

### III. EFFECTS ON ECONOMIC DEVELOPMENT

#### 1. Evolution of the Nicaraguan economy as from 1979

##### (a) Main features of the economy and inherited problems

Nicaragua presents the typical characteristics of a small agro-exporting economy, based on a small number of commodities which make it highly sensitive to the international situation. Its traditional export base was considerably expanded and diversified in the 1960s -as well as coffee it exported cotton, sugar and meat as 'motor' products- and at the same time it made some progress in industrialization within the context of the Central American Common Market integration commitments. The dynamic stimulus of the traditional export sector and of import substitution industrialization permitted a rapid expansion of the economy as from 1960, but with a very unequal distribution of its benefits among the different population strata. Thus, among the main features of the Nicaraguan economy are at present its extreme dependence on situations associated with the international economy -and among these the shortage of foreign exchange which is the principal factor limiting development- and the large number of lacks and delays of various kinds suffered by the bulk of the population.

The devastating effects of the 1972 earthquake aggravated those inequalities, punishing to a great extent the low-income groups living in the marginal areas of the city and added to the aforementioned delays.<sup>5/</sup> The sequel to the reconstruction period, still uncompleted, joined with increasingly intense civil upheaval which in turn led to a situation of progressive economic recession, characterized by a contraction of private investment, the flight of foreign exchange, growing external public indebtedness and, lastly, considerable damage occasioned by the armed conflict which culminated in the middle of 1979 at a cost of not less than 50 000 human lives and material damage amounting to some 500 million dollars.<sup>6/</sup>

When the new authorities assumed power a large extension of cotton and basic grains had remained unsown; the country was immersed in an acute internal decapitalization process and an unprecedented external financial insolvency -the total external debt amounted to 1 500 million dollars, with service payments which in 1979 would have absorbed 100% of the generation of foreign exchange earned by exports of goods and services; open unemployment of more than 30% of the economically active population and a fiscal deficit of over 1 200 million córdobas,<sup>7/</sup> equivalent to 70% of current income. As a direct result of the war and because of the transfer of capital goods abroad, there was heavy decapitalization in both production and the economic infrastructure.

##### (b) Salient aspects of the economic policy as from 1979 and its main results

In the face of this profound economic depression and the paralyzation of most production activities, combined with the longstanding problems of Nicaragua's economy, the Government Junta for National Reconstruction established a number of objectives

<sup>5/</sup> See CEPAL, Informe sobre los daños y repercusiones del terremoto de la ciudad de Managua en la economía nicaragüense (E/CN.12/AC.64/2/Rev.1), January 1973.

<sup>6/</sup> See CEPAL, Nicaragua: Repercusiones económicas de los acontecimientos políticos recientes (E/CEPAL/G.1091/Rev.1), December 1979.

<sup>7/</sup> A córdoba is Nicaragua's national currency whose official value is equal to 10 US cents.

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which at the beginning of 1980 were combined in an annual plan,<sup>8/</sup> and continued in a second plan adopted early in 1981.<sup>9/</sup> These measures were designed to reactivate production and at the same time were consistent with the social justice objectives outlined in the Government's original programme.

This reactivation was sought by imbuing the State's operational structure with dynamic force, in an endeavour to combine in a mixed economy system the interests of the workers, the Government and private enterprise. Incentives were offered to production and exports, both through credit and fiscal concessions and by fixing remunerative sales prices for the main export commodities. At the same time, an attempt was made to raise the level of well-being of the masses, not so much through the wage policy -although minimum wages were adjusted nominally in the period 1980-1981, real wages fell- but rather through the provision of services and other indirect benefits and the creation of new employment opportunities. For example, ceiling prices were fixed for a basket of basic commodities and for rents; distribution channels were organized for essential articles on the basis of popular markets; and there was some improvement in the provision of health and education services, notably the literacy campaign launched in 1980. At the same time, the year-end rates of open unemployment dropped from 23% in 1979 to 17.8% in 1980 and to 13.4% in 1981.

During this period, too, an important change was introduced in the structure of property, with the State confiscating all the assets of the overthrown political group.<sup>10/</sup> In addition, an agrarian reform was initiated on the basis of the land take over, and subsequently of the unused areas in properties of 500 manzanas on the Pacific coast and 1 000 manzanas in the rest of the country. This land is administered as State enterprises or as co-operatives of the beneficiaries.

In order to alleviate the external bottleneck, the new authorities initiated concerted action with the aim of obtaining additional credit from abroad on favourable terms -the official loans contracted between July 1979 and December 1981 amounted to about 1 200 million dollars-<sup>11/</sup> and renegotiation with private creditors

<sup>8/</sup> See Planning Ministry of Nicaragua, Programa de emergencia y reactivación en beneficio del pueblo, January 1980.

