A Decade of Structural Adjustment in Nicaragua: An Assessment

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An Assessment

Because of the program of changes embarked upon in Nicaragua from 1979 onward, the economic and financial crisis that hit Latin America during the 1980s took on particular features in that country. There, the crisis was not unleashed by adverse external shocks, high interest rates, or a reversal in the flow of commercial capital, as was the case in a majority of the countries of the region. In Nicaragua, torn apart by civil war and having to face an economic blockade, the crisis was set off by a transformation program promoted by the Sandinista revolution that was simply not sustainable. The economic and social transformations that were applied in an adverse international context and in the middle of a civil war that was destroying the economic infrastructure seriously affected the efficiency of resource allocation and generated increasing macroeconomic disequilibria. The situation led to the collapse of the Sandinista mixed economy by the end of the 1980s. From then on, policies of stabilization and structural adjustment were applied that dramatically transformed the economy of Nicaragua.

This article presents an analysis of the macroeconomic policies meant to achieve stabilization and structural adjustment during the past decade in Nicaragua, and seeks to explain their unsatisfactory outcome in spite of the radicalism of the measures adopted and their high social costs. The Nicaraguan situation was characterized by an extreme degree of political polarization and by the fact that successive governments represented apparently antagonistic political sectors. Yet the policies that were applied did demonstrate relative continuity and comparable content and, during the three governmental periods analyzed below, dramatic social disequilibria affecting a majority of the population were generated.

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These policies were initiated by the Sandinista government during the years 1988–1989 and did not enjoy the financial support or indeed the supervision of the multilateral financial institutions. Later, during the period 1990–96 these policies were strengthened by the government of President Violeta Chamorro and from 1997 by the Liberal government of President Arnoldo Alemán. These two presidents enjoyed the support of the International Monetary Fund (IMF), the World Bank, and the Inter-American Development Bank (IDB), as well as receiving generous assistance from bilateral donors. In spite of political polarization and conflicts among internal sectors that supported one government or another during the period examined, no attempt was made to put forward an alternative to the Washington consensus in the form of policies that might have combined macroeconomic equilibrium with the maintenance (or the restoration, as the case may be) of social equilibrium.

For the purpose of analyzing the policies that were applied, we can distinguish four phases: the reform period 1988–1989, when the Sandinista government was still in office; the 1990–1993 period during the presidency of Mrs. Chamorro, when hyperinflation was brought under control and the first stand-by agreement with the IMF was implemented; the 1994–1996 period, still under Mrs. Chamorro, when the first Enhanced Structural Adjustment Facility (ESAF) was implemented; and the post-1997 period which still continues, during which the second ESAF agreement with the IMF was implemented under President Alemán.

Stabilization and adjustment policy under the Sandinista government

In 1988 and 1989, the Sandinista government made serious efforts to stabilize the economy. From the time of the monetary reform of February 1988, the central objective of economic policy was to correct the macroeconomic disequilibria generated during the war years and to carry out the Sandinista version of a mixed-economy strategy. This program of stabilization and adjustment did not enjoy the support of the multilateral financial institutions, and bilateral assistance to support it was minimal.

During 1988, efforts were concentrated on achieving a realignment of the system of relative prices. To this effect, exchange rates were brought together, the cordoba was heavily devalued, and key domestic prices were set free. Moreover, measures designed to limit absorption were taken, including credit control and a reduction in the fiscal deficit.

In the absence of sufficient international reserves, the policy of influencing relative prices through devaluation simply fed inflationary expectations and generated further inflation which, in turn, made further devaluations necessary. An impressive devaluation/inflation spiral was generated in this manner: the average annual devaluation of the exchange rate in 1988 was 281,757 percent, and accumulated inflation for that year was in the order of 33,000 percent (Catalán 1993).

In spite of the reduction of public expenditures, especially in the area of social and economic investment, attempts to reduce the fiscal deficit in 1988 were frustrated by the rigidity of defense costs and the adverse supply shock associated with Hurricane Joan. The main variable in the adjustment process was real salary, which fell by more than 40 percent. A contraction in demand gave rise to a sharp drop in economic activity which reached 13.5 percent (Catalán 1993).

The main task of economic policy in 1989 was to contain the hyperinflation that had been set off by repeated devaluations. Drastic reductions in public expenditures were applied to this effect, with the result that the fiscal deficit dropped from 26.6 percent of GDP in 1988 to 6.7 percent in 1989. In addition, the real liquidity of the economy was reduced by 50 percent in relation to the 1988 level (Acevedo 1993). These measures led to a significant deceleration of inflation which came down to 1,689 percent in 1989 and deepened the economic recession: GDP dropped by 1.8 percent and unemployment and underemployment rose to almost 40 percent of the economically active population (Catalán 1996).

