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DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D.C. 20523

PROGRAM ASSISTANCE PAPER

Proposal and Recommendations
For the Review of the
Development Loan Committee

NICARAGUA - PROGRAM LOAN

AID-DLC/P-1062

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DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D.C. 20523

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January 31, 1973

MEMORANDUM FOR THE DEVELOPMENT LOAN COMMITTEE

SUBJECT: Nicaragua - Program Loan

Attached for your review are the recommendations for authorization of a loan in an amount not to exceed $15,000,000 to the Government of Nicaragua to help cover an unexpectedly large budget deficit, principally in the investment component, resulting from substantial reductions in revenues and major new spending requirements, both attributable to the earthquake which destroyed most of downtown Managua on December 23, 1972.

A draft of this proposal was discussed at the meeting of the Development Loan Staff Committee on Wednesday, January 31, 1973, and since no substantive issues remained unresolved, no further meeting was deemed necessary and a telephone poll was requested by noon on Friday, February 2, 1973.

Rachel R. Agee
Secretary
Development Loan Committee

Attachments:
Summary and Recommendations
Program Analysis
ANNEXES A and B

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NICARAGUA -- PROGRAM ASSISTANCE

I. SUMMARY AND RECOMMENDATIONS

1. Borrower and Executing Agency: The Government of Nicaragua (GON) will be the Borrower; prime responsibility for the execution of the program will reside in a high-level office to be created by the GON.

2. Amounts and Terms of the Assistance: Up to $15 million as a loan on concessional terms.

3. Purpose: The purpose of the assistance is to help cover an unexpectedly large budget deficit, principally in the investment component, resulting from substantial reductions in revenues and major new spending requirements, both attributable to the earthquake which destroyed most of downtown Managua on December 23, 1972.

4. Background: The earthquake occurred at a time when the Nicaraguan economy was in a dynamic phase, notwithstanding the drought. Significantly improved export performance, coupled with fiscal and monetary restraint, led to a substantial accumulation of reserves in 1972. The drought has caused some losses in agricultural production, including production for export, but it comes at a time of high basic commodity prices which will cushion the production losses.

While far from the most intense in recent world history, the earthquake has had a uniquely destructive effect in taking out the country's commercial and governmental core. Not only has this vastly multiplied the cost of the quake; it has also severely complicated--and will prolong--recovery. But Nicaragua's agricultural, industrial and physical infrastructure bases are largely intact, and the human entrepreneurial instinct is an already widely apparent engine of recovery. Nonetheless, it will be several years, probably 5 or more, before the recovery is complete, and the first year is sure to be the hardest. The rebuilding process in the private sector and the autonomous institutions will inevitably be gradual. The problems of the central government are enormous as a result of the disruption of public administration, substantial revenue losses which are anticipated in 1973, and the extraordinary new expenditure requirements attributable to the quake. On the other hand, balance of payments prospects are good because of the economic dynamism of the last year or two, and Nicaragua can finance a significant part of its own recovery.

While other institutions are moving with unprecedented rapidity and generosity to help Nicaragua, their resources will not start flowing for a few months and will be largely tied to specific projects. Thus, AID program assistance, particularly if it is made available promptly, can make a unique contribution to the acceleration of the recovery process by providing budgetary resources to meet the most urgent needs. In addition to the speed with which we can act and the flexibility of the funds we [redacted]ailable, we have the special advantage of having a fu[redacted]on on the spot able to adjust the program to [redacted] of experience in what inevitably will be a [redacted]t, one in which the ability to seize o[redacted] present themselves can pay major divi[redacted]

5. Views of the [redacted] The Country Team considers the proposed assist[redacted]t priority because of its anticipated contribu[redacted]aragua's economic recovery.

6. Statutory Criter[redacted]statutory criteria have been met (see Annex A).

7. Recommendations: On the basis of the conclusions of the Capital Assistance Committee that the program described herein is technically, economically, and financially justified, it is recommended that a loan not to exceed $15 million be authorized to the Government of Nicaragua. The Loan will be subject to the following terms and conditions:

(a) The Borrower shall repay the loan to AID in U.S. dollars within 40 years from the date of first disbursement under the loan including a grace period not to exceed 10 years. The Borrower shall pay interest at the rate of 2 percent per annum during the grace period and 3 percent thereafter.

(b) Prior to the release of any resources under the loan, the Borrower must provide AID with:

(i) an acceptable opinion of counsel concerning the validity of the loan agreement, and

(ii) a statement of authorized GON representatives for purposes of the loan and their specimen signatures.

(iii) evidence satisfactory to AID of the formation, staffing, and assignment of authority to an implementational body to coordinate and control GON implementation of this program and the activities to be carried out hereunder.

(c) Prior to each individual disbursement, Borrower must provide in form and substance satisfactory to AID a request for funds (LCFDR) accompanied by the following: (i) evidence that the funds requested have actually been expended and not previously reimbursed; (ii) evidence that said expenditures have been made pursuant to plans approved by the implementational body and fall within the purview of this program.

The Loan will be subject to such other terms and conditions as AID may deem advisable.

CAPITAL ASSISTANCE COMMITTEE:

Chairman	:	Lawrence Harrison, LA/DP
Engineer	:	Merten M. Vogel, LA/DR
Loan Officer	:	Paul Wenger, LA/DR
Economist	:	Clark Joel, ROCAP
Attorney	:	Bruce Gair, LA/GC
Secretary	:	Robert Ward, LA/DP

USAID/Embassy Managua:

Allan Goldstein, Program
John Sanbrailo, Capital Development
Carl Forsberg, Engineer
Carl Koone, Agriculture
Thomas O'Donnell, Embassy Economist

II. THE NATIONAL ECONOMY BEFORE THE EARTHQUAKE

A. Growth -- (See Tables II-1 and II-2)

Since 1965, the expansion of the economy has been sufficient to permit a steady growth of per capita income, which rose from $345 in 1965 to about $400 in 1972. GDP increased at an average annual rate of 4.2 percent during the period 1965-1969 and by an average of slightly more than 5 percent during the 1969-1971 period. This has permitted a per capita growth rate ranging from 1-2.5 percent per annum; population has been increasing at an annual rate of 2.8 - 3.0 percent.

This level of growth resulted from a strong expansion of the secondary sector, particularly industry, rather than growth in the primary and service sectors.

The industrial sector grew at an average rate of 8.3 percent during the 1965-1969 period; 12.5 percent from 1969 to 1970 and 7.4 percent from 1970-1971. The respective growth rates for the primary sector were 1.2 percent; 3.7 percent and 5.1 percent. The agricultural crops sector actually declined during the 1965-1970 period, primarily as a result of the depression of the cotton economy. The growth of the industrial sector can be traced to the development of the CACM, leading to the development of new export as well as import substitution industries.

By 1971, the secondary sector had grown to 25.2 percent of GDP from less than 20 percent in 1965, while the primary activities declined from 28.2 percent to 24.4 percent and agricultural crops from 21.3 percent to 15.7 percent.

The tertiary sector -- commerce, government, electric energy, potable water, etc., -- grew at the same rate as GDP and comprised 50 percent of GDP throughout this period.

GDP by expenditure retained a relatively rigid structure. Consumption generally comprised about 80-83 percent of GDP, of which about 90 percent was private consumption. Investment was generally at about 20 percent of GDP, trending slightly downward from 21.3 percent in 1965 to 19.1 percent in 1971. The overwhelming proportion of this came from the private sector. Exports and imports comprised a large share of GDP, with the former about 30 percent of GDP and the latter almost one-third. The extent of Nicaragua's reliance on external markets and financial resources becomes even more apparent in the discussion below on balance of payments, debt outstanding, and the external loan portfolio.