<sup>9/</sup> Ministry of Economic Planning of Nicaragua, Programa económico de austeridad y eficiencia, 1981, January 1981.

<sup>10/</sup> At the end of 1981, approximately 55% of the total assets of the economy were in private hands, and 45% in the public sector. The State controlled 24% of the agricultural sector, 22% of manufacturing, 100% of mining and finance, and 40% of trade.

<sup>11/</sup> Official loans were obtained from the following sources:

Multilateral	470.1
BCIE	80.8
IBRD	90.7
IDB	189.1
Others	109.5
Bilateral	348.8
United States	72.6
Western Europe	68.7
Socialist countries	56.5
Latin America	51.0
Libya	100.0
Credit lines	353.2
Suppliers	24.6

Of the above sum, during the period analysed, 840 million dollars were spent and debt servicing absorbed 370 million (90 million in amortization payments and 280 million in interest payments).

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of the previously existing external public debt was successfully concluded.

Finally, important efforts were made to improve the efficiency of the enterprises which came under State control -the so-called Popular Ownership Area- and to improve the public sector's capacity to stimulate economic growth and promote the changes postulated in the Government programme and development plans referred to above, although problems of organization and shortage of executive and intermediate staff hindered the attainment of these goals.

Unfortunately, all these efforts were made within the context of a gradual decline in the world economy, a deterioration which was particularly severe in 1981 so that the main obstacle to economic recovery -the acute scarcity of foreign exchange- was seriously aggravated. Furthermore, the changes proposed by the Government Junta for National Reconstruction were questioned both inside and outside the country, so that they were not free from pressures: private enterprise was reluctant to reactivate its investments notwithstanding the fiscal incentives offered, in view of the uncertainty of a great many entrepreneurs concerning the medium-term future of the country, and these pressures sometimes turned into acts of violence, which, among other effects, increased the authorities' concern for national security and defence. Moreover, Nicaragua, in common with the rest of the Central American countries, has also experienced recent difficulties in obtaining resources to finance its development, particularly if it is taken into account that, for various reasons, some important international agents blocked the flow of new resources into the country. Nevertheless, since 1979 the Government Junta has attained important achievements. In 1981 the gross domestic product increased for the second consecutive year at a rate of about 9%. Although real per capita income in the past year was 25% lower than that recorded five years before, this growth was appreciable, if it is considered against the backdrop of the adverse trends described above, and reflects reactivation from an extremely depressed internal situation.

The production of goods showed a recovery in 1981, basically stimulated by agriculture with a 14% increase in that sector's value added, although the production of cattle continued to fall that year. The rise took place in production both for export and for domestic consumption. Construction -the sector most severely affected by the 1979 recession- had shown in the two-year period 1980-1981 a distinct trend towards recovery -even though it only reached 75% of the 1978 level- basically influenced by public investment and the support and financing of building and low-cost housing. Notable developments in this sector are the virtual conclusion of the highway to the Atlantic (Puerto Cabezas), the great stimulus given to local roads, the works connected with the energy sector, and the building of hospitals, health centres and schools. In general, public expenditure -both special and operating- became one of the main dynamic factors of the economy; for example, the value added of the public administration contributed one-quarter of the 1981 economic growth. Of course this also gave rise to the financial disequilibrium which will be referred to later. Lastly, mining, electricity generation, transport and trade also showed fairly vigorous growth in the recent two-year period.

The manufacturing sector, in contrast, has had to face the most serious problems in its reactivation, although it grew moderately in 1980 and 1981; some factors contributing to this were the destruction of its installations and equipment, the depletion of its inventories and the breaking down of the financing-input imports-production process-distribution-exports chain. This sector continues to be affected by the lack of skilled personnel and the attitude described above of part of the private industrial sector in the face of the new economic policy guidelines, which has discouraged investment and even led to decapitalization.

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As regards the external sector, the growth of exports has been abruptly halted by the instability and drop in the prices of the main commodities and in their purchasing power, and further limited by the rise in the average price of imports. The high interest payments on the external debt, despite its recent negotiation, combined with the negative trade balance, raised the deficit on current account to approximately 490 million dollars in 1981 -a sum which for the first time comes fairly close to the current value of exports- and the shortage of foreign exchange constituted a crucial limitation on the operation of economic activities in general. This shortage contributed to the formation of a parallel market used mainly for non-essential imports and the movement of unregistered capital, in which the exchange rate almost tripled the official rate, introducing additional distortions in the financial area and in the general price system.