The measures taken during those two years considerably reduced the distortions in relative prices, brought down both public expenditures and the fiscal deficit, and gave rise to an increase in exports and a drop in imports. Yet in spite of a restrictive fiscal policy that considerably reduced the internal gap, and in the absence of sufficient international reserves, the policy of successive devaluations designed to stimulate exports had the effect of further exacerbating inflationary pressures.

Combined with the strong reduction in aggregate demand, inflation ended up feeding a recession in a dramatic manner. GDP dropped by 13.9 percent during the years 1988–1989, while the reduction in per capita GDP was 20 percent (see Appendix). The recession affected every sector of production, especially those serving the internal market. In the manufacturing sector, production dropped by 25 percent in 1988 and by 2.7 percent in 1989; almost half the small industrial workshops were forced to close down because of the recession.

Even before the monetary reforms, it seemed clear that macroeconomic disequilibria were already canceling out many of the social benefits of the revolution in the areas of basic education, basic health, and subsidies for basic consumption. Now, with these new measures, the deterioration continued, and there was an explosive rise in unemployment and underemployment. The defeat of the FSLN at the hands of the Unión Nicaragüense Opositora (UNO) at the elections of February 1990 reflected popular discontent with the consequences of adjustment, as well as a kind of weariness in the face of the sacrifices imposed by the contra war. In summary, the attempts to correct macroeconomic disequilibria accumulated over ten years of revolution unleashed a deep recession and a process of hyperinflation that carried enormous social, economic, and political costs.

During the period of transition from the outgoing to the incoming government (February to April 1990), the government relaxed the fiscal discipline that had been applied in 1989, public-sector salaries were readjusted, and, as a result, inflation and the fiscal deficit began to rise again (Dijkstra 1992). The Chamorro government put an end to the Sandinista mixed economy and opened the way for a transition toward a free-market economy in Nicaragua.

Control of hyperinflation during the Chamorro government

With the change of government of April 1990, the war was wound up, the United States ended its trade boycott of Nicaragua that had been in place since 1985, and the country was able to rejoin the international financial community. The Chamorro government continued to pursue the stabilization measures of its predecessor while simultaneously putting into place an accelerated program of economic liberalization. The stabilization and structural-reform strategy now being put forward slotted into the conceptual vision promoted by the IMF and the World Bank (Medal 1993).

From April 1990, as part of the so-called Mayorga Plan, the government attempted to contain inflation through a restrictive monetary policy and a reduction in public expenditures. Due to strong opposition by the trade unions to measures that reduced salaries and the level of employment, current government expenditures as a proportion of GDP went up and the restrictive policy caused a dramatic reduction in public investment which reached a low of 1.3 percent of GDP.

Simultaneously, a start was made toward liberalizing external trade by reducing import tariffs and the selective tax on consumption. In addition, exchange-rate policy was aimed at unifying the official rate and the free-market rate through weekly devaluations.

In July 1990, a new currency called the "gold cordoba" (*córdoba oro)* was introduced. It was indexed to the dollar and was meant later on to replace the "new cordoba" (*córdoba nuevo)* as a currency unit. The intention was to achieve price stability whenever international reserves were sufficient to maintain parity between the gold cordoba and the dollar within a regime of free convertibility.

With hyperinflation out of control, the fiscal and monetary measures that were applied were not sufficient to achieve price stability. Inflation was spreading, not only as a result of an increase in money supply or pressure on the demand side, but also because of an increase in the velocity of money set off by inflationary expectations which had been created in turn by constant and massive devaluations. In this dollarized economy, the devaluations reactivated the devaluation/inflation spiral while the restrictive policy provoked a liquidity crisis. The recession deepened without the inflationary spiral being brought under control: in 1990, the rate of inflation reached 13,490 percent, the recession went on—as evidenced by another drop in GDP of 0.1 percent—and labor underutilization reached a record 44.6 percent of the economically active population.

The fiscal deficit, which had been reduced to a manageable level in 1989, rose explosively and reached a high of 20 percent of GDP. Exports, which had improved considerably during 1989, continued to increase, but at a slower rate. Imports, which had gone down by 22 percent during the last year of the previous government, started to rise again, and that year, the trade deficit reached 18 percent of GDP (see table 2 and the appendix).