Table II-1

Nicaragua: Gross Domestic Product
(Constant 1958 Prices)

	1968	1969	1970	1971	Rate of Growth 1969/68	1970/69	1971/70
1. Gross Domestic Product	4,444.9	4,640.6	4,870.7	5,150.3	4.4	5.0	5.3
a) Primary Activities	1,169.0	1,161.9	1,193.7	1,254.0	- 0.6	2.7	5.0
1) Agriculture	826.8	774.8	772.5	808.5	- 6.7	- 0.3	4.7
2) Livestock	296.9	337.1	370.7	393.0	13.5	9.9	6.0
3) Forestry	20.5	21.6	23.8	26.7	5.4	10.2	12.2
4) Fishing	24.8	28.4	26.7	25.8	14.5	- 6.4	- 3.5
b) Secondary Activities	1,033.8	1,123.8	1,227.0	1,297.4	8.7	9.2	5.7
1) Manufacturing	825.6	900.0	1,012.9	1,087.9	9.0	12.5	7.4
2) Construction	144.6	162.9	160.4	164.6	12.7	- 1.5	2.6
3) Mining	63.6	60.9	53.7	44.9	4.3	-13.4	-19.6
c) Tertiary Activities	2,242.1	2,354.9	2,450.0	2,598.9	5.0	4.0	6.1
1) Commerce	940.0	993.6	1,025.7	1,101.9	5.7	3.2	7.4
2) Government	257.0	278.5	290.3	293.7	8.4	4.2	1.2
3) Transportation & Comm.	238.9	252.6	280.1	5.7	3.2	3.2	7.4
4) Banking	119.1	112.5	125.4	139.4	-5.9	11.5	11.2
5) Electric Power & Potable Water	84.1	91.2	100.0	107.8	8.4	9.6	7.8
6) Housing	298.0	306.7	317.5	326.7	2.9	3.5	2.9
7) Other	305.0	319.8	330.4	349.3	4.8	3.3	5.7

Source: Central Bank

Table II-2

Nicaragua: Gross Domestic Product
(Constant 1958 Prices)

	Structure						
	1965	1966	1967	1968	1969	1970	1971
1. Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0
a) Primary Activities	32.7	29.4	29.1	26.3	25.0	24.5	24.3
1) Agriculture	26.8	22.5	22.0	18.6	16.7	15.8	15.7
2) Livestock	5.2	6.0	6.2	6.7	7.3	7.6	7.6
3) Forestry	0.4	0.4	0.4	0.5	.5	.5	.5
4) Fishing	0.3	0.5	0.5	0.6	.6	.6	.5
b) Secondary Activities	17.4	19.5	18.8	23.3	24.2	25.2	25.2
1) Manufacturing	12.8	14.0	14.2	18.6	19.4	20.8	21.1
2) Construction	3.2	4.0	3.3	3.3	3.5	3.3	3.2
3) Mining	1.4	1.5	1.3	1.4	1.3	1.0	.9
c) Tertiary Activities	49.9	51.1	52.1	30.4	50.7	50.3	50.5
1) Commerce	19.9	19.9	19.8	21.1	21.4	21.0	21.4
2) Government	7.2	7.9	8.9	5.8	6.0	6.0	5.7
3) Transportation & Comm.	5.1	5.1	5.0	5.4	5.4	5.4	5.4
4) Banking	2.1	2.4	2.5	2.7	2.4	2.6	2.7
5) Electric Power & Potable Water	1.8	2.0	2.3	1.9	2.0	2.0	2.1
6) Housing	7.0	7.0	6.9	6.7	6.6	6.5	6.3
7) Other	6.8	6.8	6.9	6.8	6.7	6.8	6.8

II. THE NATIONAL ECONOMY BEFORE THE EARTHQUAKE

B. Trade and the Balance of Payments -- (See Tables II-3 and II-4)

Nicaragua's trade situation began to deteriorate after 1965, reflecting the deterioration of the cotton economy. Nicaragua's trade surplus of $16.4 million in 1965 fell to minus $25.0 million in 1967 and remained in deficit through 1971.[a] This trade decline resulted from a $25 million fall in cotton exports and an $8 million fall in cottonseed oil. Manufacturing exports more than doubled during this period, due to an increase mainly in chemical products and meat exports, but this increase was not sufficient to bring Nicaragua up to pre-1966 levels. At the same time, imports rose sharply, especially crude petroleum, machinery and equipment, and iron and steel manufacture. After increasing sharply from 1965-1967 (by $40 million), imports peaked out until 1971 and 1972 when increases of almost 10% per year were registered. From 1965-1971, exports rose by $38.3 million while imports increased by $66.5 million. Since Nicaragua's service deficit ranged from $35-40 million per year over this period, the current account deficit remained large.

This deficit was compensated for by foreign official borrowing mainly and to a lesser extent by private borrowing. In 1965, net foreign borrowing was $12.1 million but rose to $17.4 million in 1971. During the same period, official net foreign borrowing rose from $7.0 million to $32.9 million. Gross official borrowing rose even more, but so did amortizations. The former increased from $12.3 million in 1965 to $60.9 million in 1971; the latter rose from $4.9 million to $27.2 million. By 1971, amortization absorbed more than 40% of foreign official gross borrowing.

As a result of these heavy capital inflows, reserves did increase in several years. Nevertheless, due to the sharp decline after 1967, total gross reserves of the banking system reached 1965 levels only by 1971. However, as short-term obligations of the banking system rose, net reserves amounted to only $20.4 million in 1971 compared to $28.1 million in 1965. This was equal to slightly more than one month's imports.

The situation in 1972 changed dramatically, as the cotton economy boomed once again while exports of coffee, meat, shrimp, etc. also increased. As a result, there was a trade surplus of $37.9 million and a current account deficit of only $8.9 million. As the net official inflow rose to $36.3 million and other inflows remained relatively steady, reserves rose by $37.4 million. Amortization continued to increase and amounted to 40 percent of gross official borrowing. Total gross reserves of the banking system rose to about $80 million and net reserves to about $67 million.

a/ In 1970, there was a trade surplus of $0.1 million.

Table II-3

Nicaragua: Balance of Payments
(Millions of Dollars)

	1965	1968	1969	1970	1971
A. Goods, Services & Grants					
Exports, FOB 1/	149.2	161.0	157.5	177.8	186.3
Imports, FOB	132.8	165.2	-158.4	-177.7	-189.3
Trade Balance (net)	16.4	- 4.2	- 0.9	0.1	- 3.0
Services (net)	- 44.9	- 44.0	- 41.3	- 44.4	- 45.5
Grants (net)	6.5	6.3	6.5	6.0	6.5
Total	- 22.0	- 41.9	- 35.7	- 38.3	- 42.0
B. Priv. Capital Movement					
Direct Investment	8.2	16.4	12.0	15.0	12.0
Loan Withdrawals	1.8	2.1	2.4	3.4	2.2
Amortizations	- 0.8	- 1.6	- 1.8	- 2.4	- 1.8
Comm. Credits & Others	2.9	- 6.4	2.7	4.3	5.0
Total	12.1	10.5	15.3	20.3	17.4
C. Official Capital					
Loan Withdrawals 2/	12.3	49.3	29.8	47.7	60.9
Amortizations	- 4.9	- 10.3	- 12.9	- 18.4	- 27.2
Other	- 0.4	- 1.8	- 1.4	- 2.0	- 0.8
Total	7.0	37.2	15.5	27.3	32.9
D. SDR's	-	-	-	3.2	2.9
E. Errors & Omissions	3.6	- 3.7	- 1.6	- 0.1	2.1
F. Total Bal. (A+B+C+D) +E	0.7	5.5	- 6.5	12.5	13.3
G. Net Monetary Movement					
Net Position with IMF	0.4	19.0	- 1.0	- 5.2	3.0
Central Bank	- 17.8	- 20.7	6.2	- 3.8	- 6.8
Comm. Banks 3/	17.1	- 3.6	1.8	- 3.3	- 7.5
C. A. Clearings	0.4	- 0.2	- 0.5	- 0.2	- 2.0
Total	0.7	- 5.5	6.5	- 12.5	- 13.3

1/ Figures adjusted for Bal. of Payments purposes. Includes non-monetary gold.
2/ Includes long-term Banking System.
3/ Includes short-term loans. In G, above, sign (-) indicates increase of reserves; no signs means a decrease.

SOURCE: Central Bank.

Table II-4

Nicaragua: Exports by Products
(Thousands of Dollars)

	1965	1968	1969	1970	1971
Traditional Products	127,915	113,778	98,393	98,382	107,536
Sesame	2,144	2,906	2,545	2,243	1,954
Cotton	66,132	59,675	45,425	34,247	41,320
Cotton Seed	8,688	3,344	1,038	1,234	.793
Sugar	5,518	5,458	8,300	9,832	11,630
Coffee	26,354	22,683	20,563	32,086	29,251
Copper	6,100	5,592	5,077	4,192	2,488
Beans	362	949	844	1,294	2,463
Cattle	300	76	188	27	78
Ipeca	294	553	560	470	311
Gold	5,406	5,024	4,105	3,835	3,845
Silver	189	377	265	175	205
Cotton Seed Cakes	801	3,013	3,442	2,495	3,518
Other Traditional	5,617	4,128	6,021	6,342	9,720
Non-Traditional Products	18,628	47,324	59,126	77,960	79,706
Rice, milled	39	245	611	1,535	1,595
Bananas	786	3,133	2,180	256	3
Beef	6,679	15,882	20,836	26,579	28,672
Shrimps & Lobsters	2,133	5,140	6,750	5,936	5,797
Leathers, Skins & Mfrs.	384	1,018	1,525	1,910	1,036
Plywood	292	628	923	1,268	1,379
Chemical Products	2,049	4,395	6,914	9,527	11,031
Textile Products	296	1,571	1,762	4,444	4,778
Resins	-	-	-	2,450	2,221
Tobacco	49	815	1,508	1,892	2,331
Other Non-Traditional	5,863	14,497	16,118	22,163	20,863
Other	2,403	1,199	1,229	2,281	-
Total	148,946	162,301	158,748	178,623	187,242

SOURCE: Central Bank

II. THE NATIONAL ECONOMY BEFORE THE EARTHQUAKE

B. Trade and the Balance of Payments -- (continued)

Nicaragua's foreign debt outstanding has grown from $72.2 million in 1966 to $213.6 million in 1971, a three-fold increase. Seventy percent of this debt is held by autonomous agencies with almost all of the remainder held by the Central Government. The International Financial Institutions hold $102.7 million of this debt, or almost 50 percent, while the U.S. agencies (AID, DLF, and Ex-Im Bank) hold $55.0 million or 26 percent. Private U.S. banks hold $41.1 million (20 percent). The remainder is held by foreign commercial banks and suppliers. The unutilized pipeline, foreign and private, amounts to about $100 million in 1972. The debt service ratio (i.e., debt service as a proportion of exports), which was only 6 percent five years ago, had risen to about 18 percent in 1971 but apparently dropped somewhat in 1972.