On the domestic economy front, notwithstanding the austerity and rationality of the efforts made, the disequilibria and pressures of the most important economic and financial variables still exist, although inflationary pressures have diminished. In this respect, a source of concern was the growing deficit of the central government, which increased from 1 840 to over 2 900 million córdobas between 1980 and 1981 -8.5% and 11%, respectively, of GDP- despite the increase in income which almost tripled between 1979 and 1981. The rapid expansion of expenditure -in 1980 on investment and operations; in 1981 only operating expenditure- is consistent with the Government's effort to achieve its many and sometimes conflicting economic, social and security policy goals.

To sum up, in the past two-year period Nicaragua faced two longstanding development obstacles -disequilibria in the balance of payments current account and in public sector finances- added to new obstacles linked with the effort to introduce changes in the conduct of economic policy, within the context of increasing political polarization.<sup>12/</sup> What is more, the country had not yet recovered from the damage caused by the 1972 earthquake, and still less from the considerable destruction and indirect consequences of the armed conflict in 1979. Added to this whole constellation of adverse phenomena now come the effects of a new natural catastrophe.

## 2. Possible repercussions on the economy in 1982

### (a) General considerations

The natural disaster will have decisive effects on the progress of the economy in the rest of 1982 and also undoubtedly some in 1983. As regards the damage to certain natural resources linked with agriculture, its repercussions will be felt over a still longer period.

In the first place, the growth rate of nearly all the production sectors will slow down, which in its turn will affect the high levels of unemployment recorded in the country, i.e., about 13% of the work force when the disaster occurred. Perhaps the only exception will be construction, in which the urgent need for repairs to highways, bridges, buildings and housing will demand a high level of activity, which in part will probably counteract the situation of increasing unemployment, in view of the high demand for manpower characterizing this sector.

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<sup>12/</sup> For a more detailed analysis of the situations described above, see CEPAL, Nicaragua: Notas para el Estudio Económico de América Latina, 1980 y 1981 (CEPAL/MEX/1042 and E/CEPAL/MEX/1982/L.23).

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Secondly, there will be repercussions on the balance of payments with the drop in exports of agricultural commodities destroyed or damaged and the increase in external purchases of consumer goods, raw materials for agriculture and industry designed to replace lost stocks and capital goods, in particular spare parts, and to bring rapidly into operation machinery and equipment set a standstill in the production sectors. In addition, despite the magnitude of the disaster, the flow of donations thus far received (mid-June 1982) continued to be insignificant in terms of the additional needs. Hence an even greater current account deficit on the balance of payments is expected than the already high figure (520 million dollars) estimated before the disaster.

A third type of negative effects will be recorded in the public sector's operation. On the one hand, the reduction in the growth rate of the product will affect the collection of taxes, both direct and those deriving from consumption; as regards expenditure, there is no doubt that the austerity policy in current expenditure and investment envisaged before the disaster will have to be altered in the face of the urgent need to undertake activities such as the reconstruction of roads, the transport system, housing, hospitals, schools, etc. It is even possible that there should be increases in the subsidies to State agencies for the distribution of food in order to permit them to revert to the levels of operation required by the population.

It is still too early to attempt to assess the full effect of the recent disaster on the general area of Nicaragua's economy. There is no doubt, for example, that the problems of supply which it has brought about will affect the rate of inflation, as borne out by the efforts made by the authorities -with varying results- to exert a stricter control of the prices of basic commodities which had shot up in the first few weeks after the disaster; not unrelated to this is the greatly increased demand for certain materials that will necessarily arise in terms of the reconstruction process.

In short, the disaster is having negative effects on three areas of key importance for the economic situation prevailing in the country: it is reducing the production of goods, with the consequent impact on the rate of growth and employment which it was a crucial matter to imbue with renewed vigour in order to face the unemployment problems and plans to raise the population's level of consumption in the short term; it is aggravating the problem of the shortage of foreign exchange, which has already constituted a basic factor hindering the economic reactivation plans which have been put into effect since the new authorities assumed power in 1979, and at the same time it raises new requirements in terms of foreign capital, despite the high levels reached by debt service payments; and, finally, it is accentuating the disequilibrium in public finance with the reduction in public income and the rise in the expenditure required to repair the damage. It should be noted that the Government had been making praiseworthy efforts in this connexion which seemed to indicate that a considerable reduction in the absolute amount of the deficit might have been expected.

Within the as yet conjectural character of the figures, an attempt is made below to define somewhat more precisely the foreseeable effects in each of these fields.

