

## ANNEX

### **MTR Document**

### **Nicaragua CSP 2007-2013**

#### **1. PART 1: EXECUTIVE SUMMARY**

Nicaragua's **economic context** is marked by economic growth that has outpaced population growth although not high enough to bring about a substantial reduction in poverty levels. The country is highly dependent on remittances (about 12 % of GDP) and donations (according to DAC / OECD, net ODA / GNI was 15.1 % in 2007).

In the economic policy area, Nicaragua has made progress in both macroeconomic and fiscal sustainability. Since 2001 the country has strived to maintain disciplined macroeconomic policies and to carry out structural reforms. However, the global economic downturn and vulnerability to external shocks, along with dependence on foreign aid and remittances, particularly to finance the fiscal deficit, pose serious threats to the sustainability of the macroeconomic framework. Moreover, as a result of the situation arising from the last municipal elections, the suspension of a portion of foreign aid is further increasing the risk.

In terms of social cohesion and poverty as described in the CSP the situation remains generally valid, except that since 2007 the Government has placed more emphasis on social development in its policies. In practice, the main social policy reforms have taken place in education and health, providing free and universal access.

Aid effectiveness is high on the Nicaraguan Government's agenda and the donor community is actively involved in the 2007 OECD/DAC survey in relation to the monitoring of the Paris Declaration indicators.

Partly stimulated by the negotiations on the EU-CA Association Agreement, regional integration has recently received renewed impetus and significant progress has been made with the adoption of the Customs Union Framework Agreement and the signature of the Customs Union between Guatemala and El Salvador.

In the last few years, national policies have placed strong emphasis on the **education** sector. In 2007 the new administration redesigned the policy for primary and secondary education, stressing the importance of universal and free education, quality in education and the elimination of illiteracy. This should generally steer Nicaragua towards the education-related MDGs which the country is trying to reach. Inadequate curricula, untrained teachers and the poor condition of infrastructure are flagged as the main obstacles to quality in education, particularly along the Caribbean coast.

Regarding **economic and trade issues**, during the last few years Nicaragua has strengthened its macro-economic situation to attract private investment, although this has not been translated into sufficient economic growth to lead to a substantial reduction in poverty. Moreover, the current global economic crisis is having a serious impact on the Nicaraguan economy.

Despite a worrying trend in the **governance** area, some formal headway has been made in this field (e.g. the drafting of the Plan Justicia (2007), which brings together all judicial institutions; the ranking of its priorities for action (2008); the setting up of a number of new courts specialised in family matters; and the increase in special police stations for women and children). However, at the level of implementation the achievements are often less convincing. Positive reforms can still be facilitated through cooperation in specific aspects such as local governance or institutional support.

Up until 2007 all aspects of cooperation between the Government and the EC were fluid. However, from early 2008 onwards there have been growing concerns regarding the observance of underlying principles, such as human rights, rule of law and democratic processes. Following the November 2008 municipal elections these concerns grew to such an extent that the EC suspended budget support disbursements as from January 2009.

In the present economic, political and social circumstances, the CSP's focal sectors for the period 2007-2013 have been confirmed with some adjustments, in particular to the implementing modalities. A summary table showing the financial breakdown by focal area is annexed to this document (annex 1).

**Education** remains an area of key importance for Nicaragua. Achieving social mobility and better qualified human resources for the country's development still poses challenges. EC assistance for 2011-13 should include special attention to technical and vocational training to promote employability.

While the CSP's overall objective for **governance** is maintained, some adjustments should be made to the focus of EC intervention in this sensitive area. EC support should concentrate on local governance. This means strengthening the capacities not only of municipal authorities but also of the decentralised antennae of specific government institutions with the focus on specific services of benefit to vulnerable groups and for which the national institution is sufficiently independent. Broader institutional support would complement this focus of EC governance assistance, by giving priority to institutions which play an important role in safeguarding the rule of law and/or in ensuring efficient and development-oriented management of public finances. Further areas for governance intervention will be considered, provided the right conditions are met.

In line with the original objective of the general budget support programme PAPND, the EC should continue supporting the **socio-economic development** of the country as expressed in its strategies for poverty reduction and national development. Since poverty is predominantly to be found in rural areas, particular attention should be paid to supporting those aspects of the national development plan which are related to rural development. There will be specific interventions in rural development in line with the Government's sectoral strategy as a key component of its national development plan.

Strengthening the **business and investment climate** is another significant way of boosting the economy and reducing poverty. The EC therefore intends to continue working in this area during the period 2011-13.

## **2. PART 2: MAIN DEVELOPMENTS IN THE COUNTRY**

Since early 2008 the **political situation** has become somewhat tense and volatile. Following the November 2006 general elections the governing FSLN Party obtained only 38 out of a

total of 92 seats in the National Assembly. However, the Government has managed to obtain support for the key areas of its programme. In some cases this support has been gained through dubious judiciary decisions to settle the executive/parliament confrontation. The resounding victory of the FSLN in the November 2008 municipal elections has been denounced as fraudulent by opposition parties and civil society organisations. The crisis created by this contested election led to international cooperation being partially discontinued and a general suspension of budget support assistance. Since the end of 2008, the political climate has been dominated by a controversy surrounding constitutional reforms promoted by the Government, which could modify the current roles of, and relations between, the President and the National Assembly, which might even mean re-election to the post of Head of State. It is likely that these reform proposals will be rejected by opposition parties.