C. Fiscal and Monetary -- (See Tables II-5 and II-6)

Government current revenue has increased less rapidly than GNP since 1965. In 1968, revenues fell in absolute amounts from ¢483.1 million to ¢461.1 million. This decline, coupled with a continuing upward trend in Government expenditures, led to a sharp decline in Government savings. This, however, was only the continuation of a downward trend that began in 1966; prior to that period the surplus on current account had been rising. In May 1970, the Government introduced a 5 percent sales tax which was a major factor in increasing revenues. In addition, property taxes began to increase as a result of cadastral efforts, and an IMF standby, which established tax targets, spurred the Government to collect taxes more efficiently than in the past.

The growth in revenue did not result in a significant modification of the composition of revenue. On the average the rate of growth of Government tax revenue was less than that of GDP. Direct taxes were 19.5 percent of total revenue in 1965 but rose to only 22 percent in 1972. Income taxes remained at about the same level -- 12 percent.

The Government's investment budget, which declined in 1968, increased in 1969 and 1970 and then rose sharply in 1971, to a high of ¢278.7 million, excluding amortization but including transfers.

Total domestic credit is reflected in the level of imports, as Nicaragua is an import oriented, high-propensity-to-consume country. In 1967, credit increased by 19.7 percent and imports rose by 30 percent. Since 1967, credit expansion has been restricted: in 1968, it grew

II. THE NATIONAL ECONOMY BEFORE THE EARTHQUAKE

C. Fiscal and Monetary -- (continued)

by 6.3 percent; in 1969, by 8.6 percent; in 1970, by 5.2 percent; and in 1971, by about 10 percent. The slower rate of growth in credit since 1967 permitted growth in imports and GDP without leading to any inflationary pressures. (The GDP implicit price index indicates that prices have risen on average by about 2 percent per year.)

The net foreign asset position deteriorated severely from 1965 to 1971 but recovered impressively during the past year. Private savings generally have increased, but there was a phenomenal jump from 1971 to 1972: ₡387 million to ₡540 million. This can be attributed to several factors: (1) an increase in interest rates; (2) increases in exports; and (3) uncertainties in the Common Market. This latter has resulted in potential investors placing their funds in savings accounts rather than in liquid accounts or investments. There is no evidence that there was any move to transfer funds to U.S. bank accounts.

D. The Drought

1972 was a good year as measured by some of the major economic indicators. The drought of May - August, 1972, did not have an immediate impact on employment, production of major agricultural crops and foreign exchange earnings. Some of these factors, plus others such as tax collections, would not have been felt until 1973. Thus, the economy faced some problems when the earthquake struck.

The drought hit the Pacific zone mostly, but also parts of the central and north zone. In these areas live 90 percent of the agricultural population and 60 percent of the total. The Pacific coast is a major basic grains producing area but also produces cotton and coffee. The basic grains were sufficiently affected that a food deficit was projected, as corns, beans, and sorghum fell substantially below originally anticipated production levels. Rice production also declined, but stocks were sufficient to meet domestic demand. Cotton fell well below estimated production levels as did coffee.

The number of people affected by the drought may total as many as 300,000, or 50,000 heads of families -- those for whom the harvest of basic grains and cotton, and auxilliary services, represent a major portion of cash income. The Government also estimated a substantial foreign exchange loss. The impact on foreign reserves and exports would have been felt principally in 1973. The drought's major adverse impact was on employment and production. The Government had requested food assistance from AID and the WFP and had developed a small works program to insure employment for those affected by the drought. This request was being reviewed at the time of the quake.

Table II-5

Nicaragua: Central Government Operations
(Millions of Cordobas)

	1965	1966	1967	1968	1969	1970	1971
Ordinary Revenues	446.4	479.8	483.1	467.1	488.1	571.4	632.9
Current Expenditures	308.0	355.8	413.5	424.7	445.5	480.2	508.8
Surplus on Current Account	138.4	124.0	69.6	42.4	42.6	91.2	124.1
Investment	123.5	164.2	169.7	101.2	123.9	164.5	278.7
Total Expenditures	431.5	520.0	583.2	525.9	569.4	644.7	787.5
Deficit/Surplus	+14.9	40.2	100.1	58.8	81.3	73.3	154.6
Foreign Borrowing (net)	8.3	37.0	54.6	37.4	28.7	62.0	91.0
Domestic Borrowing (net)	1.5	- 4.0	13.0	8.6	12.5	18.5	13.6
Other	5.1	11.2	32.5	12.2	40.1	+ 7.2	50.0
Amortization (memo item)	17.2	22.9	23.9	29.2	30.0	31.6	42.6

Table II-6

Nicaragua: Government Income & Revenues, 1965-1971
(Millions of Cordobas)

	1965	1966	1967	1968	1969	1970	1971
A. DIRECT TAXATION							
Income Tax	53.2	61.3	69.5	52.3	50.1	55.1	63.0
Personal Property	10.9	11.7	12.5	13.0	12.8	14.4	16.2
Real Estate	16.0	18.9	19.6	25.6	23.4	30.8	31.5
Real Estate Transfer	1.8	2.3	[illegible].6	2.8	3.2	4.1	3.9
Capital	0.6	0.2	0.1	-	-	-	-
Inheritance	1.2	1.5	2.0	2.1	1.4	2.0	2.3
Vehicle Registration	3.1	3.4	4.3	3.8	4.5	4.2	5.0
Sub-Total	86.4	99.3	110.6	99.6	95.4	110.7	121.9
B. INDIRECT TAXES							
Import Duties (Cons. fees)	169.2	157.9	152.5	150.1	135.9	160.9	155.3
Export Duties	7.6	9.8	10.3	7.6	7.3	7.7	--
Consumer & Excise Taxes	140.7	154.7	160.8	167.4	201.3	228.8	267.8
Fiscal Monopolies (gross)	6.7	7.3	7.5	7.9	8.0	8.7	9.0
Other Revenues (post, tel, telephone, other misc.)	32.3	34.1	31.5	35.7	41.3	47.8	42.7
Sub-Total	356.6	363.8	362.7	368.7	393.8	453.8	483.0
TOTAL ORDINARY REVENUE	443.0	463.1	473.3	468.3	489.2	564.5	604.9

SOURCE: Central Bank for 1968-1972; previous years from Government Accounting Office; adjusted by USAID/N.

III. EFFECTS OF THE EARTHQUAKE

The earthquake which struck Managua on December 23 is unique in many respects. To our knowledge, it is the first national capital seriously damaged by a natural catastrophy since Tokyo in 1923. Of a total urban area of some 33 square kilometers, official estimates indicate 13 were completely destroyed and 14 were damaged 25 percent or more. Only 6 square kilometers escaped significant damage. The area of near-total loss included the city center, the heart of the country's government, commerce, and finance. Significantly, there was relatively little damage (less than 15 percent total loss) to industry concentrated on the city's main access routes. Agriculture and agricultural products, which accounted for more than 70 percent of the nation's exports in 1972, were virtually unaffected by the quake, although they are still suffering from a severe drought.

A working group of the National Committee of Economic Reconstruction (CNRE), which consists of representatives of the GON, the private sector, and the Central American Institute of Business Administration (INCAE), made a preliminary estimate, dated January 5, which placed the total damage at $850 million, an amount almost identical to the nation's GNP in 1971. We now believe this figure to be high, and have revised it to about $550 million by reconciling internal inconsistencies and employing more realistic quantities and unit prices in some cases. The revised estimate is summarized in Table III-1. It must still be regarded as an approximation in all parts, and contains unchanged the CNRE item of Accounts Receivable, which is, of course, subject to question. Figures appearing in the following discussion are drawn mainly from this estimate.

