrontation.

Confronted with the Contra's raids, the social revolutionary Sandinista regime's acceptance of political pluralism abated, civil liberties were confined and social spending was reduced in favor of the military budget. Still, the Sandinista government held technically correct elections in 1984. These elections were considered, for the most part, free and fair by international election observers. As part of the Central American peace process initiated in 1987, political opening was accelerated and a negotiated solution for the armed conflict with the Contras sought. The following elections of 1990 marked an important step in Nicaragua's history. The first peaceful and accepted transfer of power by free elections was achieved, and a civil government assumed office that had not earned its merits in

armed conflict. Civil presidents have been governing ever since, legitimized through competitive elections in 1990, 1996 and 2001. The strong polarization within Nicaragua's society has not been overcome since the end of Sandinista rule.

As candidate of the opposition coalition Unión Nacional Opositora (UNO), Violeta Barrios de Chamorro won the election against the incumbent Sandinista president, Daniel Ortega. The difficult process of reintegrating the rebels, the delayed de-politicization of the armed and security forces and fierce conflicts with Parliament all occurred during Chamorro's term of office (1990–1997). The president's policy of reconciliation toward the Sandinistas soon cost it the parliamentary support of a large part of her governing coalition, thereby bringing about ongoing conflicts with Parliament, as well as considerable governability problems.

The succeeding Alemán government (1997–2002) of the Partido Liberal Constitucionalista (PLC), on the other hand, had a secure parliamentary majority. Alemán's autocratic-populist style of governance, rampant corruption and power-sharing arrangements with the Sandinistas (for occupancy of the Comptroller General's Office, the Supreme Electoral Council, and the Supreme Court, as well as guaranteed parliamentary seats and thereby immunity from criminal prosecution for Alemán and Ortega), however, undermined the balance of power and impaired the functioning of state institutions.

Bolaños' government (January 2002 to present) is marked by a blockade between the different state powers resulting from Bolaños' anti-corruption campaign against Alemán. Although ultimately being convicted of embezzlement, Alemán maintained his power base in Parliament and made further power sharing agreements with Sandinista party leader Ortega. This institutional logjam has caused severe governability problems.

After the Nicaraguan Revolution, the new government inherited a severe economic and social crisis. GDP had fallen by more than 30% between 1977 and 1979, inflation was rising sharply and the banking sector was bankrupt due to massive capital flight. In addition, 600,000 Nicaraguans were homeless and food supply exhausted. Foreign debt had skyrocketed during the last years of Somoza's rule, at the end equaling GDP, and debt services accounted for up to half of state revenues.

The Sandinista regime nationalized the enormous wealth of the Somoza family and its associates, as well as the domestic banks and foreign trade. From 1978 to 1980, the state's share in generating GDP had risen from 15% to 41%. The Sandinistas introduced drastic economic measures and adjustment programs during an internally and externally induced economic crisis at the end of the 1980s, characterized in 1988 by hyperinflation of up to 10,000% and foreign debt

that equaled 500% of the GDP.

The transfer of power in 1990 spelled the end of the “mixed economy” of the Sandinista era. In keeping with a strictly market-economic and export-oriented development model, the Chamorro government followed a rigorous program of stabilization and structural adjustment, abolished the foreign trade monopoly and most price controls, opened up the banking sector and privatized some 350 state-owned businesses.

The succeeding governments remained faithful to this development model and, in collaboration with international lenders, continued to pursue transformation to a market economy. However, transformation was impeded by corruption and nepotism during Alemán’s term as president and by Parliament’s partial paralysis during Chamorro’s and Bolaños’ presidential terms. Although even today, more than two decades after the revolution, per capita income is still half the amount of 1977, the Human Development Index has shown steady increases since the end of the Somoza dynasty.

C. Assessment

1. Democracy

Nicaragua is a presidential democracy with a unicameral parliament. The state is divided into 17 administrative regions. Of these, only the two regions on the Atlantic coast, which gained autonomy in 1987, have their own legislature and executive. 152 municipalities also enjoy autonomy under the constitution and have their own elected city councils and mayors. The constitution dates back to 1987 and it was amended in 1995 and 2000. The representative democratic form of government shows serious functional problems and it is threatened in substance but not in form.

1.1. Stateness

In principle, the state has a nationwide monopoly on the use of force now that non-integrated and re-armed rebels and soldiers (Recontras, Recompas) are no longer causing the problems that they did during the Chamorro administration (1990–1997). However, there are parts of the country where the state has little presence. The operation of armed groups in these areas with an official designation as Auxiliary or Voluntary Police is a worrying development. The two Atlantic coast regions, which have been autonomous since 1987, have traditionally been neglected. The incidence of violent crime, compared to other Latin American countries, is astonishingly low. However, many Nicaraguans, especially in the northern highlands, still own weapons from the Contra war.

These weapons also include Sam 7 rockets, with which the American administration equipped the Contra movement. After the alleged sale of a Sam 7 rocket to a terrorist movement provoked a severe crisis with the U.S. administration in late 2004, plans were made to collect these illegal weapons and to destroy the Sam 7 rockets owned by the Nicaraguan army.