Generally speaking there is still satisfactory freedom of the press and freedom of speech, although some media have reported cases of administrative or legal harassment. Tension between state authorities and civil society has grown tense over the period. In an attempt to enlarge its political base, the FSLN has gradually built up a network of Councils of Citizens' Power (CPCs in Spanish) across the country. This has created some alarm among NSAs traditionally present in the country.

On the whole the situation in terms of **social cohesion and poverty** described in the CSP remains valid, except that since 2007 there has been a stronger emphasis in government policies on social development. In practice, the main social policy reforms have taken place in education and health, providing free and universal access.

There have been significant improvements in the **health** situation, and in maternal and child health in particular, one of the health policy priorities. In 2007 a new policy for primary and secondary **education** was designed, with particular emphasis on universal and free education, elimination of illiteracy and quality of education (thus rejecting the previous policy of 'school autonomy', synonymous with the privatisation of education). The Literacy Campaign, one of the main strategies of the Government of Nicaragua for achieving full literacy and schooling, was completed in 2009. According to UNESCO, the illiteracy rate was reduced from 22 % to less than 6%. The education sector still has many challenges to face before it meets international commitments and achieves quality results. However, the current education administration has taken important steps in the right direction in education policy and maintains a fluid and meaningful sector dialogue with all stakeholders.

Nevertheless, as regards the social situation there are some key obstacles to the long-term impact of these policy statements. Apart from financial constraints and persistent institutional weaknesses, these are: i) a fragmented approach; ii) a lack of general consensus on several of these policies; and (iii) a restricted concept of consultation and participation, including only institutionalised, 'civil society' structures (CPC).

Important gender issues include the approval of the Equal Opportunities Law (2008) as well as the National Program on Gender Equality. However, problems of fundamental human rights still exist (e.g. domestic violence, access to justice, removal of the right to therapeutic abortion). Women's rights groups are a specific target of the government's campaign against voices critical of civil society.

**Economic policy** in the past decade has been guided largely by the PRGF programmes with the IMF. A new three-year PRGF arrangement (SDR 72.5 million) was negotiated in 2007. Unlike previous programmes, this one focuses on the consolidation of public finances, fiscal sustainability and economic growth rather than on the implementation of structural reforms

requiring legislation to be passed. The PRGF's first review was completed successfully in October 2008 and all performance and quantitative criteria were met comfortably, although with some delays in the energy sector. In view of the political turmoil and institutional paralysis that followed the last municipal elections, the second PRGF review, scheduled for late 2008, was postponed and a technical mission for the second and third reviews of the PRGF took place in July 2009. The IMF is willing to support the Government of Nicaragua and has proved quite flexible regarding the time needed by the authorities to come up with the right policies to bring the country out of this critical phase. However, the Government of Nicaragua needs to offer more solid reform and budgetary commitments for 2010 if they intend to ensure the continuation of the PRGF programme.

Macroeconomic policies have remained prudent over the past two years. However, serious threats are posed to a sustainable macroeconomic framework by the current institutional paralysis, as well as dependence on foreign aid and remittances, particularly to finance the fiscal deficit, the global economic downturn and vulnerability to external shocks.

The contribution of **rural areas** to the sustainability of the Nicaraguan economy cannot be underestimated. Agriculture, fishing, and forestry are essential for the national economy: in 2007 the sector provided 29 % of global formal employment, 69 % of total exports and 53 % of GDP, including industries based on agricultural commodities. Between 2004 and 2007 the contribution of the primary sector increased by 13 %, and from 2007 to 2008 agricultural exports increased by approximately 40 %, according to official figures.

It is generally recognised that the primary sector can create more and better employment and boost exports, thus helping to alleviate poverty. Most agricultural exports are produced by small and medium farmers, whose specific contribution to exports is more than 50 % and to basic food production more than 90 %. In recognition of this the Nicaraguan Government continued supporting a wide rural sector approach, known as PRORURAL, which is also supported by many donors and aims to coordinate the rural sector institutions. The objectives are to ensure exports and enhance productivity with a view to boosting exports and increasing national consumption, thus overcoming the country's chronic food insecurity. One major aspect to be borne in mind is the potential of rural areas not only for agricultural production, but also for other activities such as services, tourism, **renewable energies**, etc. Gold mining by small diggers is another important activity that provides direct employment to as many as 20 000 people in rural areas according to official figures. This figure does not include children working on those sites or indirect employment. Working conditions and the environmental impacts of this activity are a source of major concern for the authorities, mainly because of the intensive use of mercury and cyanide in processing, again with no budgetary appropriations to meet this challenge.

Nicaragua is still classified as a low-income **food-deficit country**. The FAO estimates that approximately 1.5 million Nicaraguans are undernourished and that Nicaragua is one of the 14 countries in the world classified as having the highest levels of food insecurity. It has also been estimated that Nicaragua is one of the Latin American countries which has been most severely impacted by high food prices in the region. According to the Nicaraguan Survey on Health and Demography (ENDESA), chronic malnutrition affects 17 % of children under 5 years of age. In RAAN (North Atlantic Autonomous Region), with a mainly indigenous population, this rises to 24.2 %. The national average of acute undernutrition is registered at 1 % and at 1.8 % in RAAN (ENDESA, 2006-07). However, a recent study carried out in WFP intervention areas found that acute under-nutrition in RAAN affects 3.6 % of the under-fives. Food production remains one of the priority areas of the National Human Development Plan, via the National Food Programme.