The number of dead is put between 4,000 and 7,000; the number of injured at 20,000; the number of homeless between 220,000 and 250,000. The precise human toll will never be known.

CNRE estimates that 70,000 housing units were standing in the city of Managua the evening of the earthquake, with an average occupancy of 6 persons. The following morning 42,000 of these had been destroyed totally and 6,000 partially; and roughly 250,000 persons were homeless. The gross replacement cost is estimated at $214 million, including furnishings. The bulk of the housing lost was lower and lower-middle class.

Housing was the hardest hit because it was concentrated in the city center. Small factories, workshops, and service activities were also in that area, and an estimated 95 percent were destroyed. Four hospitals with a total of 1,650 beds were destroyed. An estimated 400,000 square meters of commercial buildings and warehouses were lost. Seven hundred and forty classrooms -- about 65 percent of the total in Managua -- were destroyed, and employment for some 50,000 persons disappeared at least temporarily.

TABLE III-1

Estimate of Damages
($ Millions)

	Buildings	Equipment & Furnishings	Inventories	*Non-Recoverable Emergency Expenditures	Losses on Accounts & Others	Totals
Government	15.0	9.0	1.0	30.5	30.0	85.5
Industry	2.0	10.0	2.9	2.6	17.1	34.6
Commerce	40.0	8.0	31.5	3.0	21.3	103.8
Housing	182.0	30.0	2.1	--	--	214.1
Services	19.0	7.5	4.5	4.4	--	35.4
Infrastructure	58.4	11.6	0.8	5.8	3.3	79.9
Totals	316.4	76.1	42.8	46.3	72.7	553.3

* Includes emergency expenditures for food, medicines, temporary construction, salaries, etc. due to earthquake.

The earthquake was followed by six days of fire which progressively swept through the still standing buildings in the city core. During this period the city was evacuated and the population dropped from a pre-quake 410,000 to a low of about 100,000. Some vital records were fortunately salvaged; the headquarters of the commercial and state banks were among the initial survivors, and their records and cash deposits were rescued virtually intact, preserving the financial system of the country. Government offices were not so lucky, and many critical archives and tax records were lost.

The city's infrastructure suffered a crippling blow. Preliminary evaluation places the replacement cost at $80 million. Major components of this estimate are $22 million for hospitals; $4.5 million for schools; $30 million for streets; $5 million for urban services (the estimated cost of restoring urban services to 600 blocks in the city center); and a total of over $8 million to repair damage to the electrical and communication systems. This latter figure includes an estimated $3.3 million in accounts receivable losses.

The earthquake hit the last shopping day before Christmas, and the commercial sector suffered losses estimated at $105 million in buildings, equipment, inventories, accounts receivable and other costs. Over 60 percent of the commerce of the country was concentrated in Managua and provided employment for about 20,000 persons. The overwhelming majority of this activity was located in the city center. In the chaos of the immediate aftermath of the quake, an estimated 90 percent of this capacity was paralyzed. However, with each passing day more individual businessmen and professionals are digging out of the ruins, reorganizing businesses and operating on a make-shift basis from homes, warehouses, and, in some cases, newly constructed temporary quarters.

The preliminary estimate of the losses of the government sector is $85 million. The major components of this figure are the unbudgeted emergency costs and a substantial loss in anticipated revenues. The revenue loss is principally in taxes on real estate, commercial transactions, income, and production. In other words, the most serious damage to the government was the temporary loss of a considerable portion of its tax base.

As the city and nation sort themselves out after the quake, it is clear that the production capacity of the country is largely intact. Serious damage was confined to Managua, and the rest of the country is physically unscathed. An estimated 80 percent of the nation's industry was located in or near Managua, but in one of the anomalies of the situation, only 10 percent of this was seriously damaged. As noted earlier, agriculture and agricultural products are unaffected. The construction industry, even in Managua, was largely spared. Although we have no figures, the transportation industry appears to have survived with little loss, and the streets and highways surrounding Managua are choked with trucks, busses, taxis and private cars.

One month after the earthquake there are widespread signs of reconstruction and a struggle to return to normalcy: essential services such as water and power have been restored to all inhabited areas of Managua, and the utility companies have reverted to routine operations; telephones are working in roughly 80 percent of the present city; supermarkets, stores and businesses in outlying areas are reopening; home delivery of dairy products, bottled gas, and coca-cola has been re-established; restaurants, snack bars and drive-ins are open and crowded for mid-day meals; and garbage is picked-up daily. It is only when one enters the 589-block fenced-off area that was the center of Managua that a sense of disaster returns.

IV MACROECONOMIC ANALYSIS

A. The Analytical Approach

Two independent approaches have been adopted to ascertain the magnitude of the need for additional emergency assistance as well as the kind of assistance that would be most appropriate. The first approach is a macroeconomic resource gap analysis involving the projection of resource requirements and availabilities in order to arrive at the net deficiency that would require additional emergency assistance. The second approach involves the preparation of a list of high priority emergency activities, described in a subsequent section. To facilitate understanding of the gap analysis and the inter-relationship of its various parts, we shall outline briefly the methodology used.

The objective of the gap analysis is to determine, first, the magnitude of the internal disequilibrium as measured by the deficit in the budget of the public sector (central government and autonomous institutions) and by the net credit requirements of the private sector. These requirements, together with the drop in GDP resulting from the earthquake, are then taken into account in estimating the external disequilibrium reflected in the balance of payments projection. The main steps in the methodology are as follows:

Step One: Determine the impact of the earthquake damage on the net credit requirements of the public sector, including both the central government and the autonomous institutions. The Ministry of Finance provided us with a detailed breakdown of government revenues affected by the reduction in the tax base. We were also provided with a detailed analysis of increased government expenditures resulting from emergency relief operations, clearing the rubble, repair and reconstruction of buildings and essential utilities, etc. Only damage that could be repaired during 1973 and that was considered essential for the resumption of normal operations was included here. The fiscal analysis yieldod the deficit in the government's total budget (current and capital, for central government and autonomous institutions) that requires credit financing.

Step Two: Estimate the impact of the earthquake on the credit requirements of the private sector, taking into account inventory replacement, replenishment of working capital, the need to substitute new credit for frozen accounts receivable and reconstruction. In estimating reconstruction requirements, we again considered only damages that could be repaired in 1973, given the capacity of the construction industry.

Step Three: Summation of credit requirements for both public and private sectors to arrive at the aggregate monetary injection required in 1973.

Step Four: Project the 1973 GDP by sector of origin and aggregate expenditure. The GDP projections, along with the projection of aggregate credit requirements, was undertaken in order to provide a basis for projecting import requirements in 1973.

Step Five: Project import requirements, taking account of (a) the sharp increase in credit requirements of both public and private sectors determined under Steps One and Two above; (b) the need to replace inventories and capital goods. The above factors will significantly boost import requirements. On the other hand, some dampening of import demand will result from a reduction in imports of non-essential consumer goods (e.g., automobiles) related to reduced GDP (estimated under Step Four); and by reduced importation of raw materials and intermediate goods induced by destruction or damage to warehouse facilities, plants, etc. On balance, however, imports are expected to increase substantially in 1973. Our first thought was to use GDP and credit requirements to obtain imports through multiple correlation. However, it was felt that the structural changes in the economy caused by the earthquake were so profound that this procedure was not likely to yield valid results. We therefore asked the Central Bank to project the major component categories of imports (i.e. durable and non-durable consumer goods, capital goods, and intermediate goods). We are satisfied that the Central Bank went to considerable pains to estimate these breakdowns, taking account of all known capital replacement requirements of the government, the autonomous institutions, and the private sector. Thus, while the internal disequilibrium affected judgements with respect to the estimation of import requirements, it did not yield such requirements in a mechanical way. Admittedly, the relation that we have established between the internal and external disequilibrium is still crude and requires considerable refinement.

Step Six: Project exports (with breakdown by major commodity or commodity group), services and unilateral transfer payments.

Step Seven: Project capital inflows on both private and government account. Insurance payments from abroad to earthquake victims were included in the private capital inflow. The official inflow was divided between "normal" capital inflows (unrelated to the quake) which were assumed to continue as previously scheduled; and additional IDB and IBRD loans related to the earthquake. However, AID-financed emergency assistance was excluded.

Step Eight: Determine the gap, if any, between total imports of goods and services on the one hand, and total exports plus net capital inflows as defined above.

Step Nine: Balance of payments projection for 1974-1975. While time limitations did not permit the development of a projection of public and private sector credit requirements for 1974 and 1975, the Central Bank undertook a detailed balance of payments projection for these years to determine whether an unfilled resource gap could be anticipated.