The Mayorga Plan failed, not only because of opposition on the part of the popular sectors, but also because of the poor response of the business community and delays in disbursing the aid promised by the U.S. government. Without access to the promised resources, stabilization of the exchange rate—which was seen as an essential means of anchoring prices—became an impossible task. The devaluations gave rise to more inflation which, in turn, forced new devaluations, while fiscal and monetary restrictions contributed to deepening the recession. In spite of the restrictions applied to aggregate demand, the external gap grew because no real devaluation of the exchange rate took place, and the commercial opening gave rise to a rapid increase in imports.

From August 1990, there was a large reduction in import tariffs and selective consumer taxes, mainly affecting imports. The nominal rate of protection dropped from 43.2 percent in 1990 to 15.2 percent in 1991 (Medal 1993). This emphasized even more the bias in favor of imports caused by the overvaluation of the cordoba.

After this first year, during which government and opposition took each other's measure, the government began to seek agreements with organizations of workers and producers on social and economic matters. The challenge was to resolve the extreme political polarization in the country with as much pragmatism as possible in order to make structural adjustment politically viable.

In October 1990, the trade union federations, the National Union of Agricultural Producers (Unión Nacional de Productores Agropecuarios–UNAG), and the government signed important agreements. One of the outcomes of these agreements was a commitment on the part of the government to apply economic policy more gradually and to move toward a selective reactivation that would include a restructuring of agricultural credits. In addition, it recognized the land assignations carried out by the Sandinistas, and the government committed itself to providing compensation to owners who had been unjustly expropriated. For their part, the trade unions agreed to forego strike action, while the government agreed that some of the state enterprises should be privatized for the benefit of the workers. COSEP (Superior Council of Private Enterprise), which represented the larger businesses in Nicaragua, and a sector of the UNO opposed this agreement.

The economic consultations of late 1990 yielded an agreement between the government and the Sandinista opposition, making it possible to implement the Lacayo Plan. This brought inflation to an end in 1991. In March of that year, the new cordoba was devalued by 400 percent, which caused prices to rise by 300 percent; this signaled the introduction of the gold cordoba to replace the new cordoba as the unit of currency. There was a further price rise of 20 percent in April, and from then on, inflation suddenly disappeared.

The anti-inflationary strategy included the dollarization of domestic prices and, later on, freezing the exchange rate. Once prices had been indexed to the dollar, the exchange rate was frozen in a credible manner by making the gold cordoba freely convertible with the dollar. This required substantial international reserves, which were obtained from external donors. From then on, the means of exchange became the gold cordoba indexed to the dollar.

To neutralize inflationary inertia and support the price stabilization already achieved, the government ordered a reduction in various prices and tariffs charged by public services; it also put administrative controls on key prices, including a freeze on salaries and the exchange rate. Donations by the U.S. Agency for International Development (USAID) ensured an abundant supply of foodstuff during the first three months, thus strengthening the package of measures already taken.

The exchange-rate stability, which had made price stabilization possible, was achieved thanks to external resources flowing in during 1991, mainly from the United States. Total external aid during 1991 was U.S.$884.5 million in grants (equivalent to 51.2 percent of GDP) and U.S.$604.6 million in loans (Banco Central 1992). The program of economic stabilization was supported by U.S.$717 million, of which U.S.$306 million was in liquid currency that was used to finance imports, increase international reserves, and finance the fiscal deficit ("Nitlaplán" 1993).

Once price stability had been achieved by the second quarter of 1991, the government announced that the stabilization phase was over and the time had come to launch a reactivation of the economy. This optimism was based on the supposition that price stabilization and the guarantees offered to the private sector would lead to a substantial increase in private investment. This proved to be an unrealistic expectation, and what took place was an outflow of capital without any increase in private investment. The outflow of capital can be explained by the overvaluation of the gold cordoba, combined with free convertibility. The low level of investment has many explanations, including the interests and fears of large producers. Sending their capital abroad was a more attractive proposition, and investing in Nicaragua was affected by problems such as the lack of a clear solution to the problem of property, the poor infrastructure, and the fragile nature of the economic stability.

Small and medium producers failed to invest on a substantial scale, mainly for economic reasons. The maxi-devaluation of the dollar in March 1991, along with credit restrictions, had led to capital shortage and bankruptcies among small and medium producers. Moreover, because of the stabilization program, they were in no position to compensate for their increasing costs by raising prices. Once price stability had been achieved, the restrictive nature of fiscal and financial policy remained, and recessionary tendencies were accentuated.