All citizens formally possess equal civil rights. State and church are formally separate, although the church exerts great political influence. Under the Alemán government, state and church were in fact tightly interwoven, even with respect to finances. The Bolaños government has distanced itself from the church and it insists on the secular nature of the state. Since more than 90% of the population belongs to one of the Christian denominations and religion is still actively practiced and entrenched in everyday life, a completely secular state cannot be considered an option based on popular will. This is evident in the heated debate over therapeutic abortion or the popular support for a law prohibiting same sex relationships and the brusque rejection of an appeal by the Nicaraguan Supreme Court.

State infrastructure and administrative institutions are present almost everywhere in the country. Partly due to social reasons, state institutions are not accessible to all of the population, and functionally they are somewhat deficient. In distant regions, Peace Commissions run by local citizens resolve disputes.

1.2. Political participation

The right to vote by general, direct, equal, secret and free ballot is constitutionally guaranteed, and democratic elections take place regularly on the national and regional level. Presidential and parliamentary elections were last held in November 2001, elections in the two autonomous regions in March 2002 and municipal elections in November 2004. The Catholic Church and the United States intervene strongly during elections in favor of their preferred candidates, opposing Sandinista office seekers.

In principle, the power to govern is vested in the elected representatives, but serious conflicts between state institutions continually push the country to the verge of un-governability. These conflicts can usually be traced back to self-interested elite agreements that diminish the influence of elections on political outcomes. Voter turnout has decreased dramatically. In the regional elections of 2004, only 49% of the electorate went to the polls, compared to 90% in the national elections of 2001 and 65% in the regional elections of 2000.

After the extensive de-politicization of the armed and security forces in the 1990s, extra-constitutional veto powers no longer exist within the country. Considering the external debt of Nicaragua and its dependence on ODA and loans from international lenders for one third of the national budget, the strong veto power

held by international financial institutions, donors and especially the U.S. administration cannot be ignored. The heavily debated privatization of the water sector can be regarded an example of this. The Bolaños administration has been urged by the international financial institutions and the U.S. administration to liberalize the water sector, while civil society organizations backed by public support have been advocating maintaining state control. The administration's reaction has been to publicly negate privatization and to introduce private control through the back door.

There is unrestricted freedom of association and of assembly de jure. Only strict laws on the legal personality of political parties can be considered an unfair legal restriction, as they favor the two dominating parties, the PLC and the FSLN. The laws, created by the pacto político, not only prevent micro-parties, but also inhibit fair competition for parties with notable support. De facto economic constraints also inhibit the freedom of association and of assembly. All public and private sector workers, except the military and the police, are entitled to form and join unions of their own choosing. Half of Nicaragua's workforce, including agricultural workers, is unionized.

Freedom of speech and of the press are guaranteed by the constitution and vigorously exercised. However, under the Alemán government, a law was passed in 2001 that would require journalists to register with a national body. In a 1985 advisory opinion, the Inter-American Court of Human Rights had ruled that such provisions violate the American Convention on Human Rights. The law has not yet been enacted and is under appeal at the Nicaraguan Supreme Court. Other restrictions include libel being a criminal offence, laws requiring journalists to reveal their sources under special circumstances and a constitutional provision that only covers the freedom of information for "truthful" information. In spite of these possibly harmful legal provisions, debate in the Nicaraguan press and public is very vivid. Media enterprises also receive special tax cuts guaranteed by the constitution.

Repression of journalists is rare. The only de facto infringement of freedoms of speech and press that the Bolaños government can be held accountable for is the closing of the radio station La Poderosa, which was close to former president Alemán. Still, there have been harassments of journalists investigating alleged links between drug traffickers and police officials on the Atlantic coast. The murder of journalist María José Bravo by the outgoing mayor of El Ayote, Eugenio Hernández, during the regional elections in 2004 was the first political murder of a journalist in Nicaragua for years. Hernández has been sentenced for premeditated murder to 25 years in prison.

The Sandinistas transferred radio and television stations to their supporters before handing over power in 1990. Therefore, radio and television coverage generally leans toward favoring the Sandinistas. Newspapers take a wide variety of political standpoints. Access to the media shows a social exclusion due to poverty. Eighty

percent of households own a radio, 60% a television and 13% a telephone. The use of the internet is rapidly growing but still does not cover more than 2% of the population. President Bolaños has ended the practice, customary during the Alemán administration, of using public advertising to punish and reward the media. Bolaños introduced a new system based on market share to distribute public advertising funds. This has caused smaller media outlets to close.

1.3. Rule of law

Besides the executive, legislative and judicial branches, there also is an electoral branch of government composed of the Supreme Electoral Council, which is responsible for organizing and holding elections. There is a formal balance of power, but this balance is compromised by the blatant politicization of state institutions. When state powers are in conflict, they block one another to a dangerous extent, sometimes even exceeding their authority. During such conflicts, the other powers actively seek the balance of power.

The judicial branch is institutionally differentiated and formally independent, but it is subject to political influence and corruption. It demonstrates considerable functional deficiencies. Appointments of judges to the Supreme Court are a political issue and are decided according to political considerations.

