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Statement by Mr. Marino on Nicaragua
Executive Board Meeting 92/144
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The Nicaraguan authorities wish to express their recognition to the staff for a well focused staff report for the 1992 Article IV consultation which highlights the substantial progress achieved under the stand-by arrangement. Such progress has been possible in great part through the generous support of the international community, which has helped Nicaragua maintain its exceptional stabilization and structural reform efforts. Due recognition should be given to the Fund's technical assistance for its contributions in the formulation and implementation of the adjustment program and structural reforms. The Nicaraguan authorities hope that in the near future the conditions will be ripe to undertake a further deepening of their reform efforts with the support of an ESAF arrangement.

The pace and progress of the Nicaraguan adjustment program adopted since 1991 should be assessed taking into account the following factors: a) Nicaragua is one of the poorest highly indebted countries in the world; b) Nicaragua is also an economy in transition, moving from a command system towards a market-based system; c) Human capital is scarce and the institutional framework is slowly being rebuilt. Therefore, Nicaragua has a wide range of problems to address simultaneously. It has to deal with the conditions of extreme poverty faced by its population, it has to strengthen its democracy and it has to lay the foundations to foster economic growth.

The commitment of the Nicaraguan authorities to the stabilization program has been demonstrated by its firm implementation of the required measures in spite of the severe exogenous shocks that their economy has confronted. During the program period, Nicaragua has suffered a severe drought, a volcanic eruption, a tidal wave, the collapse of the international price of several of its main exports--e.g., coffee--and shortfalls in programmed external aid.

The centerpiece of the adjustment program of Nicaragua is the <u>fiscal consolidation</u> that is taking place. The current account balance of the consolidated non-financial public sector is expected to show a surplus of around 2 percent of GDP in 1992. This would imply a swing of over 30 percentage points of GDP from the deficit registered in 1990. This has been achieved by increasing total government revenues by 11 percentage points to around an expected 31.5 percent of GDP in 1992 and by cutting current expenditure by close to 20 percentage points of GDP to an expected level of around 29.5 percent of GDP in 1992.

The central government deficit (before grants) is expected to be broadly in line with the program targets. However, the deficit, after grants, will be higher than programmed because of shortfalls in external assistance. The tax measures implemented earlier in the year did not affect the accounts of the central government. This is highlighted by the figures on tax collections which show that they have remained broadly in line with the program. In Nicaragua the tax to GDP ratio is now close to 25 percent of GDP, which is relatively high for a country with a per capita income of less than 400 dollars.

As pointed out by the staff in its buff statement, the end-September target for current expenditure of the central government was exceeded by around 1 percentage point of GDP. However, this current expenditure is in a sense an "investment expenditure" because it forms part of the structural transformations that Nicaragua has to undertake. In fact, these expenditures correspond to the "Investment in Peace" program being conducted by the government of Nicaragua. These expenditures have been used to buy back and destroy a huge amount of arms and to make the compensation payments to the demobilized troops.

Credit policy has been conducted with the aim of consolidating the important fall in inflation observed during the year and with a view to advance the process of liberalization of the financial system. The quantitative performance criteria for the net international reserves and net domestic assets of the central bank and external debt operations for end-September 1992 were observed. However, in view of the continued delays in the disbursement of some external assistance, and in order to remain broadly in line with the external targets and to avoid inflationary pressures, the monetary authorities of Nicaragua have this week adopted measures to tighten credit policy. Among the most important actions are the suspension of central bank rediscounts to the state owned banks and the agreement with the state banks to maintain frozen their deposits in the central bank. These two measures should contribute to curtail credit expansion over the coming months.

In addition, the monetary authorities are studying the possibility of issuing stabilization bonds in order to mop up excess liquidity, and to strengthen the instruments available for monetary control. Also, as part of the effort to have more effective control over credit expansion by the banking system, the government will require public enterprises to shift part of their deposits from the commercial banks to the central bank.

Exchange rate policy has played a central role in achieving price stability since March 1991. Nevertheless, the Nicaraguan authorities are committed to keep exchange rate policy under close review to avoid losses in external competitiveness and in order to eliminate the multiple currency practices. The Nicaraguan authorities consider that as soon as there is progress in eliminating certain indexation practices in the labor market, the conditions for the unification of the exchange rates will be laid out.

The medium term scenario highlights the importance of financial aid and debt relief for Nicaragua. Only if Nicaragua receives exceptional treatment from its debtor countries will it be able to consolidate the stabilization effort and regain external viability.

In spite of the important progress achieved in restoring macro-economic stability, the economy of Nicaragua remains fragile, highly dependent on external aid and vulnerable to external shocks. The Nicaraguan authorities recognize the important challenges ahead in dealing with property rights' issues, and with the process of liberalization and privatization. However, they are fully committed to the strategy put forth and supported by the stand-by arrangement and hope for a prompt resolution of the issue of financing assurances under the program in order to complete the review.