The country's current **energy** matrix relies on fuel wood or agricultural residues for over 50 %, of the energy supply to households (cooking), small and medium enterprises and, in some seasons of the year, electricity to the national grid. Largely because of the use of fuel wood to meet energy needs and the corresponding change in the pattern of land use, Nicaragua's contribution to climate change is negative. Hydro-wind power options to produce electricity are not the main sources of energy. Nevertheless, the national development plan pays more attention to renewable sources of energy (hydroelectric, geothermal and solar), particularly to generate electricity. For example, there is currently a medium-term investment plan to generate electricity through renewable sources which should be finalised by 2014.

**Aid effectiveness** is high on the Nicaraguan Government's agenda and the donor community participated actively in the 2007 OECD/DAC survey on the monitoring of the Paris Declaration indicators. Donors are concerned about the Government's interpretation of the concept of alignment, according to which all funds should be channelled and/or controlled by the Government of Nicaragua. Much progress is still needed in the area of 'ownership', 'alignment' and 'harmonisation'. Donors need to make better use of common platforms for commitments, disbursements and monitoring, not to mention the use of country systems where possible. The Accra Agenda for Action (September 2008) is a considerable challenge for Nicaragua with its insistence on all-inclusive dialogue with social development partners and the need to ensure broader involvement of stakeholders (parliaments, local governments, civil society, the private sector, etc.).

With the adoption of the EU Code of Conduct (CoC) on Complementarity and Division of Labour in Development Policy in May 2007 the European Commission and the Member States entered into lengthy discussions concerning the Guiding Principles of the CoC and how to implement them in the Nicaraguan context. Several decisive actions were undertaken in 2008-2009 in order to gather the necessary information and make headway on the Division of Labour issue:

1. An independent survey on the 11 Guiding Principles was carried out (all 11 MS and the EC participated) and the Final Report was made available in February 2008;
2. Two HQ questionnaires were completed by EU donors on specific aspects related to the Division of Labour and progress in Nicaragua ( November 2008 & October 2009);
3. A matrix of EU donor presence at sector level was developed in January 2008;
4. An on-line data base of EU Development Cooperation in Nicaragua was developed (<http://nic.odadata.eu/>) in April 2008 and provides a comprehensive mapping of on-going EU cooperation. This database has been updated and the new improved version was to be launched on 23/10/09;
5. The second EU Blue Book for Development Cooperation will be presented to the public on 23/10/09 ( the first was launched in April 2008).

The donor architecture is changing rapidly in Nicaragua with the withdrawal of British cooperation in 2009 and Swedish cooperation by 2011. Many EU and non-EU donors are reviewing their current programming for the period 2009-2011 and it is only once this has been decided that it will be possible to proceed with targeted discussions on the division of labour. The Government of Nicaragua claims that it still supports the harmonisation and alignment process. However, to date there have been very few tangible initiatives from their

side. The partner country's perception of the division of labour process is not always positive, as they fear this will lead to reductions in the volume of overall aid and excess streamlining of the donor dialogue.

Partly stimulated by the negotiations of the **EU-CA Association Agreement** (seven rounds of negotiations for the signature of the Agreement took place in 2008-2009 with a view to completing by mid 2010), there has lately been a renewed impetus and important progress has been achieved, such as the adoption of the Customs Union Framework Agreement and, more recently, the signature of the Customs Union between Guatemala and El Salvador, recently also supported by Honduras. Nicaragua intends to join within the next months. Regarding the Association Agreement, despite some difference of opinion, now resolved, regarding the Economic and Financial Fund (Fondo Común Económico y Financiero), Nicaragua recognises that these negotiations are important for Central America since they can open up significant opportunities for integration in the global market.

Progress has been made in the definition of regional priorities as well as sector-specific strategies on core topics, such as regional security, social cohesion, energy and agricultural policy. A preliminary proposal from the Central America Integration System (Sistema de Integración centroamericana or SICA) Pluriannual Plan for the period 2009-2011 has been prepared. If it is approved, the Plan could become a political roadmap for integration, as well as providing guidelines for donors working on regional harmonisation and alignment initiatives. The main difficulty at the regional level is still to be found in the financial area. In the absence of a regional funding mechanism, institutions rely on Member States' contributions as a primary source of income, which has proven to be insufficient and often subject to delays. As a result, institutions remain heavily dependent on external cooperation, normally on a project basis, since there are no pre-conditions for GBS or SPSP. There have been attempts to define a proposal for a self-sustainable financial mechanism. However, it is important to ensure consistency with parallel proposals to create funds which are supported both internally (e.g. cohesion fund to finance the regional social strategy) and externally (e.g. Compensation Fund promoted by Nicaragua in the Association Agreement negotiation rounds).