Corruption is a fundamental evil in the country's political culture. For a long time, it only attracted adverse publicity without being punished. In the course of President Bolaños' anti-corruption campaign, however, former President Alemán was prosecuted and sentenced for corruption. Alemán was sentenced to 20 years in prison; he was fined \$17 million and he received a 20-year ban on seeking public office. Still, Bolaños' fight against corruption was hit severely when he admitted to negotiating special treatment for Alemán and refraining from charging other officials of the Alemán administration in exchange for parliamentary support from the PLC. When Alemán and Ortega used their advantage on the Comptroller's Office to charge Bolaños for corruption during the 2001 election campaign, an attempt that culminated in an unconstitutional request by the Comptroller's Office to impeach Bolaños, the bell may have sounded for the last round of Bolaños' anticorruption campaign. In early 2005, legislation was drafted that would stop investigations against Bolaños and other state officials and would amnesty those already sentenced.

Civil freedoms exist and they are exercised by the Nicaraguan people. In considering the response to violations, the weaknesses of the judiciary have to be taken into account. Human rights are respected largely. Threats against and harassment of human rights defenders as well as excessive use of force by public security forces are a problem but constitute only individual cases. Abuses have been investigated, and some of the offenders have been punished, but a certain degree of impunity persists. Violence against women and children, including

domestic violence, rape and sexual exploitation are prevalent. The constitution provides for freedom of religion, and the government's policy and practice generally respect these rights in full. The constitution also prohibits discrimination. Still, discrimination against indigenous people occurs, and salary discrimination against women is recurrent. The overall ratio of female earned income to male earned income is 0.44. Access to justice is hampered by long distances and a lack of financial means, especially for those living in rural areas. The innovative approaches of local Peace Commissions and the judicial training of laypersons to become rural judicial facilitators have proven successful in granting access to disadvantaged communities.

1.4. Stability of democratic institutions

Democratic institutions are unstable and not particularly effective. However, they do operate essentially according to their functional purposes, institutional rivalries result in heavy efficiency losses. Political power struggles are perpetuated at the institutional level and they regularly lead to political crises and stalemates. In 2002, Parliament's work was brought to a standstill during the struggle surrounding the revocation of Alemán's immunity. The frictions were only temporarily under control, while the few members of the PLC backing president Bolaños were co-operating with the Sandinistas. Since the Sandinistas and the caucus of liberal Alemánists co-operate, the frictions escalated in early 2005 to the point that president Bolaños was at the brink of declaring a state of emergency.

Other prominent state institutions show no better performance. The politicization of the Comptroller General and the Supreme Electoral Council by the pacto político has undermined their functioning.

All relevant actors accept democratic institutions. The support for these institutions, however, is strongly linked to political power interests. Inter-elite arrangements like those the Alemán government made with the hostile Sandinistas served not least to safeguard positions and sinecures. Democratic institutions are not damaged from external actors, therefore, but from within.

1.5. Political and social integration

The landscape of political parties is highly polarized and exhibits characteristics of a two-party system. This is reinforced by an electoral law, which mandates high hurdles for small parties attempting to participate in elections. Although the parties are very much centered on personalities, the two decisive political camps, the Liberals and the Sandinistas, have considerable social bases. This is promoted partly by clientelistic structures and the partisan infiltration of associations and interest groups. Therefore, voter volatility is low. The only way in which

Nicaraguans express their frustration about politicians' self-interested actions is by not voting. Until now, no attempt to establish a third party that breaks with clientelism and the polarization between both influential political camps has been successful.

Personal-power ambitions and inner-party conflicts occasionally lead to party splits that can affect parliamentary majorities. This happened in 2002, when the liberal party split between followers of Bolaños and followers of Alemán, and earlier during the administration of Violeta Barrios de Chamorro, when the UNO alliance of parties fell apart.

Interest groups are able to organize themselves, but they are to some extent under the influence of partisan actors. The NGO sector has become an important economic sector. More than 10% of the labor force work in this sector and produce about 7% of GDP. While most of these organizations are active in the fields of self-help, there are also some very qualified lobbying groups. These do not only include subsidiaries of international NGOs, but also local groups that are skilled in advocacy and have specialist think tanks to call on for research. Socioeconomic bottlenecks and the greater influence of partisan organizations limit the balancing of social interests.

Though approval of the democratic form of government declined during the evaluation period, this fact should not be overvalued. While in 1998, 72% of respondents to Latinobarómetro polls indicated that democracy is preferable to all other forms of government, the approval rating had declined to 39% by 2004. If the described problems of the political system and the self-serving attitude of politicians are considered, this decline is only worrisome because these problems are endemic to Nicaraguan politics. The data proves, however, that the low approval rate is not endemic. When Bolaños took office and launched his anti-corruption campaign, approval ratings soared from 43% in 2001 to 63% in 2002. And in the same poll, in which the 39% approval rating of democracy was ascertained, 67% of Nicaraguans agreed to Churchill's statement that democracy may not be perfect but the best form of government. Seventy-six percent declared that democracy is the only form of government to develop successfully and 70% stated that under no circumstances would they support a military government.

