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Summing Up by the Acting Chairman
Nicaragua—First and Second Reviews Under the Second Annual Arrangement Under the Poverty Reduction and Growth Facility (PRGF) and Request for Waiver of Performance Criteria and for Extension of Commitment Period; Decision Point Under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative
Executive Board Meeting 00/126—December 18, 2000

Directors commended the authorities for their success in the reconstruction effort and in bringing down inflation since the large-scale devastation caused by Hurricane Mitch in 1998. They noted, however, that progress over the last year had been mixed, with persistent problems of governance and difficulties in the domestic banking system. They urged the authorities to redouble their efforts to tackle these two issues. Most Directors considered that the recent decisions taken by the authorities to restore macroeconomic and financial sector stability, as well as continued progress with structural reform, were a sufficient basis for completing the first and second reviews under Nicaragua's PRGF arrangement with the Fund. A number of Directors, however, expressed disappointment at Nicaragua's recent economic performance: they were concerned about the persistence of serious governance problems and remained unconvinced that the authorities' remedial actions would suffice to effectively correct the recent weakening of the financial situation.

Directors noted that the domestic banking system remains fragile, notwithstanding the government's recent actions to improve prudential regulation and supervision. They agreed that it was critically important to further strengthen the banking sector, by thorough implementation of satisfactory resolution plans for weak banks and by taking forceful action to forestall future problems, in order to sustain the progress made on the macroeconomic front in recent years. Essential elements of such action should include detailed assessments of the financial conditions of all banks, and strict enforcement of existing financial legislation and prudential regulations. Appropriate training and resources also need to be provided to the supervisory authorities, and the institutional, legal, and prudential framework should be improved as necessary.

Directors stressed the need to rebuild the official international reserve cushion in the wake of the recent banking problems, and agreed that this would require appropriately tight monetary and fiscal policies. They supported the authorities' plans to shift public sector deposits from the commercial banks to the central bank and to intensify open market operations in the near term.

Directors stressed that continued fiscal restraint will be essential in order to reduce the burden on monetary policy, ease the pressure on interest rates, and limit the potentially adverse impact on bank portfolios. The authorities should continue to restrain domestically financed spending, while protecting poverty reducing outlays. Directors supported the authorities' intention to strongly resist pressures for large government wage increases. In view of the substantial costs of restructuring the financial system and the need to rebuild international reserves, they also fully supported the authorities' plans to save substantial privatization receipts in 2000 and 2001 and use them to help increase official international reserves.

Directors noted that the current crawling peg exchange rate system, supported by prudent fiscal, credit, and wage policies, had helped to bring inflation down and uphold confidence. They agreed that maintaining the existing exchange rate system is appropriate, provided the authorities remain committed to defend it by tightening fiscal and credit policies, as needed.

On structural policies, Directors commended the authorities for the important steps being taken to expand the role of the private sector by establishing regulatory frameworks for private investment and by advances in privatizing the electricity and telecommunications companies, and leasing the ports, water, and sewage facilities. They urged the authorities to continue privatizations by competitive bidding. Directors recommended that efforts be redoubled to fully implement in 2001 Nicaragua's social security reform, which will help to protect the solvency of the public finances and secure workers' pensions. They urged the authorities to improve the efficiency in the delivery of education and health services, to put in place an effective social safety net, and to rehabilitate and expand infrastructures, especially in rural areas.

Directors acknowledged the progress being made toward improving governance, but emphasized the need for much stronger efforts in this area. In particular, further steps should be taken to improve public sector procurement procedures; strengthen the civil service; bolster the efficacy of the Comptroller's Office; increase the transparency of, and control over, the public finances; and strengthen the judicial system and property rights. Directors welcomed the specific floating completion point conditions relating to governance. They underscored that rigorous implementation of actions in this area was necessary to ensure effective use of HIPC assistance to achieve poverty reduction.

Directors expressed concern that a macroeconomic framework for 2001 had not yet been finalized. They endorsed the authorities' commitment to maintain fiscal, credit, and wage restraint, and save privatization proceeds, but stressed the need to put in place promptly a macroeconomic framework for 2001 that could be supported by the third annual arrangement under the PRGF.

Directors approved in principle the completion of the reviews under the second annual PRGF arrangement and disbursement of the second and third loan of the arrangement. This approval in principle would be confirmed once the World Bank Board has endorsed the Interim Poverty Reduction Strategy Paper (I-PRSP) expected on Thursday, December 21.

Interim Poverty Reduction Strategy (I-PRSP)

Directors agreed that the authorities' I-PRSP provided a sound basis for completion of a full PRSP and for Fund concessional assistance. They recommended the authorities to pursue broad-based consultations with civil society in preparation of the PRSP. They agreed on the need for further elaboration and strengthening of the underlying macroeconomic framework and more explicit costing and prioritization of social programs.

Enhanced HIPC Initiative Decision Point.

Directors agreed that, in view of Nicaragua's status as a PRGF-eligible and IDA-only country, and its unsustainable external debt burden, even after the full application of traditional debt relief mechanisms, Nicaragua is eligible for assistance under the enhanced HIPC Initiative. Most Directors also agreed that Nicaragua's performance under its PRGF arrangement, the understandings reached on key economic policies for 2001 pending agreement on a new annual arrangement, and progress on the preparation of a PRSP, provide a basis for reaching the decision point under the enhanced HIPC Initiative now (provided this was confirmed by the World Bank Board). Several Directors, however, expressed serious concern about Nicaragua's recent economic performance and about the country's record on governance. A few Directors were of the view that consideration of the decision point should have been postponed until agreement on a third annual PRGF arrangement would give assurances to the Board about the country's medium-term policy framework. On interim assistance from the Fund, Directors welcomed Management's assurance that this matter would be brought to the Board for decision only after there are satisfactory financing assurances, and that the Board would be informed at that stage on progress with preparation of the PRGF-supported program.

Directors agreed that Nicaragua could reach its floating completion point when the conditions specified in Box 6 of the decision point document (EBS/00/259) are implemented, including satisfactory implementation for one year of its PRSP, maintenance of a stable macroeconomic framework, and satisfactory performance under a program supported by a PRGF arrangement. In view of Nicaragua's recent uneven performance under the PRGF, Directors noted that they would attach particular importance to the fully satisfactory implementation of the completion point conditions. They particularly stressed the importance of measures to strengthen governance and the reporting on the use of budgetary savings arising from interim relief in the PRSP process. Some Directors also attached importance to giving greater independence to key public institutions such as the Central Bank, Superintendency of Banks, Comptroller's Office, and Supreme Court.

Finally, Directors underscored the importance of a successful resolution of Nicaragua's debts to non-Paris Club creditors, given these debts' large share in the country's total external debt and concerns about Nicaragua's continued external vulnerability, even after assistance under the enhanced HIPC Initiative. Directors welcomed the formal commitment by Costa Rica, Guatemala, and Honduras, as informed to the staff, to their full participation in the debt relief to be provided to Nicaragua under the Initiative, and urged other non Paris Club creditors to follow their lead.