### **3. PART 3: PERFORMANCE ASSESSMENT**

#### **3.1. 3.1 Country performance**

**Education**, one of the focal sectors of the CSP, is high on the Government's social agenda. Nicaragua faces difficulties in reaching education-related MDGs, despite good gender equality standards for access to primary education as well as some progress in enrolment rates at all education levels. However, in 2008 over 500,000 children were not in school with big differences between rural and urban areas especially in secondary school. Completion and repeat rates are still problematic. Inadequate curricula, untrained teachers and the poor state of infrastructure are reported to be the main obstacles to the quality of education, particularly along the Caribbean coast. If education is to promote employability and social mobility, more attention should be given to technical secondary education. Since 2007, the Government of Nicaragua's education policy has focused on providing free primary and secondary education and has made remarkable efforts to achieve universal coverage and to improve the quality of education.. The institutional development plan 2007-2011 (Plan de Desarrollo Institucional or PDI) is the main sector policy reference. Despite some shortcomings, it should steer Nicaragua towards the education-related MDGs. In 2008 the PDI was completed and

improved through an in-depth review, which identified key points for the strengthening of institutions and capacity building. The main result of this exercise is greater consistency between the Government's general social policy and the Ministry of Education's (MINED) strategies and planning instruments. MINED is currently developing its Ten Year Plan 2011-2021 (PDE in Spanish), which will eventually constitute the long-term reference document for the education sector, covering primary, secondary, technical and university education. MINED is making a real effort to improve the quality of education. The reform of the primary and secondary study programme (curriculum) is now complete (except for some secondary level grades) and is being implemented. However, a number of specific aspects still need to be improved, such as rural pre-school and rural primary education, as well as secondary distance education. There are large differences in the quantity and quality of education between regions and vulnerable groups of the population. The line Ministry has a clear leadership in the sector and has managed to reach a global consensus on the new educational model, involving civil society. It has a fluid dialogue with donors, coordinated through periodic roundtables. The European Commission has been the donors' spokesperson for several years.

Notwithstanding the persistence of problems related to **governance** (another focal sector), in recent years Nicaragua has made some formal headway in this field. Important accomplishments are: the drafting of the Plan Justicia (2007), which brings together all judicial institutions, the ranking of its action priorities (2008), the setting up of a number of new courts specialised in family matters and the increase in special police stations for women and children. However, from the point of view of their implementation these achievements are often debatable. The approval of the long-awaited implementing regulation for the judicial career law (June 2008) opens the door to a gradual increase in professionalism and, it is to be hoped, less partisanship in the judiciary. Nevertheless, the judicial system, which remains under the control of the Ortega-Alemán 'Pacto's,' has issued a number of key decisions that have been perceived as politically motivated. The separation of powers has also suffered other setbacks, such as the behaviour of the Supreme Electoral Council in the 2008 municipal elections. It would seem that it did not live up to its role as independent guardian of the electoral process. Presidential decrees have frequently been used to allow the executive to bypass parliamentary control. There is also evidence of gaps between the legal framework and its implementation, as can be seen in the existence of a new implementing regulation for the Law on Access to Information, alongside the discretionary use of extra-budgetary public funds from Venezuela. Similarly, the fight against corruption could be stepped up, given that a strategy to combat it has been prepared. However, a report by Transparency International shows a slight deterioration in Nicaragua's ranking in the Corruption Perception Index table, placing it as the worst in Central America<sup>1</sup>.

Despite the apparent lack of political will to introduce reform in the area of governance, cooperation, and technical assistance in particular, can help bridge the gap between the legal framework and its implementation. More technical, lower-profile (hence less conflictual) improvements in governance and public administration systems might be more appropriate for engaging the national authorities, while contributing to improve democratic governance and the rights of the poor. Acting at local level, building citizens' capacities and working with local administrations, might also be more effective than involvement at national level. However, considering the allegations of serious fraud in some municipalities during the last local elections, we will need to identify our partners very carefully.

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<sup>1</sup> From place n. 123 in 2007 to n. 134 in 2008.

Environmental governance is another major issue, particularly in view of the recently approved Penal Code that includes environmental crimes in the penal justice system. Some natural resources, such as water, are particularly well suited to be managed under an approach of this kind.

Regarding **economic and trade issues**, which is a focal area of the 2007-2013 CSP, during the last few years Nicaragua has strengthened its macro-economic situation to attract private investment, although this still does not mean that there have been any substantial improvements in the living conditions of less-favoured people. Until 2008 most of the macroeconomic indicators remained stable.

However, the macroeconomic situation did deteriorate during the last months of 2008 and the beginning of 2009. Although some of the difficulties that prevented the carrying out of the second PRGF review have now been overcome, recent economic developments pose serious risks to the macroeconomic stability of the country. Economic growth has been lower than expected, reflecting the slowdown in the global economy, registering at 3.8 % in 2007 (versus the 4.2 % projection), with an inflation rate of 16.9 % in 2007. In 2008, projections for economic growth and inflation were 3 % and 13.7 % respectively. Preliminary data show that growth was led by the dynamism of the commercial sector, with exports increasing by 19 % compared to 2007, while imports increased by 24 %. The current account deficit increased from 18.3 % of GDP in 2007 to around 26 % of GDP in 2008, reflecting the increases in oil and commodity prices. In turn, fiscal performance has been stronger than projected, as the consolidated combined public sector (after grants) posted a surplus of 0.9 % in 2007 and 0.8 % of GDP in 2008, well below the IMF target of 1.8 % of GDP. In 2009 there has been a marked downturn in consumer spending, reflecting a fall in remittances from Nicaraguans living abroad, mostly in the US and Costa Rica. There was an 0.8 % reduction in remittances contracted in the first quarter of 2009, compared with a 10.5 % increase in 2008. Private investment is falling owing to the difficult international climate and receding confidence in the current administration. Government consumption and investment will be the main supports of growth. Preferential access to the US through DR-CAFTA will help to offset some of the negative impact of the global slowdown on the external sector. The contribution of the external balance turned positive in 2009, reflecting an even sharper fall in imports than decline in exports. On the supply side, agricultural output is similarly slowing down as coffee production drops, and the sector's growth is suffering as a result of domestic credit restrictions and foreign aid delays. Public-sector spending restraint and a reduction in private-sector construction activity will lead to a decline in overall construction growth. Manufacturing is falling back as well, particularly in export free zones, given the decrease in import demand on Nicaragua's main markets. Similarly, services growth is expected to decline, owing to a falling off in consumer spending and tourism growth.