Self-organization among the population encounters socioeconomic barriers and is therefore generally weak. Self-help organizations are active to combat the most pressing social ills, like the prevalence of street children and drug abuse, but the lack of funds prevents major successes. The trust among the population generally is low. Wounds inflicted during the Somoza dictatorship and the Contra war have not been healed.

2. Market economy

2.1. Level of socioeconomic development

The country's development status is low. Nicaragua is the second most impoverished country in the Western Hemisphere. Social exclusion through poverty and social hardship is quantitatively and qualitatively very pronounced and structurally entrenched. The Gini Index decreased slightly from 60.3 in 1998 to 55.1 in 2001, but it still indicates extremely distinct social inequality. The gender-related development index GDI shows only a slightly worse score than the overall HDI. With a Human Poverty Index of 18.3%, Nicaragua ranks 37th of 95 developing countries. The population living on \$1 per day or less has decreased slightly within the last ten years from 50% to 46%. The absolute poverty level has decreased from 20% to 15% but still amounts to 27% in rural areas. These slight decreases still indicate increases in absolute numbers because of high population growth. While the official unemployment figure amounts to 10%, underemployment is estimated at between 40 and 50%.

2.2. Organization of the market and competition

Since the 1990s, the governments have been pursuing a strict market-economy and export-oriented development model based on the private economy and oriented toward the principles of free-market competition, though the rules of the game are not always followed. Apart from the possibility of presidential decrees that can suddenly change the rules of the game, the greatest threats to a market economy cannot be found in economic policy but within the aforementioned problems of corruption and the weak legal system. Besides utilities like energy and water, the state controls the prices of only very few products. The average minimum wage is \$70 per month and an additional 45% of the minimum wage for social security. Profits can be used and transferred freely. There is no limitation on currency convertibility. Foreign and domestic investments are treated equally. In a cluster approach to development, the Bolaños administration favors some sectors, like the tourism industry, by offering tax exemptions on profits, building materials and property. The informal sector in Nicaragua is large and substantial and slightly outnumbers the formal sector.

Nicaragua has no special legislation on competition policy. However, there are some laws covering particular economic sectors that regulate industries such as electric power, telecommunications and financial markets. Besides monopolies in the utilities sector that are generally regulated by these laws, competition laws would be required to safeguard local producers and companies from international competitors that have monopolistic market shares in some sectors.

Foreign trade has been, in principle, liberalized. Nicaragua has prohibited all WTO-inconsistent non-tariff barriers and has not introduced import prohibitions on commercial grounds. Nicaragua does not subsidize exports directly or provide export financing. The MFN rate (most favourable nation rate) declined sharply

during the 1990s and is now at around 4 percent. Nicaragua applies a nine-tier tariff structure from 0% to 190%, with the highest tariffs only used for some agricultural products. A temporary protection tariff on 900 products was phased out in 2001.

The banking sector expanded during the 1990s with the founding of 14 new private banks. State banks were closed or privatized between 1994 and 2000. In February 2000, the last state owned bank, Banco de Crédito Popular, was closed due to severe losses. Many households were left without access to credit from the formal banking sector since the closing of the state-owned national development bank BANADES in 1998. Microfinance institutions have partially filled this gap. Deposits are dollarized with about two thirds denominated in U.S. dollars. There are also three non-bank financial intermediaries, but their weight in the financial sector is minimal. The state monopoly on insurance was abolished in 1997. Today there are four private insurance companies besides the state owned insurer INISER. On Nicaragua's stock exchange, Bolsanic, mainly government-issued bonds are traded.

After the closing of state banks and the bankruptcy of two smaller private banks at the end of the 1990s, a severe banking crisis was triggered in July 2000 when Interbank, the major bank at the time with a market share of 15%, went bankrupt. Within the next twelve months, three more private banks followed. The central bank lent its support by intervening to protect bank deposits.

The requirements for banking operations had already become stricter when the National Assembly approved a series of laws to meet the principles of the Basel Accords in 1999. Since the crisis, independent supervision of the banking sector has been further strengthened and its scope of operations enlarged. Nicaragua has also ratified its commitments to the 1997 WTO Financial Services Agreement, covering most banking services. The banking sector is still underdeveloped in size and depth compared to Nicaragua's neighbors and it cannot yet be considered stable.

2.3. Currency and price stability

In Nicaragua, a largely consistent inflation and exchange rate policy is pursued. Since 1998, the inflation rate has declined from 18.5% to a level of 4% in 2002. It then increased again to almost 9% in 2004, mainly due to higher energy prices. The Nicaraguan currency (córdoba) has been devalued annually by a crawling peg mechanism since 1993. The crawling peg stood at an annual rate of 12% until 1999. In November 1999, it was adjusted to 6%, and since January 2004, it stands at 5%. The sustainability of the peg and its continuous decline prove the success of Nicaragua's exchange-driven monetary policy, which strives for greater stability of currency and prices as well as for providing greater certainty for economic actors.