B. Fiscal Analysis and Projections

In reviewing the post-earthquake 1973 budget, a number of assumptions and uncertainties must be registered, as follows: (1) original budget estimates have been higher than actual collections (in 1972, the difference was 5.5 percent); (2) the level of taxes will depend importantly on the degree of resumption of economic activity which in turn will be affected, in part, by the level, type, and rapidity of external financial assistance; (3) the administrative capacity of the Government to collect taxes and (4) the extent of tax evasion. As the commercial sector has been a major source of taxes, the rate at which it will recover will determine the extent to which taxes can be recuperated. The type of commercial demand and its composition will also affect the level of taxes.

The Government has introduced two new taxes: (1) a 10 percent tax on agricultural exports, including cotton, coffee and meat, and (2) a one month salary tax on employees of the Government and autonomous agencies. The Government is not considering any new taxes at this time, but is thinking of restructuring the tax system in 1974, as tax collections generally have been inelastic. This is an appropriate and desirable policy decision.

1. Government Revenues -- (Table IV B-1)

a. Direct Taxes -- In 1971 and 1972, direct taxes rose 9.8 percent and 19.4 percent respectively. This increase occurred mainly in the income and property tax categories. The Government had estimated a pre-quake increase in 1973 of 12.4 percent.

The post-quake estimate is C$6.6 million or 69.2 percent of the 1972 budget and 61.5 percent of the pre-quake 1973 budget. The estimate is based on the fact that income taxes came primarily from commercial establishments located in Managua, now almost totally destroyed, and that property taxes also came mainly from Managua and in large measure from the destroyed area. These factors are compensated by the one month salary tax on government employees. The new level of taxes collected from this sector is based on the assumption that commercial activity will be slow in recovering. We believe that economic activity may recover faster than anticipated, and in fact is already recovering on the outskirts of the city. There will in any event be problems with the administrative capacity of the Government to collect taxes, the public's willingness to pay, and its skill at evasion.

b. Production and Consumption Taxes -- These taxes have been the single largest component of the tax structure during the past few years and include a multitude of indirect taxes of commodities, including alcohol,

Table IV B-1

CURRENT REVENUES OF CENTRAL GOVERNMENT
(In millions of current cordobas)

	1971	1972	1973 Projection w/o Earthquake	1973 Projection w/ Earthquake
Current Revenues				
Total	615.5	634.0	709.8	584.9
Tax Revenues, Total				
Direct Taxes	122.1	139.7	157.2	96.6
Income Taxes	63.2	69.9	77.5	31.5
Property Taxes	58.9	69.8	79.7	32.2
Salary Contribution (1)	--	--	--	32.9
Indirect Taxes (Foreign)	175.4	176.6	190.7	252.6
Import Duties (2)	170.3	173.6	187.5	142.2
Export Duties (1)	5.1	3.0	3.2	110.4
Internal Indirect Taxes	257.8	283.8	306.4	209.7
Taxes on Beer & Liquor	47.4	49.2	53.1	33.9
Tobacco	39.8	42.8	45.2	34.2
Oil	46.5	51.3	54.7	56.5
Sales Tax 2%	5.1	5.6	5.9	2.8
Compensatory Tax	7.6	8.7	9.5	4.4
5% General Sales Tax	57.8	63.8	70.1	28.7
Other	53.6		208.1	49.2
Non Tax Revenues	[illegible]0.2	33.9	55.4	26.0

(1) Decree No. 83 of 6 January 1973.
(2) For an import level estimated at $266.9 million.

beer, tobacco, sugar and petroleum. They also include the general 5 percent sales tax, the single largest item.

In 1971, tax collections rose by 18.9 percent to a peak of ¢282.6 million, due mainly to the 5 percent sales tax. In 1972, consumption taxes fell to ¢279.8 million, a decline of 1 percent. This decline was primarily due to a decline in 5 percent sales tax collections, which fell from ¢71.8 million to ¢63.8 million. 1/ The pre-quake estimate of ¢291.6 million is a 4.3 percent increase over the 1972 level.

The post-quake estimate is ¢209.7 million. This level is 73.9 percent of the 1972 level and 68.4 percent of the pre-quake 1973 level. This estimate is based on the assumption that private commercial activities, sales, and private consumption will recover slowly during the year. We believe that these activities may increase at a faster rate than anticipated, due in part to the larger inflow of external financial resources anticipated during the year. Inventory replacement will be a major factor in determining whether renewed consumer demands can be accommodated.

c. Foreign Trade Taxes -- The level of these duties is calculated on the basis of the level of imports estimated for 1973 (see Balance of Payments table) plus the new 10 percent export tax. Import taxes are projected to decline substantially (by ¢45.3 million) over the original 1973 level owing to the expected decline in the importation of durable consumer goods, but the 10 percent export tax will more than offset this loss. Thus, duties on foreign trade are the only component of the tax system that is expected to increase, due to the new export tax and the high level of import requirements which will prevent a major decline in general import duties.

Thus as a result of these detailed calculations, total GON revenue is estimated to reach about 83 percent of the original 1973 revenue target.

2. Central Government Expenditures and the Deficit -- (Table IV B-2)

a. Current Expenditures -- The original 1973 estimate was ¢616.0 million or 19.5 percent about the 1972 level. As a result of the earthquake, this level has been increased to ¢742.3 million, an increment of ¢126.3 million. This increase is accounted for by the following factors: (1) a new office of seismology; (2) corps of city clean-up personnel, 5,000 strong; (3) a new Ministry of Reconstruction; (4) additional operating expenses for combustibles; (5) demolition and clean-up expenses.

1/ This tax was introduced in May, 1970. Thus the first full year of collection was in 1971. The decline in 1972 was due to either: (1) a reduction in private consumption and/or (2) a weakening of the collection process.

Table IV B-2

PROJECTED EXPENDITURES OF CENTRAL GOVERNMENT

(Millions of Current Córdobas)

	1971	1972	1973 B. E.	1973 A. E.
TOTAL	508.8	514.3	616.0	742.3
1) Current Expenditures				
Salaries	278.7	280.4	302.9	347.4
Purchases of goods	105.1	102.4	121.4	203.2
Interest on Debt	18.3	36.2	50.1	50.1
External	12.4	30.4	38.3	38.3
Internal	5.9	5.8	11.8	11.8
Current Transfers	106.7	95.3	141.6	141.6
2) Current Surplus (+) or Deficit (-) in Current Budget	106.7 (+)	119.7 (+)	93.8 (+)	157.4 (-)
3) Capital Expenditures	317.2	385.1	262.4	291.1
Direct	137.7	193.6	179.4	208.1
Indirect	140.9	148.0	6.6	6.6
Amortization of Public	38.6	43.5	76.4	76.4
TOTAL	826.0	899.4	878.4	1.033.4
4) Credit Requirement of Central Government (Items 3-2)	210.5 (-)	265.4 (-)	168.6 (-)	448.5 (-)
Earmarked Revenue	4.9	5.3	6.4	6.4
Other	23.7	9.3	25.5	25.5
I.O.U.s to INSS	25.8	17.3	28.2	28.2
Internal Credit	31.6	.9	-	-
External Credit	113.3	257.8	108.5	108.5
Surplus or Deficit	11.2 (-)	25.2 (+)	-	279.9 (-)

Note: The amount of extraordinary expenditures in the post-quake 1973 budget does not - include new investment or support to the autonomous entities or decentralized - agencies.

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With a revenue target of ¢584.9 million as stated in the previous section, the current account deficit will total ¢157.4 million. Last year there was a current account surplus of ¢119.7 million.

The revised Capital Expenditure level is estimated at ¢291.1 million and is ¢28.7 million above the pre-earthquake level to accommodate mainly a minimum level of expenditure for equipment and machinery and the construction and repair of government buildings. With the addition of the expenditures to the current account deficit, the total budget deficit will be ¢448.5 million.

This budgetary deficit will be covered as follows:

	(¢ millions)
1. Budgetary Deficit Financing	448.5
1. Internal Borrowing	60.1
2. External Borrowing	108.5
Total Borrowing	168.6
3. Uncovered Deficit	
Government Budget Deficit	279.9

The above represents only the budgetary deficit of the Central Government and excludes the current account deficit of the autonomous agencies. The deficit of these agencies on current account is ¢102.9 million, and this deficit as well as that of the Central Government will be taken into account in calculating aggregate credit requirements in Section IV-C. 1/

1/ The capital requirements of the autonomous institutions will also be estimated in Section IV-C.

C. Monetary Analysis and Projections

In this section, we shall (1) describe certain considerations that will have significant impact on the monetary outlook of 1973; (2) estimate the credit requirements of the private sector and describe the methodology utilized; and (3) present a consolidated picture of the total credit requirements estimated for the economy in 1973, inclusive of the requirements of the public sector estimated under IV-B.