The Government, with the support of some donors, has made progress in the definition and implementation of the sector programme in support of SMEs. However, the Government's capacity to implement these types of projects is limited, mainly because of its complex administrative procedures and highly centralised decision-making process. The dialogue between the Government and the private sector remains active, albeit challenging, in particular due to the control exerted by the CPCs on entrepreneurs. After several years of gradual improvement the business and investment climate has declined slightly in the past two years. There were open conflicts between the Government and multinational companies in the energy and tourism sector. Generally speaking, these conflicts have been resolved. However, this situation is likely to have negative consequences on the FDI for the next few years. In 2008 the Government approved an industrialisation development policy which is not only



based on the 'maquilas' scheme, but also aims to promote a better regulatory framework for industry and developing entrepreneurship capacities, technology, quality systems and competitiveness. So far, however the Government does not have the budgetary resources to implement this policy.

Until the political crisis triggered by the November 2008 municipal elections, budget support proved to be a valid tool for strengthening the dialogue between donors and the Government on national and sectoral policies. It helped the drive towards more transparent and effective management of public resources. The Government values this form of aid highly since resources are fully in line with its national and sectoral policies. A Budget Support Group (BSG), composed of nine agencies, was created in 2005 and a Joint Financing Arrangement, which sets out the fundamental principles governing the provision of budget support, was signed by the donor group and the Government during the same year. DELNIC chaired the group during the first semester of 2008 and it is now an active member of the steering committee together with the Netherlands and the Swiss Cooperation.

The BSG regularly reviews the Government's performance on the basis of a Performance Assessment Matrix (PAM), in which donors and the Government jointly agreed upon a list of actions/indicators/targets for a medium-term period (3 years). Political and technical dialogue is ongoing through the organisation of annual and mid-year review meetings. While the annual meetings are used to assess performance against the indicators and targets established in the PAM, giving the Government an indication of future financial commitments, the mid-year meetings serve to establish priorities for the future and confirm disbursements for the following year.

Regarding public finance management (PFM), in October 2008 the authorities presented a Financial Administration Modernisation Plan. In the Government's view, the fact that the plan's timeline extends beyond the term of a single administration is proof of the country's long-term commitment to the improvement of PFM. The plan shows a high level of ownership and is based on a solid legal framework and background studies. It clearly defines strategic orientation, actions and indicators and provides a detailed cost analysis.

Despite these positive aspects, the final version focuses exclusively on the modernisation and capacity building of the Ministry of Finance, leaving out line ministries and other important entities. Relations with the Comptroller's Office and the National Assembly as the two key institutions that exert control over the use of public funds would also need to be improved.

Lastly, the National Development Strategy (*Plan Nacional de Desarrollo Humano - PNDH*) has been approved and the Government is currently working on its operational document. The final version of the plan shows a strong social orientation and commitment to poverty reduction and it identifies macroeconomic stability as a means of fostering economic growth. Following a joint analysis by members of the BSG, there is an overall consensus that this version of the plan shows improvements over the previous version and contains the minimum elements expected of a PRSP. In May 2009 the Government presented a summarised version covering the period 2009-2011, which takes into account the current economic crisis faced by the country. The document is clear and is also better structured than the previous one. However, a matrix with concrete medium-term actions and targets is still pending.

A recent evaluation of EC's cooperation with Nicaragua (1998-2008) reports that the general and sector budget support programmes implemented during this period were relevant to the national context and led to a clear improvement of public finance management. These operations were requested by the Government and carried out in close collaboration with

other donors. The budget support programme for the education sector (PAPSE) encountered specific difficulties for reasons both internal (e.g. exaggerated number of indicators and unreliable statistics) and external (high turnover of ministers). However, more positive results have been achieved through intense policy dialogue in recent years (2007-2008). The report recommends that the EC's double-tranche system (fixed and variable tranches) should be reconsidered so as to simplify this aid modality. In addition, budget support programmes should focus on a restricted number of indicators free from measurement problems or error margins that could invalidate their use.

### 3.2. 3.2 Cooperation performance

As stipulated in the 2002-2006 CSP, the Delegation drew up three **budget support** (BS) programmes: a general programme for macroeconomic support with a rural focus (called PAPND) and two sector BS programmes for education and justice (PAPSE and PAPJ respectively) for a total amount of €137.5M.

The **GBS-PAPND** was first implemented in 2006. So far two fixed tranches and one variable tranche (€1.5M out of the committed amount of €68 M) have been disbursed. No new general budget support programme has been formulated yet under the CSP 2007-2013. The previous education SBS programme ended in 2007 as programmed. A total of 96.6% (€50.7M) of its budgeted amount was disbursed. Under the 2007-2013 CSP, out of the overall €44.8M indicatively foreseen for a new sector BS programme in education, €10.7M were committed in the AAP 2007. The following commitment of €12.7M was included in the AAP 2008, which was approved by the September 2008 DCI Committee, but was later suspended at HQ level because of concerns about the country's political situation.