Pushed by international lenders and corresponding self-commitments, Nicaraguan governments have been pursuing a policy of continuous stability since the 1990s. In the last ten years, the fiscal deficit after donations has averaged around 4% of GDP. In January 2004, Nicaragua reached the completion point of the enhanced HIPC initiative. According to this agreement, \$4.5 billion of Nicaragua's external debt of \$6.6 billion will be cancelled over the course of the coming years. On top of its external debt, Nicaragua also has an internal debt of \$1.4 billion. In addition, the trade deficit is large and chronic, and Nicaragua's exports are not very diversified. The exports of coffee and beef make up almost one third of total exports. The terms of trade are continually worsening; from 1998 to 2004 they worsened by 25%.

2.4. Private property

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

Since 1990, Nicaragua has privatized a significant number of its public utilities and disposed of more than 350 government-owned enterprises. The government still owns the water and sewerage company and it has awarded first tenders to private firms in early 2005, the port authority, the country's largest insurance company, two free trade zones and a few small enterprises.

2.5. Welfare regime

Nicaragua faces grave social problems. The small number of workers employed in the formal sector limits the participation in official social security schemes with determined entitlements. There are currently nearly 100 safety net programs in Nicaragua, ranging from food assistance, social infrastructure and programs for special target groups to rural development. The government spends about half its budget on the social sector. Still, large segments of the impoverished population, especially in rural areas, are beyond the reach of the country's social safety net. Systematic efforts to reduce poverty have been underway since 2001 within the framework of the Poverty Reduction Strategy Papers (PRSP). The initiation of *La Red de Protección Social* in 2000 has shown positive effects in the education,

health and nutrition of targeted groups and it might set a positive example for other programs to follow. The pension scheme should have been changed from a pay-as-you-go system to a capitalization system in July 2004, but this has been postponed by a year due to uncertainty regarding the transition costs.

The society is socially heterogeneous. There is a vast social gulf between the many poor and the few rich, and there is a clear divide between city and country. The two formally autonomous Atlantic regions are culturally very different from the rest of Nicaragua, and they are economically and financially disadvantaged. Public services cannot redress these imbalances. Women's literacy and school enrollment rates are as high as those of men are, but on average women do not earn even half as much.

2.6. Economic performance

The Nicaraguan economy is weak in spite of the successful macroeconomic recovery in the 1990s. GDP still has not reached the levels of before the Nicaraguan Revolution. The economy is extremely vulnerable given the precarious financial situation, the dependency on a small number of export products and Nicaragua's disposition to natural shocks like hurricanes and volcanic activity. In addition, it is highly dependent on foreign aid. For all the successes in achieving stability, serious economic problems remain. These include high unemployment and underemployment, low per capita GDP growth, chronic deficits in the state budget and, above all, in trade, and a huge external and internal debt that despite the debt relief under the HIPC initiative, is hardly sustainable.

Inflation is quite low, however, especially in contrast to the hyperinflationary times toward the end of the 1980s. In addition to international assistance, remittances (*remesas familiares*) from Nicaraguans living abroad are of great economic importance. They total \$600 million a year and profit about one million Nicaraguans.

2.7. Sustainability

Environmental consciousness is underdeveloped in Nicaragua and subordinate to the push for growth. The 2005 Environmental Sustainability Index ranks Nicaragua 66th of 146 nations. Nicaragua's environment is still maintained at a healthy level. This is mainly due to the low level of economic development. If economic growth should pick up, Nicaragua's environmental sustainability might be at stake. Nicaragua's institutions and underlying social patterns of skills, attitudes, and networks to foster effective responses to environmental challenges are rather weak. A positive aspect is Nicaragua's international collaboration on environmental matters.

State and private educational institutions exist in important segments (preschool, primary and secondary school and higher education), but their overall quality is variable. Total educational expenditures amount to 16% of public budget expenditures or about 6.5% of GDP. Education is a constitutional right, and under the constitution, universities are entitled to a 6% share of public budget funds. Primary education is the main focus of educational expenditures. However, if per student expenditures are considered, the focus of spending is not directed at Nicaragua's most pressing needs, especially if more equity is sought. While in 2002, \$105 were spent on each student in primary school, this figure was only \$40 for secondary school students and much higher for university students at \$963.

School enrollment rates have been increasing steadily. However, the net enrollment rate of 83% still does not cover all children of the age group between 7 and 12 years. The gross enrollment rate for secondary school is at 54%. The completion rate for primary school after 6th grade is 69% of students and 34% for secondary school students. The pupil to teacher ratio is 36 for primary school and

45 for secondary school. Non-attendance is more acute in rural areas and among the extremely poor.

The increased coverage of primary education was only possible through the employment of teachers with poor qualifications. Student achievement was evaluated for the first time in 2002. In 3rd grade, only 30% of students had reached a minimum acceptable level of Spanish and less than 14% had done so in Mathematics. These figures did not increase for students in 6th grade. According to a national survey from 2001, 77% of the adult population and 86% of the youth can read. Female literacy equals male literacy in the adult population and is 5 percentage points higher for the age group from 15 to 24 years.