Monetary Outlook

The earthquake has affected the monetary situation in three principal ways: (1) it has significantly reduced the economy's productive capacity; (2) it has impaired the ability of borrowers to repay bank loans, thus freezing the portfolios of the banks and the accounts receivable of creditors; (3) it has expanded significantly borrowing requirements -- to replace inventories and equipment, provide working capital, and supply funds for repair and reconstruction.

As a consequence, the monetary authorities expect:

(1) A significant reduction in the country's Gross Domestic Product in 1973. Preliminary estimates indicate a decline of about 4 percent below the 1972 level and of about 7-8 percent below the 1973 level in the absence of the earthquake.

(2) A substantial increase in demand for Central Bank credit: since the commercial banking system will be unable to meet short-term credit requirements because of its frozen loan portfolio, the Central Bank will be called upon to meet short-term credit requirements that the banking system would have been able to meet with its own funds in normal times. Failure to expand Central Bank credit would cause a drop in production.

(3) A withdrawal of deposits by the public, particularly in time and savings deposits, as people who lost income and wealth draw down their liquid balances.

(4) Pressure on foreign exchange reserves owing to vastly expanded credit requirements and the impaired ability of the economy to meet such requirements with its own capacity.

Central Bank authorities prefer to formulate their dilemma in an alternative way: they see a vast expansion of money supply induced by Central Bank credit expansion; but no increase, and possibly a reduction, in the public's demand for money; hence, a strong pressure on the country's foreign exchange reserves.

Monetary authorities emphasize that the consequences of the earthquake damage are further compounded by the serious drought suffered during the summer months of 1972. The drought caused foreign exchange losses in basic grains (corn, beans, sorghum, and sesame) as well as a significant reduction in the production of cotton and coffee which will have its impact in 1973. The loss in the production of basic crops is expected to have reduced net foreign exchange earnings by $10 million in 1972, while exports of cotton and coffee are expected to depress foreign exchange earnings by $37 million in 1973, as compared to what they would have been otherwise.

In view of the monetary authorities' great concern for their reserve position, we have given particular attention to the balance of payments projection presented in the next section. The Central Bank has taken pains to ensure that their projection makes adequate allowance for expanded import requirements induced by the earthquake as well as for reduced export earnings related to the drought. We found that on the basis of the data available to the team at this time, and on the most reasonable assumptions that can be made with respect to imports, exports and capital flows, the government need not concern itself unduly about its foreign exchange reserve situation. This conclusion is predicated on the assumption that large-scale reconstruction activities (especially in the area of private housing) will be spread out over a period of years and will for the most part be financed by long-term foreign loans.

Credit Requirements of the Private Sector in 1973

The credit requirements of the private economy, broken down by major economic sector, are presented in Table IV C-1. In developing this projection, we faced the conceptual problem of defining the scope of the current requirements that should be included. There is no question about including credit needed to replace inventories and provide working capital. However, with respect to repair and reconstruction, the question arises as to the proportion of the total value of the damage that should be included in the 1973 requirements. We decided to include only the value of repair and reconstruction that reasonably could be expected to be executed over 1973, given the physical limitations imposed by time, the capacity of the construction industry and the availability of qualified administrative personnel. The general outlines of the methodology are as follows:

Housing: The total capacity of the building construction industry is estimated at $50-70 million (₵350-490 a year) a year. We have chosen the upper end of the range as the basis for our calculation, and assumed that 80% of this capacity will be allocated to the private sector. Thus, a maximum of ₵390 million worth of private buildings could be constructed in 1973. This productive capacity was then divided between private housing

Table IV C-1

Total Credit Required by Private Sector from Banking System and Financial Intermediaries 1/
(Millions of Cordobas)

	1971	1972	1973 BE 2/	1973 AE 2/
Commerce and Services		31.3	23.1	259.0
Housing		46.4	50.0	330.0
Industry		65.5	88.4	159.0
Agriculture and Cattle		41.8	104.2	104.2
Other		1.6	.1	.1
TOTAL	165.2	186.6	265.8	852.3

1/ On basis of increases in year-end balances outstanding.

2/ BE Before earthquake; AE After earthquake and commercial buildings in accordance with the earthquake damage report prepared by INCAE. According to the INCAE estimate, 84 percent of the value of destroyed buildings consists of residential dwellings. We have therefore assumed that the credit requirement for private residential housing construction in 1973 would amount to ₡330 million (84% of ₡390 million), which is the amount entered in Table IV B-1. Given the delays necessarily involved in planning and implementation, we suspect that the actual figure may be significantly lower.

Commerce and Services: The estimated requirement of ₡259 million for commerce was estimated as follows:

Construction (16% of ₡390 million)	₡62 million
Reduction in requirements related to reduced public activity	-18.5
Inventory damage less amount that can be financed by businesses' own resources	123.5
Replacement of damaged machinery & equipment (50% of total)	42.0
Requirements of Service Sector	50.0
TOTAL	259.0 million

Industry: A breakdown of the projected industry requirement of ₡159.0 million is as follows:

Replacement of machinery and equipment	₡ 70.0 million
Replacement of accounts receivable	119.7
Reduced requirement related to the decline in production	- 30.7
Total Credit Requirement	₡159.0 million

Total private sector credit requirements in 1973 thus come to ¢852.3 million compared to a normal pre-earthquake estimate requirement of ¢265.8 million, and to a requirement of only ¢186.6 million for 1972 (Table IV C-1).

The total combined net credit requirement (current and capital) of both public and private sectors are estimated in Table IV C-2. The table includes all capital requirements regardless of whether financing has been secured. The concept of capital requirement includes real investment only, and excludes the credit allocations granted by the autonomous institutions.

The figures for the Central Government were explained in the fiscal section. Those for the credit requirements of the private sector are from Table IV C-1.

The credit requirements for the autonomous institutions exclude the houses that they plan to build during 1973. The Housing Bank has plans for the construction of ¢2.84 billion worth of houses ($406.0 million) over the next three years. They would like to build ¢800 million ($114 million) of houses during 1973. This sum substantially exceeds the construction capacity of the housing industry, other physical bottlenecks, and likely financing. We have therefore excluded the housing program from Table IV C-2. Note, however, that we have already included ¢390 million worth of private residential and commercial construction under the requirements of the private sector. Thus, most of the capacity of the construction industry is accounted for, and substantial construction over this limit will require importation of construction contractors complete with equipment, from management and crews.

Note that even with the exclusion of the Housing Bank program, aggregate gross credit requirements for both the public and private sector have expanded by ¢1.04 billion, or $149 million.

The requirements presented in Table IV C-2 are gross in the sense that they do not make allowance for loans already contracted. In Table IV C-3 we have attempted to estimate net additional credit requirements on the basis of whatever data were available and some general rule of thumb. We had an exact figure only with respect to the net additional credit requirement of the Central Government. With respect to the autonomous agencies, we assumed that the total gross credit requirement would require new financing. With respect to the private sector, we assumed that 30 percent of the gross credit requirement could be met from the firm's own resources or through private foreign supplier credit. This calculation obviously requires considerable refining. After these adjustments, net credit requirements for 1973 are still a substantial ¢1.28 billion, or $183 million. However, there are further reductions, difficult to quantify, which are likely to reduce this figure, perhaps substantially, such as planning and implementation delays in the construction industry.

D. GDP Projection

The Central Bank's projection of the Gross Domestic Product by sector of origin in current cordobas appears in Table IV D-1. Note that the Bank projects a 4 percent decline in the current GDP for 1973. This estimate is 7-8 percent below what the 1973 GDP would have been in the absence of the earthquake.

By far the sharpest decline is registered in housing income (32.8%); next comes transportation and communications (5.9%), and commerce (5.8%). The breakdown of GDP by final expenditures is currently being prepared.

Table IV C-2

Combined Credit Requirements in 1972 of Public and Private Sectors
(C$ Millions)

	1971	1972	1973
Central Government:			
Capital Expenditures	317.2	385.1	291.1
Less Surplus or Plus Deficit	Less	Less	Plus
in Operating Budget	106.7	119.7	157.4 1/
Credit Requirements	210.5	265.4	448.5
Autonomous Agencies:			
Capital Expenditures 2/	-	273.6	300.0
Less Surplus or Plus Deficit		Less	Plus
in Operating Budget	56.2	63.6	102.9
Credit Requirement of Autonomous Agencies	-	210.0	402.9
Credit Requirement of Private Sector	165.2	186.6	852.3
TOTAL CREDIT REQUIREMENTS	-	662.0	1,703.6

1/ Makes allowances for the C$155.0 million extraordinary budget which is included under current expenditures.