(b) Prospects for the economic situation in 1982 before the disaster

The two main financial bottlenecks which with varying intensity had characterized the economic situation in 1981 <sup>13/</sup> -extreme shortage of foreign exchange and serious fiscal imbalance- were accentuated after the first quarter of 1982, causing a drastic fall in economic activity -with negative effects on employment- and increased inflationary pressures.

In the first place, the rigidities which were already evident previously in economic relations with other countries, in general, became more acute. On the one hand, with a volume of exports which would apparently exceed the previous year's level, the further decline in world prices of the main commodities, would increase the loss in trade, which would not be compensated for by the efforts to continue reducing imports. Hence the current account balance would almost maintain, in general terms, the critical 1981 levels. On the other hand, the high level of cumulative indebtedness -which, in addition to the level of the inherited debt, is explained by the execution of projects mainly benefiting the production sectors and economic and social infrastructure- and the difficulty in executing investment projects, determined that disbursements would not be high, so that an even sharper drop in international reserves was expected at the end of 1982. As already stated in the preceding pages, among the causes underlying these predictions, both the international situation and the conjunctural circumstances in Central America played an important part.

Secondly, as regards public finance, the aforementioned difficulties which increasingly encouraged a less expansive expenditure policy gave grounds for assuming that in 1982 the high fiscal deficit would be reduced, basically thanks to a rise in tax income (improvements in the collection of taxes on income and property and new charges on beverages and tobacco). The fiscal situation, however, would in any case maintain its critical levels since, for example, the coefficient of fiscal deficit/total expenditure of the Government would only have fallen from 34% to 30%. It should also be noted that the above-mentioned efforts to moderate the vigorous growth of public expenditure with the aim of reducing the financial disequilibrium conflicted with various pressures deriving from the international situation which, for reasons unrelated to economics, required in the present year more than in the past the orientation of more resources to defence.

Both these disequilibria -balance of payments and fiscal- owing to both internal and external factors had determined, as noted earlier, that already at the beginning of the year the goals considered in the Government's economic plan contemplated a slowing down of the growth rate from nearly 9% in 1981 to less than 5% in 1982. Subsequently, the more serious situation with respect to the shortage of foreign exchange, over and above what was expected, had already determined an additional drop in this rate as a result of more pessimistic prospects in the case of manufacturing industry, one of the sectors which in Nicaragua is most dependent on supplies of imported raw materials <sup>14/</sup> (see table 17). In order to understand the persistence of the low levels of real economic activity, it should be taken into account that the growth that had been predicted for 1982 meant that even the total value added at constant prices would be lower than that recorded in the middle of the 1970s, and would represent approximately 80% of the 1977 total.

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<sup>13/</sup> See Nicaragua: Notas para el Estudio Económico, 1981, op. cit.

<sup>14/</sup> It is considered that in May manufacturing operated at 60% of its installed capacity.

Table 17

NICARAGUA: GROSS DOMESTIC PRODUCT BY ECONOMIC ACTIVITY, 1981  
AND PROJECTIONS FOR 1982 a/  
(Growth rates)

Item	1980	1981	1982	
			Expected before the disaster	Probable results after the disaster
<u>Gross domestic product</u>	<u>10.0</u>	<u>8.9</u>	<u>4.2</u> <u>b/</u>	<u>0.7</u>
Goods	0.7	10.3	6.4	2.1
Agriculture	-10.0	14.3	7.4	3.1 <u>c/</u>
Mining	49.2	6.6	14.4	0.0
Manufacturing	11.8	2.8	4.9 <u>d/</u>	-0.4
Construction	117.3	34.8	7.0	10.0
Services	115.8	9.2	2.9	-0.8
Electricity, gas and water	11.8	16.0	15.0	-2.5
Transport, storage and communications	18.5	6.1	...	-5.0
Trade and finance	16.3	6.9	3.0	0.0
Ownership of dwellings	-	4.9	...	...
Public administration and defence, and other services	26.2	11.8	0.0	0.0

Source: CEPAL, on the basis of figures supplied by the Planning Ministry.

a/ Preliminary, subject to subsequent revision.

b/ Already adjusted for the drop in the industrial growth rate.

c/ Estimated on the basis of table 10, an increase was expected in the agricultural quantum of 15.7%, which was reduced to 8.8% because of the disaster, this proportion was maintained in calculating the new growth rate of the agricultural product. The estimated losses in livestock production and in stocks of products ready for sale were reduced (see table 13).

d/ Owing to foreign exchange problems, it had been proposed to reduce this rate to 2.2% even before the disaster.