The anti-inflationary successes achieved in 1991 were not fully appreciated, because of the economic recession and the social consequences of the policies that had been carried out. Although inflation only reached minimal levels from April 1991, there was a decline in GDP of 0.2 percent which, in per capita terms, meant a fall of 2.9 percent. The trade deficit reached 70 percent, while unemployment and underemployment affected more than 53 percent of the economically active population. Unemployment, low wages, and deterioration in education and health care caused a worsening of extreme poverty and social tensions, setting off a dangerous process of social disintegration. Moreover, although the economic consultations of late 1990 meant a temporary truce between the government and the Sandinista opposition, the most radical sector of the UNO opposed the pact and, as a result, the government's political support base was considerably weakened. From that moment on, the problem of property and compensation for expropriated owners would constitute a permanent political obstacle to economic and political normalization in Nicaragua.

In 1993, the law privatizing state agricultural enterprises was approved. The legislation provided for privatization to be carried out for the benefit of four groups, each receiving 25 percent. These were first, demobilized troops from the Sandinista army; second, demobilized troops from the Nicaraguan Resistance; third, the workers who had been employed on these farms; and fourth, those who used to own them (Dijkstra 1998). Although this approach to privatization would contribute to the process of pacification and complete the distribution of land that had been controlled by the Sandinista government, it did not provide for optimal economic efficiency and constituted an invitation to corruption.

Expropriated owners supported by the radical sector of the UNO considered this legislation invalid. During this period, some 351 industrial enterprises, accounting for 30 percent of GDP, were quickly privatized. Since these enterprises provided a significant share of the budget and there were no alternative sources of financing, these liberalization measures clashed with the restrictive fiscal policies designed to lower the deficit.

The first ESAF agreement and the economic recovery

The donor community had been pressing for a structural adjustment program supervised by the IMF and the World Bank. The discussions, which ultimately led to the approval of the first ESAF agreement with the IMF and the second economic-recovery loan with the World Bank, went on for almost two years. This delay can be explained by the internal conflicts generated by the various proposals, but also by differences between the government and the multilateral institutions. The conflicts and disagreements revolved around three main areas: the problem of legalization of the agricultural land and urban properties assigned by the Sandinista government; the problem of the state banks; and, more generally, the question of reducing the size of the public sector. What was at stake here was a reversal of the transformations that had taken place during the period of Sandinista government, in a situation where the Sandinistas still held sufficient social and economic power to prevent it and the government lacked the political support to apply the reforms demanded by the multilateral institutions.

Although the Chamorro government was prepared to legalize the assignment of land, the conflict between those who supported the legalization of land assigned under the Sandinista government and those who wanted the land to be returned to the original owners was complicated by a new factor. The U.S. government insisted that properties that had belonged to its own nationals (nationalized Nicaraguans) be returned to their original owners or that compensation be paid. These American pressures complicated the situation by raising the costs of any compensation program.

The U.S. government and the multilateral institutions demanded the closure of state banks such as Banades (the National Development Bank), BANIC (Banco Nacional de informações comercials), and the Banco Popular, while the constitution, adopted during the period of the Sandinista government, did not allow it. At a minimum, the government wanted to maintain Banades as a state bank to support productive activities (to avoid excessive social costs associated with a major recession), since small private banks refrained from investing in productive activities because of the high level of risk involved. The state banks had already been restructured and recapitalized in 1992 and 1993 with the help of the World Bank and the IDB (Dijkstra 1998).

The multilateral institutions put forward a plan to raise water and electricity rates and the privatization of public utilities. TELCOR, the telephone company, was a profitable enterprise, and the income generated by its sale to the private sector could be used to finance compensation bonds. Another topic of discussion was the size of salaries paid to the public sector. The government argued that the possibilities for a decrease were exhausted, since a major reduction in costs would imply significant expenditure cuts for education, health, the police, and defense.

At the beginning of 1994, the Nicaraguan government signed the ESAF agreement with the IMF and reached an agreement with the World Bank for the approval of an economic-recovery loan. As part of those agreements, the government won the argument on the question of Banades, which was to be restructured once more and receive a new injection of capital from the IDB. On the other hand, it accepted the views of the multilateral institutions regarding compensation, the privatization of state enterprises, and a reduction in the size of the public sector (13,500 positions were to be eliminated over three years). The ESAF agreement and the economic-recovery loan came into force in June 1994, the bilateral donors supported the agreement by increasing their aid, and international reserves rose in 1994 (Dijkstra 1998).