2/ Excludes credit allocations other than for real investment.

SOURCE: For Central Government: Working Group of Ministry of Finance
For Private Sector: Central Bank with adjustments by AID Team
For Autonomous Institutions: Ministry of Finance for operating budget; AID Team for Capital Budget.

Table IV C-3

Projected Requirement for New Financing in 1973
(In Millions of Dollars)

	Gross Requirement (From Table III C-2)	Financing Assured, own Resources and Supplier Credit	Additional Financing Needed
Central Government	448.5	168.6 1/	279.9
Autonomous Agencies 2/	402.9	-	402.9
Private Sector	852.3	255.0 3/	597.3
Total	1,703.7	423.6	1,280.1

1/ SOURCE: Working Group of Ministry of Finance.

2/ Excludes any major housing construction. The $402.9 million is the sum of the operating budget deficit and a capital budget of C$300 million.

3/ Assumes that 30% of total from credit requirement would be obtained by businesses either from own resources or through supplier credit.

Projection of Gross Domestic Product by Sector of Origin
(In Millions of Cordobas)

	1971	1972	1973 AE	% Change 1972--73
Gross Domestic Product	6,471.0	7,010.1	6,728.8	- 4.0
Primary Activities	1,567.5	1,677.5	1,599.3	- 4.5
Secondary Activities	1,429.5	1,570.7	1,562.8	- .5
Tertiary Activities	3,474.0	3,761.9	3,566.7	- 4.7
Commerce	1,293.7	1,438.4	1,353.7	- 5.8
General Government	506.6	543.1	590.8	+ 8.9
Transportation & Communications	328.8	365.6	343.9	- 5.9
Banking & Finance	163.6	170.2	170.2	0
Power & Drinking Water	126.6	142.8	136.8	- 4.2
Housing Rentals	369.2	377.7	253.5	-32.8
Other Services	685.5	724.1	717.8	- 1.0

NOTE: AE - After Earthquake

SOURCE: Central Bank estimates based on INCAE damage report.

E. Balance of Payments Analysis and Projections

Special attention was given to the balance of payments by the team as well as by the Central Bank as this is the most crucial piece in the determination of the resources gap calling for emergency financing. At the team's request, the Central Bank provided considerable breakdown, back-up tables, and information on the methodology utilized. Only some of this supporting documentation is included here.

1. Projection for 1973

The balance of payments projections 1/ are presented in Tables IV E-3 through IV E-5. A summary as well as our suggested adjustments to the estimates are shown in Tables IV E-1 and IV E-2. The Central Bank projects merchandise imports to increase by $63 million or 30 percent. This projection includes a rather arbitrary 5% increase as a "margin of error", which we have allowed to stand. Note that the balance on goods and services shifts from a minus $13 million in 1972 to a minus $87 million in 1973, a deterioration of $74 million; while the balance of payments as a whole shifts from a positive balance of $34 million in 1972 to a $10 to 30 million deficit in 1973. In the last column, which shows our adjustments, we have restored $6.0 million in unilateral transfers which we felt were arbitrarily excluded (see footnote 1/ to Table E-1) and allowed for a minimum inflow of earthquake insurance payments from abroad which were also omitted from the Central Bank's balance of payments projection. As a result of these two adjustments, our projected 1973 deficit is only about $10 million, compared to the $31 million for the Central Bank. The basis for the import projection is provided by Table IV E-3; exports, in Table E-4; earnings from services in Table E-5; and capital inflows in Table E-6.

1/ The initial projections were made by the Central Bank. The Team lowered the Bank's import projections for 1974-75, and supplied the capital inflow projections for all years.

Table IV E-1

Summary Statement of Balance of Payments Projected for 1973
($ Millions)

			1973	
		1972	Central Bank Projection	USAID Adjustment
1.	Exports of Goods	236.0	229.8	229.8
2.	Imports of Goods (CIF)	-216.8	-280.3	-280.3
3.	Trade Balance	19.2	- 50.5	- 50.5
4.	Services, Net	32.0	- 36.4	- 36.4
5.	Balance of Goods & Services	12.8	- 86.9	- 86.9
6.	Unilateral Transfers	6.3	--	6.0 1/
7.	Net Capital Inflow	43.4	56.1	71.1 2/
8.	Errors & Ommissions	- 3.0	--	--
9.	Net Surplus (+) or (-)	+ 33.9	- 30.8	- 9.8

1/ The Central Bank omitted unilateral transfers in 1973 on the ground that all such transfers involved in-kind donations for earthquake victims which were also excluded from the projection of merchandise imports. They argue that the inclusion cannot be properly estimated and that it would increase merchandise imports by the same amount.

2/ Includes a projected $15.0 million in insurance payments to earthquake victims excluded by the Central Bank projection, this may prove to be very conservative;

3/ Does not include resources in the proposed AID emergency loan; extra-ordinary drawings that the IMF is prepared to authorize; The resources of the Central American Monetary Stabilization Fund; nor temporary loans from the Central American central banks.

Even if the relatively pessimistic Central Bank projections were accepted, it would not appear that the country would face a serious balance of payments crisis. The projection makes no allowance for the present AID emergency program or the possible borrowing from the IMF or the Central American Stabilization Fund. Moreover, net international reserves reached a peak of $68.3 million as of December 31, 1972. A drawdown of $20 million over 1973 appears permissible, and the Central Bank has indicated that it would allow some drop in its foreign exchange holdings.

The Central Bank is understandably reluctant to have recourse to the IMF or the Stabilization Fund. The monetary authorities argue persuasively that these institutions were set up to provide short-term loans to meet temporary balance of payments deficits, such as imbalances caused by a bad crop or adverse market conditions. An earthquake, however, produces a structural disequilibrium as it impairs the country's productive capacity and raises its import requirements over a period of several years. In this situation, the authorities feel that they need grants or long-term loans on concessionary terms, not short-term credits.

2. Projection for 1974-1975

The balance of payments projection for 1974-1975 is summarized in Table IV E-2. The Team accepted the export projections of the Central Bank but reduced some of their import projections which appeared inflated. The Team projected capital inflows as it had some knowledge of the plans of the international agencies.

Total imports are projected to decline slightly in 1974 as substantial replacement of inventories and destroyed capital goods was projected to have taken place in 1973. Exports are projected to rise moderately. As a result, both the negative trade balance and the deficit on current account are expected to decline in 1974. At the same time, a sharp increase in capital inflows is projected for 1974 as a result of increased disbursements by IDB, IBRD, and AID under loans authorized in 1973. The projection of AID disbursements in Table IV E-2 and E-6 excludes the emergency assistance that will be provided under the present proposal. The combined effect of the reduced deficit on current account and the substantial expansion of capital inflow is to produce a surplus in the balance of payments of some $48 million in 1974 (line 10 of Table IV E-2). The associated rapid increase in reserves strengthens our conclusion that some drawdown in reserves could be effected in 1973, if the need arose.

In 1975, imports are projected to climb back to the 1973 level. Exports are expected to increase by 5%. The trade deficit and the deficit on current account will change little. Some reduction in the inflow of capital account is projected, though this decline is largely attributable to the exclusion of possible 1974 loan authorization from the 1975 project disbursements. Even so, the total net capital inflow is projected to be substantially larger than the deficit on current account. The outcome is another substantial increase ($26 million) in foreign exchange reserves.

Table IV E-2

Balance of Payments Gap Projection*
1973-75
(In million of Dollars)

		1973	1974	1975
1.	Exports and Merchandise	229.8	236.8	248.7
2.	Imports of Merchandise (CIF)	-280.3 1/	-275.0 2/	-285.0 2/
3.	Balance of Trade	- 50.5	- 38.2	- 36.3
4.	Services, Net	- 36.4	- 33.4	- 33.6
5.	Unilateral Transfers 3/	6.0	6.8	7.0
6.	Balance on Current Account	- 80.9	- 64.8	- 62.9
7.	Private Capital Inflows 4/	29.2	40.0	35.0
8.	Official Capital Inflows 5/	41.9	72.6	54.0
9.	Balance on Capital Account	71.1	112.6	89.0
10.	Surplus (+) or Deficit (-)	- 9.8	+ 47.8	+ 26.1

* Exclusive of AID Emergency Assistance

1/ Central Bank projection

2/ Central Bank projection as modified (i.e., lowered) by AID Team

3/ Central Bank excludes all unilateral transfers in 1973 on the assumption that all donations for that year are earthquake related, and are therefore (a) very difficult to estimate, (b) their inclusion would entail an equal upward revision of the import figure as the latter excludes all in-kind donations. We have, however, projected unilateral transfers at the "normal" pre-earthquake level.

4/ Includes projected earthquake insurance payments, and for 1974-1975, private inflows under the AID Housing Investment Guaranty Program. Projected by AID Team. For breakdown see Table IV E.[illegible].