3. Management

3.1. Level of difficulty

The level of difficulty was high at the beginning of the evaluation period in 2003. According to World Bank classifications, Nicaragua is a low-income economy and severely indebted. Several other factors have contributed to the extremely difficult conditions for any development or transformation management, including: the precarious condition of the state's finances despite successes in achieving stability, the vulnerability to natural disasters and world economic influences, the low diversity of exports, the comparably high share of the agricultural sector in the economy, the poor quality of transport infrastructure, and the serious social problems such as widespread poverty and underemployment, especially in rural areas. The educational level of the population, however, as measured against the UN Education Index, has been in the middle range, and

attention to further primary education had already increased prior to the evaluation period. The rate of adults living with HIV and AIDS was still low in 2002 at 0.2% but increasing.

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

With the exception of regionally concentrated minorities along the Atlantic coast, Nicaragua is an ethnically homogeneous society of predominantly Spanish-speaking Mestizos. The line of ethnic conflict therefore has had significance only in the Atlantic region, if at all. The prevailing lines of conflict are politically and socially defined. The extreme political polarization and the socioeconomic disparities have led to open political and social conflicts. The resort to violence in these conflicts had already become uncommon prior to the evaluation period.

Profile of the Political System

Regime type:	<i>Democracy</i>	Constraints to executive authority:	2
System of government:	<i>Presidential</i>	Electoral system disproportionality:	10.01
		Latest parliamentary election:	04.11.2001
		Effective number of parties:	2
1. Head of State:	<i>Enrique Bolaños</i>	Cabinet duration:	01/02-present
Head of Government:	<i>Enrique Bolaños</i>	Parties in government:	3
Type of government:	<i>divided government</i>		
		Number of ministries:	12
		Number of ministers:	12
<p>Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution. Electoral disproportionality (Gallagher index) reflects the extent to which electoral rules are majoritarian (high values) or proportional: $\sqrt{\frac{1}{2} \sum (v_i - p_i)^2}$; v_i is the share of votes gained by party i; p_i is the share of parliamentary mandates controlled by party i. For presidential/ semi-presidential systems, the geometric mean of presidential election and parliamentary election disproportionality is calculated. Effective number of parties reflects the political weight of parties (Laakso/Taagepera index) = $1 / (\sum p_i^2)$; p_i is the share of parliamentary mandates controlled by party i. Number of ministries/ ministers denotes the situation on 1 January 2005.</p>			

3.2. Steering capability

In consultation with the international donor community and with feedback from civil society, the government is pursuing the following goals: establishing macroeconomic stability, reducing poverty, establishing the rule of law, increasing the efficiency of public expenditures through structural reforms and promoting foreign and domestic private investment. The current government's medium and long-term strategy and action plans are consistent and policy priorities are reasonable, but plans are sometimes over-optimistic with respect to the capabilities and resources available, the prospects for success and the

anticipated time horizon. The continually under-estimated budget deficits illustrate this most noticeably. Within the political leadership, a split is apparent, with some members of the elite setting priorities according to personal gains and others according to the goals of democracy and a market economy. Which group wins the upper hand will be decisive for future development.

The Bolaños administration has achieved some of its reform goals, most noticeably debt relief under the enhanced HIPC initiative by complying with requirements agreed upon with the IMF and World Bank. The precarious situation in Parliament and the cooperation between Ortega and Alemán have not allowed other reforms aimed at furthering democracy and a market economy to come into effect. The reform of the Bolaños administration aimed at a more independent and professional judiciary seems doomed to failure because it is contradictory to the interests of influential members of the political elite, namely Ortega and Alemán. The political leadership for the most part shows little willingness and ability to learn. The administration usually proves flexible enough to make some corrections and improvements in its economic, social and political programs. Political instability and obstruction in Parliament, however, increased rather than decreased. Policies and planning still do not sufficiently heed the country's vulnerability to natural catastrophes and world economic influences. Expectations tied to further liberalization and privatization, expansion of free-trade agreements and the promotion of tourism remain too high and scarcely reflect on the social consequences. The basic unwillingness of influential leaders to learn is simplistically demonstrated by personnel policies in preparation for the presidential elections in 2006. The inner circle of the FSLN tried to install Ortega as the Sandinista candidate at any cost, despite his three previous unsuccessful candidacies and the party's opportunity to nominate Herty Lewites, the most popular politician in Nicaragua and former mayor of Managua, who was instead expelled from the party. In the PLC, the Alemánistas favor an Alemán candidacy if he is amnestied in time, expelling the second most popular politician in Nicaragua, Eduardo Montealegre.

3.3. Resource efficiency

On the revenue side, the government has been successful in attracting aid and debt relief from outside and has been implementing a tax reform that provides more efficiency as well as equity and higher revenues in June 2003 internally. On the expenditure side, budgetary discipline continued to improve during the evaluation period. The quality of public service and of the bureaucracy, the competence of civil servants and the independence of the civil service from political pressures are low. This resulted in a percentile score of 17.5 in the World Bank's governance indicator on Government Effectiveness in 2002 (161st of 195). Some measures were taken to tackle these problems; others did not pass in the National Assembly. A new civil service law was implemented in July 2004 to professionalize the civil service. Steps have been taken to strengthen public procurement practices.

Judicial reform has been halted by the same pact between Ortega and Alemán that politicized the Comptroller General's office.