Once the IMF had disbursed the first part of the agreed financial resources, it was clear that the government was in no position to meet the quantitative targets laid down by the Fund. Fiscal revenues were lower and expenditures greater than planned and, consequently, both borrowings and the fiscal deficit exceeded the agreed ceilings. Although the IMF did not officially suspend the ESAF agreement (the program was not called off track), in fact, no new funds were provided. In 1995, the IMF and the government agreed on a bridging program. Under its terms, the government had to reduce credits to the private sector if public sector credit increased. In 1996, a new bridging program was agreed to, which, in view of the fact that 1996 was an election year, posed further unrealistic credit restrictions.

During this period of restricted disbursement by the IMF, most bilateral donors maintained their support so as not to endanger the advances in economic and po-

Table 1
Aid to Nicaragua, as classified by the Central Bank (U.S.$ million)

	1990	1991	1992	1993	1994	1995	1996	1997
Liquid	119	887	483	146	217	191	120	71
Tied	459	303	223	276	445	475	544	489
Debt relief	0	1,318	237	263	524	1,758	5,005	531
—Restructuring	0	1,059	153	102	362	271	762	390
—Interest capitalization	0	0	31	13	20	34	35	37
—Forgiveness	0	259	53	148	142	1,453	4,208	104
Total	578	2,508	944	685	1,185	2,424	5,669	1091

Source: Central Bank of Nicaragua, in Dijkstra 1998.

litical stability that had been achieved. In 1995 and 1996, a generous program of debt relief was implemented; with the aid of various bilateral donors, commercial debt was purchased for just eight cents on the dollar, a considerable contribution by the commercial creditors.

The structural reforms that had been agreed with the World Bank in respect of qualitative targets were not implemented in accordance with the terms of the agreement. The bill to privatize TELCOR, introduced in the national assembly in 1994, was not passed. In 1995, the national assembly approved a new constitution, which restricted the powers of the executive. The majority in the national assembly objected to the privatization of TELCOR, now ENITEL, and the privatization was blocked. The World Bank suspended disbursements at the beginning of 1995, but subsequently reinstated them on the grounds that the government had done what it could. In other areas, such as reducing employment in the public sector, privatizing more state enterprises, and paying compensation, the terms of the agreement were not met either, although some progress was made.

Since 1994, the Nicaraguan economy has experienced positive economic growth that has brought an end to the long period of economic recession. In per capita terms, there was weak growth in 1994, but increases in 1995 and 1996 (see Appendix). These increases, during the later years of the Chamorro government, are mainly explained by the fact that foreign demand grew, while domestic demand remained relatively stable.

The main factor that explains the change in trend in the external sector is the effect of the exchange-rate policy implemented in 1993: in the context of low inflation, the policy of the crawling peg led to a gradual improvement in the real exchange rate. From then on, the impact of the trade deficit on GDP began to diminish. The real devaluation of the exchange rate, along with other favorable factors, such as improved prices for some export products, particularly coffee, and increases in productivity in other areas, account for the increases in exports. Despite increases in exports, there remained a considerable deficit in the balance of trade; in 1996, exports covered only 60 percent of the value of imports.

While internal demand remained relatively stable from 1993 onward, there was a considerable change in its composition as a result of the policies applied. The role of consumption in the GDP decreased by 16 percent between 1993 and 1996. Because of the policy of reducing the size of the public sector, the reduction in consumption by this sector was greater than that of the private sector. On the other hand, the increase in investment in the public sector surpassed that in the private sector, which indicates a lack of confidence in the private sector. In a broad context of economic recession, the reforms implemented from 1990 onward had the initial effect of bringing about a relative increase in private consumption at the expense of consumption by the public sector. From 1994 onward, both private and public consumption saw their share of GDP decline; in this second phase of structural adjustment characterized by a real devaluation in the rate of exchange, the demand for tradable goods increased at the expense of nontradable goods (Dijkstra 1998).

The Alemán government and the second ESAF agreement

In January 1997, a month after the election victory of the Liberal Alliance headed by the Liberal Party (PLC), a new government headed by President Alemán took office. During the election campaign, the liberals put forward a populist and nationalist platform that included strong criticism of attempts to reach agreements with the Sandinistas and of Nicaragua's subordination to the demands of both multilateral agencies and bilateral donors ("Nitlaplán" 1998).

The first months of the liberal government were characterized by internal conflict and disputes with donors. The donors opposed measures to dismiss technical personnel from the public administration to make way for persons linked to the PLC. They also condemned the closure of the ministry of social action (Ministerio de Acción Social–MAS*)* which the previous government had set up with external funding to coordinate poverty-alleviation projects.