In **education**, experience has shown that because of the constraints of the indicators matrix the EC has limited opportunities to focus on specific aspects of the sector (e.g. the Government's willingness to cover certain areas, poor reliability of data, fragmented institutional competences, etc.). For example, although vocational training and the specific situation of education in rural areas are priorities in PAPSE II, the corresponding indicators could not be included in the indicators matrix. Hence, a broader sectoral dialogue is needed, so as to exploit synergies between donors' programmes and seek to improve coherence between them.

Although the **justice** SBS programme was signed in 2007, it has not yet started due to delays and lack of internal coordination among the different government institutions involved.

In terms of **technical assistance**, given the difficulties in implementing the first institutional support programme, the Delegation was not keen to continue a similar approach. Instead the decision was taken to distribute the TA funds within different programmes (PAPSE II — €2M, PAPND II — €2M, PROMIPYME — €1.4M) to be formulated according to the CSP. So far only €0.7M have been committed with the PAPSE II.

Given the importance of the **Budget Support Group's** (BSG) decision for the macro stability of the country, a high-level dialogue between the Government of Nicaragua and the BSG took place during the months of May and June 2009. Its objective was to reach an understanding on the way forward for this aid modality. Although there is common ground with the Government of Nicaragua on issues related to economic governance, the group concluded that regarding the substance of the main democratic-governance-related issues, for the time being there was no appreciable commitment by the Government of Nicaragua on measures to improve the electoral system. However, the authorities have recently shown some signs of being willing to adopt some corrective measures for future elections (e.g. allowing

for national and international observation). The EC pointed out to the other donors that the BSG now has the opportunity to reap the benefits of the pressure applied in the last months and that ending the dialogue at this moment or taking an irreversible position would not produce any result. Therefore, the EC explained that in order to decide on the future of its budget support programmes, it would not dictate conditions but would see whether the written offer presented by the Government of Nicaragua in September would be put into practice in the following months. Meanwhile, given that some tangible steps have been taken towards improving democratic rights, it has been decided to release the 2008 tranche of the education sector budget support programme (PAPSE II). A sum of €10 million Euro was disbursed in October 2009. Regarding the other budget support partners, while it is likely that the WB and IDB will resume, it seems improbable that any of the bilateral donors will make general budget support disbursements in 2009.

The programme's financing agreement to make improvements in the **investment and business** climate was signed in December 2008. However, its implementation has not yet started. Generally speaking, the Government's capacity to implement projects in this area is limited by its complex administrative procedures and a highly centralised decision-making process. The EC Delegation has been in charge of coordinating the Private Sector Donor Group. Although an SBS programme in support of SMEs was initially envisaged in the 2008 AAP, its identification sheet was rejected by the QSG because it did not have a clear and well-defined sector policy. Hence, it was concluded that aid to this sector should be delivered through projects. A new project modality proposal was submitted in 2008, but was also rejected for the same reason. The Delegation should prepare a new AF for the second semester of 2009, including commitments for both 2008 and 2009 for €15 million in total.

#### **4. CONCLUSIONS OF THE MID-TERM REVIEW**

Given the economic, political and social circumstances described above, the focal sectors of the Nicaragua Strategy Paper for the period of 2007-2013 and the amount allocated to each of them are confirmed with some adjustments, in particular as regards the implementing modalities. As regards implementation generally, the shift to sector approaches should continue although the political context *inter alia* will determine the specific modalities.

##### **1) Education**

**Education** remains an area of key importance for the country, as shown by the enduring challenges surrounding social mobility and better qualified human resources. In recognition of the importance of this sector for the country's development, national policies lay strong emphasis on it. Special attention should be given to vocational training to promote employability and social mobility. Since technical and vocational education beyond the secondary level is within the mandate of the government body INATEC rather than the Ministry of Education, EC assistance for 2011-13 should include intervention in support of this sub-sector. Investment in the infrastructure of vocational centres will only have a sustainable impact if there is a sound technical education policy in place, including trained human resources, curricula, and links with the relevant private and public sector institutions). Since this is not the case in INATEC, the policy and institutional dimension should definitely provide scope for EC intervention in this sub-sector.

This risk of institutional politicalisation will be mitigated by maintaining a continuous and close dialogue with the responsible authorities and coordinating with key stakeholders.

## 2) Economic and Trade issues

**Macroeconomic sustainability** is essential to achieve the MDGs and ensure social cohesion. However, it being currently impossible to provide budgetary support, EC macroeconomic support will be replaced by a more general approach. The intention is to continue contributing to the improvement of Nicaragua's socio-economic conditions and to the strengthening of the business and investment climate in line with the national development plan.

This assistance will continue to be provided in order to help fight poverty and promote sustainable development.

Poverty is predominant in rural areas. Hence, in line with the focus originally given to the general budget support programme (PAPND), particular attention should be paid to supporting those aspects of the national development plan which relate to rural development. In line with the recommendation resulting from the evaluation of the EC's cooperation with Nicaragua during 1998-2008, there will be specific interventions in rural development, including possible support to key infrastructure projects, in line with the Government's sectoral strategy as a key component of its national development plan. Moreover, a multi-actor approach will be adopted. In close collaboration with the members of the rural pool fund, the Commission intends to finance initiatives linked to SMEs aimed at increasing competitiveness, improving food security and boosting export levels. An interesting option is support for renewable energies, particularly the sustainable production of wood fuel for use in SMEs, facilitating reforestation and a positive carbon emissions balance.