The Municipal Transfer Law implemented a decentralization process in 2004. It transfers 4% of central government tax revenues to municipalities. The share is supposed to reach 10% by 2010. While decentralization will show some positive effects on governance by empowering municipalities and fostering local participation, the legislation also shows inadequacies in that it does not transfer expenditure responsibilities along with the funds and in its lack of proper auditing provisions.

For the most part, the government coordinates conflicting objectives in a very simplistic manner. Economic growth is the clear priority. Therefore, policies are enforced according to the Washington Consensus. Other objectives, most importantly poverty reduction, are not considered separate objectives by the government, but instead are expected to be automatically solved by the anticipated economic growth. This problem-solving approach has not proven to be successful.

Corruption represents a special and endemic problem to Nicaragua. Personalism, patronage and corruption are part of the country's political culture. In Transparency International's 2004 Corruption Perception Index, Nicaragua ranked 97th with a score of 2.7 of a maximum of 10. The legal, political and administrative accounting structures may enable transparency and integrity of the public administration and punish criminal conduct; They need be enforced. The law of civic participation was approved by the National Assembly in June 2003, unlike the law of access to information, which has until now received no decision. President Bolaños' anti-corruption campaign has received strong public support. The conviction of president Alemán for corruption was a novelty in Nicaraguan politics. The aforementioned proposed law that would amnesty state officials convicted of corruption and stop investigations on others, including president Bolaños, could nullify this achievement.

3.4. Consensus-building

All important political actors basically agree on the goals of a market economy and democracy. Differences remain in matters of distribution and the degree of emphasis on social aspects. The parties also differ on the economic competence ascribed to them. Characteristically, foreign investors and local businesses reacted very cautiously to the possibility of an electoral victory by the Sandinistas in 2001. Influential political leaders, while claiming their support for democracy and a market economy, are occupied with designing these institutions to pursue their own economic interests and personal ambitions for power in a manner that is extremely detrimental to the functional capabilities of political institutions and to the public welfare. Anti-democratic veto powers had been appeased before the

evaluation period.

The political leadership, despite many pacts made behind closed doors, displays strong polarization along political and social cleavages in public. The socio-economic differences can only be reduced over the long term. The political divide created during the Sandinista regime and the injustices of the Contra war provide political leaders with a comfortable base on which to build their calls for support to such an extent that they have little incentive to redress it seriously. At times, politicians to achieve greater unity and to foster a spirit of solidarity among citizens use patriotic discourse. This is only partially successful, given the generally poor image of politics and lack of reconciliation for past injustices. The actual risk of violence is small at present, however.

The government has promoted participation of civil society, but the record remains contradictory. The preparation of Nicaragua's Interim-PRSP has been more open than the final PRSP. Civil society also participated in compiling the National Development Plan. Since 1999, an advisory body made up of different interest groups and organizations (CONPES) advises the president on economic and social programs. Even though many different groups participate in CONPES, it must be said that the business sector has a clear preponderance. At the beginning of president Bolaños' term, the working relationship worsened but improved thereafter. Another innovative approach to foster participation of ordinary citizens is PROCONSULTA. In Parliament, different interest groups are heard during committee sessions. Overall, interest groups that lobby for changes in Washington Consensus style policies have little influence. It also has to be heeded that many organizations are not independent actors but partisan organizations.

3.5. International cooperation

Nicaragua is extremely dependent upon support from abroad. Efforts to attract subsidies and investment and to reduce external debt have been the central foreign policy themes since the beginning of the 1990s. Political actors make purposeful use of international assistance and align their reform policies to the conditions of the international donor community. The international donor community regards the current government as credible and reliable, but the problems and risks of Nicaragua's economic and political development are evident. This results in very negative commercial risk ratings.

The government is actively seeking to develop and consolidate cooperative international relationships. Nicaragua is a member of all-important international bodies. Nicaragua also actively furthers Central American integration. The most important project of regional integration of the Bolaños administration is the Central American Free Trade Agreement (CAFTA). At times, however, international integration seems to be a mere instrument in national power

struggles. Bolaños' instrumental resort to the Central American Court of Justice and the Organization of American States during the institutional crises at the end of 2004 and beginning of 2005 and the reaction of Alemán and Ortega, who claimed international interference, have damaged the country's international image.

Nicaragua has brought two territorial disputes before the International Court of Justice that have not yet been decided. In December 1999, Nicaragua initiated proceedings against Honduras and in December 2001, against Colombia over maritime delimitation. With neighboring Costa Rica, disputes over navigational rights on the San Juan River persist, but trust-building measures have commenced. On the Atlantic coast, drug trafficking and arms-for-drugs dealings are increasing. Nicaraguan police and naval guards have not yet been able to control the situation.