As a consequence of these problems, aid flows were reduced in 1997 and various government investment projects were delayed. Supporters of a macroeconomic policy dependent on external aid and programs supervised by multilateral institutions won the argument over their opponents when international reserves began to decline toward the middle of the year.

There were also different views of monetary policy, though consensus prevailed in general terms on the need to apply a restrictive fiscal and monetary policy. The ministry of agriculture put forward a plan to stimulate agricultural production by granting new credits and, to this end, it was felt necessary for Banades to remain a state bank.

Once again, the donor community supported the idea of an aid program, conditional on a new agreement being reached with the multilateral institutions. The main conditions stipulated by the donors were precisely those reforms that had not been implemented under the previous ESAF: the privatization of ENITEL, tax-reform legislation, the closure of Banades, and, once again, the question of property rights. To avoid the problem of failure in implementing the agreement because of opposition in parliament, the IMF demanded that the national assembly, where the liberals had a majority, approve the reforms before the new agreement could be signed.

This time, the privatization of public utility companies was not a point of contention between the government and the IMF. At the end of 1997, a series of decisions was made, including the privatization of ENITEL, along with a restructuring of the electricity provider ENEL, the privatization of the water-distribution company, and an opening of the petroleum sector to private investment. The tax-reform legislation which eliminated exemptions from tariffs and value-added tax (VAT) was initially opposed by the liberals, but the law was approved in May 1997.

Also approved were the closure of Banades and the sale of its various branch outlets to the private sector after the World Bank and the IDB agreed to finance their purchase. To rescue the credits aimed at stimulating the agricultural sector, the reserves requirement for banks providing credits to that sector were abolished and a new rural-credit fund was created as a second-floor institution to stimulate agricultural lending by private banks. Finally, the privatization of BANIC and the Banco de Crédito Popular, the other two state banks, was also approved.

The problem of property rights was resolved as a result of an agreement between the PLC and the Sandinista Party, which was approved by the national assembly in December 1997. Titles to land that had been allocated to small farmers were legalized; those who had received large urban properties were ordered to compensate the previous owners, and large landowners whose land had been expropriated were either compensated or offered an equivalent amount of land.

Finally, in March 1999, the IMF approved the second ESAF agreement, which included a highly restrictive fiscal and monetary policy for the period 1998–2000. In April 1998, the donor countries committed themselves to providing U.S.$1.8 billion in economic support during the period 1998–2000 (CEPAL 2000), while the Paris Club announced debt-relief measures worth U.S.$200 million for the period 1997–2000 (Banco Central 1998). With respect to fiscal policy, the public-sector deficit was to go down from 16 percent to 4 percent of GDP during the year 2000, and current public-sector expenditures from 22.5 percent to 18.5 percent of GDP during the same year (Dijkstra 1998). As far as trade policy is concerned, the Alemán government proposed various trade-liberalization measures in accordance with a calendar of tariff reductions (CEPAL 2000).

Reactivation of the economy initiated in 1993 was maintained during the first year of the Alemán government, though this did not last. In 1997, economic activity slowed down and inflation went up considerably.

Growth during those years was associated with an increase in internal demand, generated by the increased availability of credits, and consumption, as well as private investment, rose during 1997 and 1998. In 1997, exports maintained their upward trend, thanks to a real devaluation of the exchange rate (rate slippage coupled with low inflation). This tendency was reversed in 1998 when there was a real appreciation of the exchange rate (a rate of inflation greater than the slippage factor), as well as a drop in exports.

The increase in consumption and level of investment led to a significant rise in imports, especially in 1997. In 1998, the tendency toward higher imports was strengthened by the lower tariffs provided for under the tariff-reduction calendar already agreed to. That year, regular import tariffs, as well as temporary tariffs, dropped by ten percentage points, resulting in a tariff schedule ranging from nil to 15 percent (CEPAL 2000).

During the early years of the Alemán government, fiscal discipline was strengthened, and both consumption and public investment declined. The policy of exchange-rate slippage, with a nominal annual devaluation of 12 percent, was maintained, in spite of announcements made during the election campaign. On the other hand, credit policy and the monetarization of foreign investment contributed to an increase in money supply. This monetary expansion led to an increase in internal demand which, coupled with the tariff reductions already generated in place, caused a sharp increase in imports and of the trade deficit. The external disequilibrium shot up to more than 40 percent of GDP at the expense of international reserves.