Strengthening the **business and investment climate** is another important way of increasing economic growth and reducing poverty. The EC intends to continue work in this area during the period 2011-13. Despite the recurrent problems of low execution, the forthcoming conclusion of an Association Agreement between Central America and the EU will open the door to a wide range of actions: 1) helping to meet regional and international commitments; 2) contributing to the design of environment-friendly industrialisation; 3) exchanges of experience between Nicaraguan and European actors; 4) supporting SMEs; 5) boosting service provision; 6) accepting international norms and standards and supporting customs administrations in order to promote trade facilitation; 7) stepping up compliance with international labour standards.

## 3) Governance and institutional support

Promoting democracy and rule of law remains relevant in the present Nicaraguan context. Despite a worrying trend, it is still possible to facilitate positive reforms by providing cooperation in specific areas. While the overall objective of the CSP regarding governance has not changed, adjustments should be made to the focus of EC intervention in this sensitive area. A balance must be struck between the need to work with institutions which are sufficiently free from partisan influences and the obligation to obtain the Government's agreement in the context of bilateral cooperation. Moreover, for the sake of aid efficiency, EC assistance for governance should be consistent with the work of other major donors in this field or should adopt a programme-based approach, subject to the right political conditions. Under this rationale, EC governance assistance should aim to strengthen institutions which

can counterbalance the concentration of power and to build up citizens' capacity to demand and exercise their rights.

**Local governance** should be a focus of EC support. This would include strengthening not only the capacities of municipal authorities, but also the decentralised antennae of specific government institutions. The focus would be on specific services for vulnerable groups where the national institution is sufficiently independent. Land tenure would be crucial. The most direct way of strengthening the democratic participation of citizens in public affairs is at local level and better access to basic services will immediately benefit the poorest areas. Improving local governance will add an institutional dimension to rural economic development and will lead to better management of natural resources and the environment. Obviously, local governance is not exempt from political sensitivities. The legitimacy of certain municipal authorities after the 2008 elections will need to be carefully managed, as will the role of institutionalised bodies of civil society. Implementation of support to local governance could be based on successful experiences in Nicaragua, such as German cooperation.

Broader **institutional support** would complement this focal point of EC governance assistance. Priority should be given to institutions which play an important role in safeguarding the rule of law or in ensuring the efficient and development-oriented management of public finance. If future political conditions allow, the former could concern the National Police, currently of good repute, which has a well-developed strategic plan and is already supported by a number of Member States. The Ministry of Finance is essential for financial governance, and, again depending on the political situation, EC support might target improvements in the fiscal regime. EC intervention in this area is also intended to strengthen implementation of the various aspects of public finance management reform: revenue collection, procurement, budget execution and auditing. Efforts will continue to focus on the modernising of public institutions and developing the capacity of civil servants. Supporting both these institutions would extend the EC support provided under the first NIP.

There is one general risk to be borne in mind. The growing role of the CPCs, apparently replacing the official institutions as the channels of implementation of key public policies, is a matter of concern. The danger is that the governing party may provide public services selectively in a partisan manner as a way of 'buying' support. To address this risk, donors will monitor closely the provision of public services by the Government. They will also maintain a continuous dialogue with the authorities and provide support for capacity building through technical assistance.

## **5. PRESENTATION OF THE SECOND NATIONAL INDICATIVE PROGRAMME**

### **5.1. Main priorities and goals**

Like the first National Indicative Programme (NIP), the second NIP (NIP 2) for 2011-2013 concerns financial and technical cooperation. It has been drawn up following a series of discussions about the intervention framework for the CSP's three focal sectors, the programme of indicative commitments and a careful assessment of the political, economic and social context of the country.

Consistency with Nicaraguan national policies will be a key element when deciding on support for an action, the aim being to ensure efficiency and sustainability.

### **5.2. Sectors of cooperation**

As indicated above, the focal sectors for intervention will remain: education, governance and institutional support, and economic and trade issues.

EC interventions will be integrated into donor coordination mechanisms in line with the Paris Declaration. Although aid effectiveness is high on Nicaragua's agenda, there is still room for considerable progress in the use of common platforms for commitments, disbursements and monitoring.

Consultation with the different actors shows the need for capacity building, in particular to professionalise an administration which is largely based on political loyalties rather than merit. Therefore, specific capacity building will be provided for all focal sectors and possible cross-cutting issues.

Assistance will also involve devising a better communication system between Government and civil society and between civil society and the donor community.

#### **5.2.1. *Education***

Main priorities and goals: The overall objective is to raise the quantitative and qualitative level of education, particularly vocational education.

Specific objectives and target beneficiaries: The EC will continue to support and co-finance the implementation of the 2001- 2015 National Education Plan, with a special emphasis on primary and secondary schools as well as vocational training, based on an assessment of the private sector's needs. Particular attention will be paid to the educational MDGs and to the quality of teaching and curricula. Activities could take the form of programmatic support and/or projects.

Expected results: The EC contribution will help Nicaragua to achieve the education-related MDGs and the expected results are linked to the implementation of the national education plan. The indicators are clear, and numerous. A few of them, including the completion of

primary school and the illiteracy rate, can be found in annex 11.3 of the CSP. The Government's main commitments are: to implement the policy of expanding access to education; to pursue the reform of secondary education; and to respond to private-sector demand for vocational training.