4. Trend of development

4.1. Democratic development

The political regime fulfills the minimum conditions of a political democracy, but the functional problems associated with democracy and the rule of law were not overcome during the evaluation period. In particular, the pacto político made in 2000 between then president Alemán and Ortega and the "acuerdos" that followed have harmed political institutions considerably. The pact politicized the Comptroller General's Office, the Supreme Electoral Council and the Supreme Court. It also changed electoral law to preserve the dominance of the Liberals and the Sandinistas. Bolaños' anti-corruption campaign has been an important step to further the rule of law but it faces an uncertain future. Participation by intermediary organizations and ordinary citizens also has improved. Tensions between the executive and the legislature were severe throughout the evaluation period. Constitutional amendments initiated by Alemán and Ortega that would have increased the power of Parliament at the expense of the executive almost triggered the declaration of a state of emergency by Bolaños in early 2005. The peaceful solution of this conflict prevented the worst and proved that the political elite is still capable of peaceful conflict resolution. Overall, the levels of stateness, political participation, the rule of law and social integration have not changed significantly, while institutional stability has considerably deteriorated.

4.2. Market economy development

The country's development status, as measured against the HDI, improved during the evaluation period. Nevertheless, Nicaragua's HDI of 0.667 is still considerably below the Latin American average of 0.777.

Table: Development of macroeconomic fundamentals (2000–2004)

	2000	2001	2002	2003	2004
Growth of GDP in %	4.3	3.0	0.9	2.3	4.0
Export growth in %	17.7	40.1	0.7	14.4	16.3
Import growth in %	-2.7	9.4	2.5	9.1	16.3
Inflation in % (CPI)	9.9	4.7	4.0	6.6	8.9
Investment in % of GDP (IMF)	33.4	31.0	32.1	31.5	32.4*
Tax Revenue in % of GDP (IMF)	n.a.	13.6	14.3	15.8	16.5*
(Urban) Unemployment in %	8.3	11.3	11,6	10,2	9.3
Budget balance in % of GDP ^a	-5.0	-8.7	-4,1	-3,3	-3,8
Current account balance in billion \$	-0.789	-0.785	-0.784	-0.780	-0.840

^{a)} including grants, interest payments and public financial sector.

* IMF prognosis

Sources: CEPAL: Balance preliminar de las economías de América Latina y el Caribe, December 2004; CEPAL: Estudio Económico 2004-05, August 2005; Banco Central de Nicaragua; IMF; Dresdner Bank Lateinamerika.

There has been no fundamental change in the basic institutional conditions for a market economy, despite individual reforms that were implemented or initiated. During the evaluation period, Nicaragua had an average economic growth rate per capita of 0.8%. Considering the low level of economic development and the unequal distribution of wealth, these growth rates could not significantly improve the living conditions of the population. In 2002, Nicaragua even experienced a slight negative per capita growth for the first time since 1993. The Nicaraguan economy continues to suffer from the same chronic weaknesses. These weaknesses include: low trust in the country's stability by investors; one-sided, trade-related dependence; worsening terms of trade; dependency on a small number of export products; a high share of the agricultural sector in the economy; a disposition to natural shocks; chronic budget and trade deficits; high rates of open and hidden unemployment; and an enormous debt, despite the debt cancellation at the beginning of 2004.

D. Strategic Perspective

Before the period of observation, Nicaragua already had, in principle, a liberal democratic regime and market economy, though it was severely limited in functionality and efficiency. In the political sphere, the political-institutional conflicts between government and Parliament have reached a worrying level. The

tensions in the domestic political climate must be eased and the functionality of democratic institutions restored. To achieve these goals in the end, it is of

paramount importance that in the future, the legislature represents the interests of the Nicaraguan people as a whole and not of the two caudillos Alemán and Ortega.

There are two possible ways to achieve this goal. One possibility is the establishment of a new party that overcomes the endemic clientele-ism and polarization of Nicaraguan politics. The newly founded Alliance for the Republic (APRE) of President Bolaños, which fell short of expectations in the 2004 regional elections, could be a realistic option. This can only be decided by the Nicaraguan people. Foreign assistance, however, also has its part to play. APRE cannot be successful if the United States and other important international actors continue to press all non-Sandinista actors to unify in order to prevent Sandinista election victories. Besides refraining from such action, international assistance also can actively contribute to a third force in Nicaraguan politics while not undermining the sovereignty of the new party.

The other possible path of overcoming the malfunctions of Nicaraguan politics and its parties would be the rise to power of new politicians like Lewites and Montealegre. Again, only a majority of party members can democratically dethrone the party juntas. International actors can only show their support of these candidates and their disapproval of the present self-interested caudillos.

To strengthen and consolidate Nicaraguan democracy, international actors have to continue to support the reforms aimed at better governance and the rule of law. The bills introduced by the Bolaños government to depoliticize the judiciary and to grant the right to information to Nicaraguan citizens, which have been stopped in Parliament by the pact between Ortega and Alemán, are two examples.

Another possible way of supporting Nicaraguan democracy and its equitable economic development is to hear the people's voice in economic policy. The process of policymaking in this area is dominated by international actors and has not been opened up to broad participation, despite efforts to allow participation in the Poverty Reduction Strategy process and in the creation of the National Development Plan. Washington Consensus style policies have not alleviated poverty for ordinary Nicaraguans. Reasonably, it can be questioned whether market liberalization under CAFTA in its present form will show positive effects for Nicaraguans. After the relief granted under the enhanced HIPC initiative, it must also be reassessed whether Nicaragua's internal and external debt burden is sustainable.