External shocks to aggregate supply contributed to a weakening of the 1998 economic revival and explain the significant rise in inflation that took place. The drought in the first semester, caused by El Niño, and, of course, Hurricane Mitch, which lashed the Atlantic coastal area in October 1998, are notorious examples.

Hurricane Mitch is regarded as the greatest natural disaster since the earthquake in 1973: 2,400 people died, more than 400,000 were made homeless, production was disrupted, and homes and roads were destroyed.

The damage to infrastructure and production was estimated at U.S.$1,400 million, which is equivalent to 50 percent of GDP. The government devised an investment program to cover a five-year period to be financed from external concessionary loans. As an emergency measure, the Paris Club declared a moratorium on external debt repayment for the period 1999–2000, while Cuba, Austria, and Canada canceled the debt outright (CEPAL 2000).

During the early years of the Alemán government, in spite of the external shocks, Nicaragua successfully met the terms and conditions of the second ESAF, thus allowing the door to remain open for the country to be considered for inclusion in the Highly Indebted Poor Countries (HIPC) initiative. This initiative—promoted by the IMF and the World Bank—is particularly beneficial to highly indebted and very poor countries with positive macroeconomic indicators (economic growth with price stabilization and a reduced fiscal deficit) that are willing to apply poverty-reduction policies.

Table 2
Gaps and aid, as percentage of GDP

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Fiscal deficit	20	8	8	7	10	9	8	6	2.2
Commercial deficit	18	30	33	26	26	23	24	41	39
Aid	37	69	38	23	36	35	34	28	n.a.

Source: Dijkstra 1998; for 1998, CEPAL 2000.

Some conclusions

For more than a decade since 1988, macroeconomic policies intended to eliminate macroeconomic disequilibria and lead to sustainable growth have been applied in Nicaragua.

The aim of the restrictive fiscal and monetary policies was to reduce the internal and external gaps by reducing absorption. The aim of the exchange-rate policy of devaluation of the cordoba was to stimulate supply in the sector producing tradable goods. The logic behind structural transformation was to stimulate aggregate supply through better relative prices and greater productivity in the tradable goods sector by liberalizing markets of goods and services, production, and financial factors.

In 1991, hyperinflation was brought under control and, from then onward, relatively low inflation rates were maintained. Six consecutive years of economic growth started in 1994, bringing an end to a long period of recession. If we present the results in this way, we can easily come to the conclusion that the policies were successful.

However, the price stability has been fragile, and the growth observed during the economic recovery of the late 1990s was weak. If an average growth rate similar to that achieved in the recovery period were maintained without interruption, it would take two decades to achieve the level of production per capita that existed at the outset of the reforms in 1988. In terms of growth, the results of the stabilization and adjustment policies have been poor.

The social costs of applying these policies have been high. Social costs may be measured in terms of loss of well-being brought about by implementing the reforms during the long period of recession (with negative growth in per capita GDP). They may also be measured in terms of regressive income distribution: the adjustment programs have contributed to a deterioration in income distribution in Nicaragua (Dijkstra 1998). Throughout the 1990s, half of the entire population and three-quarters of the rural population in Nicaragua lived in conditions of extreme poverty (CEPAL 2000).

As the aim of the policies was to eliminate macroeconomic disequilibria, another way of evaluating the results is to see to what extent this problem was solved in a sustainable way. In 1990, the sum of internal and external gaps represented 38 percent of GDP, whereas in 1998, these gaps represented 41.2 percent of a smaller GDP.

During the entire period examined, the total gap has not been persistently higher than 30 percent of GDP, and in the first years of the Alemán government, it was higher than 40 percent. In spite of a reduction in the budget deficit, the total gap increased as a result of a higher trade deficit.

This means that the macroeconomic disequilibria have not been cured, but that their composition has changed. These disequilibria have been almost entirely financed by foreign aid, which means that any stability achieved is very vulnerable and that the growth that has been achieved is barely sustainable. After over a decade of reforms, more than a third of the smaller and more unequally distributed income enjoyed by Nicaraguans is dependent on foreign aid.

In these circumstances, a reduction or interruption in the flow of concessionary resources will lead to a rapid exhaustion of international reserves and subsequently to a resurgence of inflation and economic recession caused by the inability to finance imports. The implementation of structural adjustment programs in Nicaragua has led to massive dependence on foreign aid.