Sector allocation: Interventions in this sector will amount to 35 % of the total envelope given to Nicaragua.

### **5.2.2. Governance and institutional support**

Main priorities and goals: The overall objective of this area is to strengthen Nicaragua's institutional capacity and governance. Success is dependent on the current political situation and its evolution. Civil society needs to be involved in policy making and implementation.

Specific objectives: (i) to pursue the effective implementation of rule of law, especially in more local areas of the territory (ii) to improve the functioning of institutions which are vital if citizens' rights and the rule of law are to be guaranteed.

Among the options to be considered in a changing governance context, actions in the following areas could be financed: local governance; national police and safeguarding of rule of law; and capacity building for improved governance of key public authorities.

Expected results: A specific set of indicators for governance will be drawn up from the Performance Assessment Matrix agreed with the Government (see Annex 11). A number of relevant indicators for Nicaragua are also set out in Annexes 11.1 and 11.2 of the CSP.

Sector allocation: Good governance and institutional support could account for 17.5 % and 5 % of the National Indicative Programme respectively.

### **5.2.3. Economic and trade issues**

Main priorities and goals: In this sector, the main objectives are to help improve socio-economic conditions in Nicaragua and foster economic growth through the strengthening of the business and investment climate.

**Specific objectives: The EC will support the socio-economic development of the country in line with the National Development Strategy. The situation in terms of social cohesion and poverty, as described in the CSP, remains generally valid, the one notable exception being the new Government's stronger emphasis on social development in its policies since 2007. As stated in the National Human Development Plan of 2008, this focus should be implemented through improved social services and social security, food security, water and sanitation, and energy. The EC will help with the implementation of some of the key socio-economic policy reform programmes. This might also include support to infrastructure projects, which would have a positive impact on the socio-economic conditions of the country.**

As regards the business and investment climate, the country needs to consolidate its policy-planning capacity, cushion any integration shocks and maximise its benefits. Coherence with

international and regional commitments, in particular with the negotiations on the Association Agreement, is fundamental and opens doors to a wide range of actions.

Expected results: The expected results and outcome indicators for socio-economic development will be aligned with those of the national development strategy. Performance in this area will be monitored through the achievement of MDG numbers 1 (Eradicate Extreme Poverty and Hunger), 4 and 5 (Child Health and Maternal Health) and their respective targets. For the business and investment climate, there are several indicators in the various Government papers. Some are set out in Annex 11.4 of the CSP. However, others will need to be developed according to the integration agenda and the requirements linked to the Association Agreement.

Sector allocation: Around 42.5 % of the National Indicative Programme could be allocated to actions in the field of socio- economic development and investment climate.

### **5.3. Integration of cross-cutting themes**

Cross-cutting issues are an important element of discussion and policy dialogue when the Commission, along with other donors, participates in, and is consulted on, national sector and development policies. An analysis of the best way to mainstream cross-cutting issues in the different EC projects/programmes will be carried out when identification or financing documents are drawn up. In addition to mainstreaming, specific ad hoc financing for cross-cutting issues could be provided using thematic lines. As mentioned in the CSP, a number of cross-cutting issues are particularly relevant to Nicaragua and could receive financing outside focal sectors. These include rural development, regional economic integration, environmental sustainability, gender and HIV/AIDS.

The Government is addressing the issue of renewable energy sources, particularly to generate electricity. For example, there is currently a medium-term investment plan to generate electricity through renewable sources, which should be finalised by 2014. Given the relevance of this issue for sustainable development, the EC intends to intensify this dialogue with local authorities and civil society.

Non-state actors have been a significant partner of EC cooperation in Nicaragua for some time. In 2008 the EC financed more than 50 civil society initiatives at local level, essentially through the thematic programmes. Non-state actors are also involved in the implementation of bilateral cooperation programmes. Since the adoption of the CSP, in addition to ad hoc contacts with civil society organisations, they have been formally consulted by the Commission in relation to the drafting of the Mid-Term Review document, the establishment of national priorities for the thematic programmes and the EIDHR. The Commission has also organised three regional workshops aimed specifically at improving coordination among EU-financed NGOs.

The National Assembly has not been a significant partner in EC cooperation. Strengthening this relation will be a challenge, considering that the functioning of the Assembly has recently been reconfirmed in line with the 'Pacto', rather than with democratic principles. Nevertheless, EC cooperation involves the Assembly through two specific channels: i) the conditions for the variable tranches of the budget support programme include activities to strengthen the capacity of, and dialogue between, the National Assembly and the Office of the



Comptroller General; and ii) a specific component of the programme ‘Good governance in Nicaragua’ (for implementation in 2009) is aimed at modernising the National Assembly.

### Summary table of focal/non focal areas and the financial breakdown

Sectors CSP 2007-2013 (Million €)	NIP 1 (M€)	NIP 2 (M€)	TOTAL NIP 1+2
	2007-2010	2011-13	(M€)
<b>Governance (17.5 %) and institutional support (5 %)</b>			
<b>Governance</b>  <i>including Institutional Support</i>	22.7	25.45	48.15
<b>Education (35 %)</b>			
<b>Education</b>	44.8	30.1	74.9
<b>Economic and trade issues (42.5 %)</b>			
<b>Socio-economic development</b>  <b>Investment climate</b>	46.9	44.05	90.95
<b>TOTAL</b>	<b>114.4</b>	<b>99.6</b>	<b>214</b>