Despite the political differences of the different governments in power during the period, the policies implemented have exhibited continuity and similarity of content. There has been broad consensus, not only on the lack of sustainability of the situation prior to adjustment, but also on the necessity and inevitability of adjustment and the lack of a viable alternative (Medal 1998). In the 1990s, perhaps with the exception of the impact of Hurricane Mitch in 1998, these results have not been affected in any significant way by adverse external shocks. This suggests that an explanation of the poor results of the reforms must be sought in the way in which they have been implemented.

The Sandinista policy of adjustment and stabilization failed because of an attempt to carry out an exchange-rate policy that simply was not viable. In a context of high-inflation expectations and greatly distorted relative prices, the devaluation of the cordoba, which was supposed to stimulate exports, led to higher inflation, since international reserves were insufficient to provide support. This higher level of inflation led to even greater devaluations. In combination with a strong contraction of demand caused by a restrictive fiscal policy, this devaluation/inflation spiral ended up generating a dramatic economic recession.

The first attempt at stabilization under the Chamorro government failed as a result of lack of political support; moreover, with inflation expectations out of control, the policy of devaluating without sufficient international reserves led to an acceleration of inflation. In a context of restrictive policies designed to close the gaps, the liberalization of external trade begun in 1990 contributed to an increase in the trade deficit.

Later on, with the implementation of the Lacayo Plan in 1991, inflation came under control, but at a very high cost in external resources. This can be explained by the fact that while the currency was anchored to the dollar, the cordoba appreciated rapidly in real terms, thus stimulating imports and lowering export incentives. In addition, imports were encouraged by the ongoing process of trade liberalization and an overvalued currency mixed with free convertibility. This combination led to a high level of capital flight (including a flight of external aid).

Another source of contradiction was the policy of contraction of public expenditures, designed to reduce the budget deficit while simultaneously privatizing state enterprises and liberalizing trade, thus eliminating sources of government revenues that could not be replaced. The deficit was not eliminated, but from then on, it was financed from foreign-aid resources. As for the tax reform, all it did was contribute to a simplification of the system of tax exemptions without providing a sustainable system to finance government expenditures.

Although the Alemán government prevented the public sector from obtaining resources through direct control of public-utility companies, other sources of financing to support the budget were created as a result of a tax reform that was approved in 1997. The tax base was broadened and several exemptions were eliminated, thus creating conditions for a sustainable reduction of the internal gap. Nevertheless, a fuller liberalization of external trade contributed to a rise in the enormous external gap.

We can conclude that, due to inconsistencies in the application of the policy, the relatively poor results that were obtained were only made possible by the level of foreign aid. Contradictory measures were taken. On the one hand, restrictions were applied to limit absorption to control inflation and the trade deficit; on the other hand, consumption was stimulated or the resources available to the state were reduced through measures designed to dismantle state interventionism. In Nicaragua, the process of liberalization created both a fiscal and a trade deficit, thus contributing to maintaining the macroeconomic disequilibria that were being fought with restrictive fiscal and monetary policies. The free convertibility of an overvalued cordoba resulted in a waste of external resources.

These observations strengthen the belief that the process of reform must take place in phases, the sequence and speed of which should depend on initial conditions (McKinnon 1993). In the case of Nicaragua, it seems that the speed and simultaneous nature of measures taken to further the process of market liberalization were determined by political factors rather than by their technical feasibility. The purpose was to dismantle interventionist policies at all costs, in the ingenuous belief that perfect markets would emerge automatically from an intervention-free world.

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Appendix
Some macroeconomic indicators of Nicaragua, 1990–1998

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Growth GDP in %	–11.0	–2.9	–0.1	–0.2	0.4	–0.4	3.3	4.3	4.7	5.1	4.0
Growth GDP in p.c. %	–14.0	–6.1	–3.0	–2.9	–2.5	–3.3	0.3	1.3	1.8	2.3	0.9
Inflation in %	33,000	1,300	13,490	866	3.5	19.5	14.4	11.1	12.1	7.3	8.5
External sector, in U.S.$millions											
Export	273	341	392	350	309	356	476	647	805	866	802
Import	857	667	682	843	919	831	953	1,114	1,299	1,6609	1,647
Trade Balance	–583	–326	–290	–492	–610	–475	–477	–468	–494	–742	–845
Current account	–846	–531	–385	–852	–1,095	–879	–893	–755	–700	–814	–804
External public debt (in % of GDP)	n.a.	n.a.	965.0	593.1	585.4	609.5	638.4	543.1	308.9	296.7	295.2

Source: 1988 and 1989, Dijkstra 1998; other years, CEPAL 2000.