5/ Projected by AID Team. For detailed breakdown, see Table IV E.6

We have had some difficulty in reconciling this optimistic balance of payments prognosis with the significant deficit we found in the public sector and with the vast increase in credit requirements projected in the private sector in 1973. It is therefore appropriate that we review the main reasons for the continued strength of the balance of payments in the face of the substantial additional credit requirements in the domestic economy.

First and most importantly, there is the substantial and rapidly increasing capital inflow on both private and official account. The increase in the private inflow is related to the AID Housing Guaranty program as well as the earthquake insurance payments from abroad anticipated over the next three years (projected at a minimum of $45 million). We have noted that the capital inflow (private plus official) is projected to increase from $43 million in 1972 to $71 million in 1973 and $113 million in 1974. Note that the disequilibrium in the internal economy does express itself in the substantial deficit on current account, which rose from $13 million in 1972 to a projected $80 million in 1973.

Second, the earthquake hit Nicaragua in a year when the country was in a relatively strong balance of payments position. Note than a gain of $34 million in reserves took place in 1972. 1/. Thus, the deterioration of the current account situation in 1973 is reflected in large part in the disappearance of the strong net positive balance achieved in 1972 (see line 9 of Table IV E-1).

1/ It is true that some of the gain in reserves in 1972 was due to accidental factors: the government borrowed abroad funds on a long-term basis in order to repay a short-term high-interest loan, but later found that the creditor refused the conversion. Moreover, INCEI (the grain stabilization agency) borrowed funds to effect some grain imports which were not used. Both of these loans found their way into the reserves. Nevertheless, most of the gain in reserves achieved in 1972 resulted from substantial increases in exports of goods and services.

Thirdly, part of the net credit requirement estimate for the private sector will not express itself in an increased demand for imports. Specifically, new bank credit needed to take the place of temporarily frozen accounts receivable and to provide working capital (other than for inventory replacement) is not likely to entail a significant claim on foreign exchange.

Finally, Nicaragua has been able to accumulate reserves over 1970-72, and is thus in a position to permit some drawdown during 1973, perhaps in the order of $20 million.

The large capital inflow projected through 1975 does not, of course, indicate that the resources needed to rebuild Managua are assured. While an attempt was made to reflect some of the repair and reconstruction requirements in the import projections, it must be borne in mind that the allowance for reconstruction activities was constrained by the limited capacity of the construction industry as well as by other physical and administrative bottlenecks. Moreover, our balance of payments projection covers only three years while reconstruction will extend over a much longer period. It is nevertheless clear that the substantial loans projected over 1973-1975 will get reconstruction off to a good start.

The major significance of Nicaragua's relatively strong balance of payments and reserve position is that it will enable the monetary authorities to expand credit to cover the operating deficit of the Central Government and of the autonomous institutions, as well as supply credit to replace inventories and destroyed equipment. As indicated, the Central Bank has attempted to make allowances for these requirements in its import projections. At the same time, it is obvious that large scale reconstruction of housing, commercial establishments and public buildings cannot be undertaken through bank credit expansion, as the cost of such reconstruction, if concentrated over a three-year period (as provided in the Housing Bank's current plan) is massive and would inevitably quickly exhaust the country's foreign exchange reserves.

Reconstruction must be spread over a period of several years and be tied to new foreign loans on concessionary terms designed for this purpose.

F. Projection of Debt Service Charges

External debt service charges are projected on Table IV F-1. Note that the ratio of these charges to total exports of goods and services ranges from 15 to 18 percent. This ratio is relatively high but not unmanageable in terms of Nicaragua's historical experience as well as in comparison with other Central American countries. In 1966, Nicaragua's total external debt service charges amounted to only 5.6 percent of its exports of goods and services, a ratio which rose to 10.6 percent in 1970. For Central America as a whole, the ratio stood at 7.4 percent in 1970. 1/

1/ SOURCE: IBRD, Economic and Social Data Division; and SIECA, Indicadores Económicos No. 12, July 1971, P. 25.

Table IV. E.3

Projection of Imports
(Millions of Dollars, CIF)

		1971	1972	1973	1974	1975
1.	Non-Durable Consumer Goods	42.4	46.3	46.3	51.0	55.0
2.	Consumer Durables	22.1	23.5	18.0	24.0	26.5
3.	Fuels and Lubricants	15.1	15.7	21.5	21.5	21.5
4.	Raw Materials and Intermediate Products for Agriculture	8.1	12.2	14.5	16.0	17.6
5.	Raw Materials and Intermediate Products for Industry Other than Construction	62.0	65.6	66.4	69.4	73.4
6.	Construction Materials	13.3	9.1	21.0	25.0	25.0
7.	Capital Goods for Agriculture	3.6	5.6	5.9	7.5	8.0
8.	Capital Goods for Industry	34.8	29.2	46.8	35.0	37.8
9.	Transport Equipment	8.6	9.3	12.0	12.5	13.0
10.	Miscellaneous	0.4	0.3	20.0	5.0	5.0
11.	Total	210.4	216.8	272.4	266.9	282.8
12.	Total Inclusive of Allowance for Margin of Error	210.4	216.8	280.0	275.0	285.0

SOURCE: Central Bank as modified by AID Team

Table IV E-4

Projected Exports of Goods 1973-1975
(Millions of Dollars)

	1971	1972	B-E 1973	A-E 1973	1974	1975
Agricultural Products	130.8	170.4	175.0	172.4	175.3	181.1
Cotton 1/	41.3	61.2	51.6	52.2	57.9	61.3
Cotton Seed	0.8	1.7	1.1	1.1	1.2	1.3
Coffee 2/	29.3	31.3	42.6	42.6	34.1	34.0
Bananas	-	1.7	3.5	3.5	6.0	7.0
Shrimp and Lobster	5.8	9.4	11.7	11.7	11.8	11.5
Sugar	11.6	15.0	14.1	14.1	14.5	14.5
Meat 3/	28.7	35.9	36.7	33.9	36.0	37.0
Other Agricultural Products	13.3	14.2	13.7	13.3	13.8	14.5
Industrial Products	52.4	59.3	68.5	51.3	55.6	61.6
Mineral Products	6.5	6.3	6.1	6.1	5.9	6.0
TOTAL EXPORTS	189.7	236.0	249.6	229.8	236.8	248.7

1/ Cotton projection takes account of Central Bank survey as well as reports from Ministry of Agriculture. Figure for 1973 is down because of drought.

2/ Coffee export projection for 1973 is based on assumptions of a price of $50 per quintal, and that Nicaragua will be able to dispose of only half of its accumulated stock. The Embassy Economic Officer feels that this estimate is on the conservative side. The Central Bank projected a slight drop in coffee price in 1975.

3/ Meat projection takes account of the high slaughter rate in recent years and of the disincentive effect of the export tax.

SOURCE: Central Bank

Table IV E-5

Projection of Services Over 1973 -1975
(In Million of Dollars)

	1973			1973			1973		
	Income	Payment	Balance	Income	Payment	Balance	Income	Payment	Balanc
A. General Services	23.0	54.2	-31.2	32.4	57.6	-25.2	33.2	59.7	-26.5
Freight and Insurance	5.0	26.7	-21.7	5.5	26.0	-20.5	5.7	27.9	-22.2
Other Transport Costs	6.3	10.0	- 3.7	6.2	10.3	- 4.1	6.6	10.4	- 3.8
Travel	9.2	10 0	- 0.8	13.1	13.5	- 0.4	13.1	13.5	- 0.4
Government Expenditures	2.5	1.5	1.0	2.6	1.6	1.0	2.6	1.6	1.0
Other Services		6.0	- 6.0	5.0	6.2	- 1.2	5.2	6.3	- 1.1
B. Remuneration of Factors	8.4	40.3	-31.9	7.8	42.3	-34.5	8.1	43.1	-35.0
Profits	-	19.6	-19.6	-	20.0	-20.0	-	20.1	-20.1
Interest	3.9	15.2	-11.3	3.0	16.6	-13.6	3.2	17.1	-13.9
Wages and Salaries	2.5	3.0	- 0.5	2.6	3.1	- 0.5	2.6	3.2	- 0.6
Others	2.0	2.5	- 0.5	2.2	2.6	- 0.4	2.3	2.7	- 0.4
TOTAL (A ≠ B)	31.4	94.5	-63.1	40.2	99.9	-59.7	41.3	102.8	-61.5

SOURCE: Central Bank, Department of Economic Studies

Table IV E-6

PROJECTED CAPITAL INFLOWS*
(Millions of Dollars)

	1971	1972	1973 B. E.	1973 A. E.	1974	1975
Capital Inflow on Private Account (Net)	15.5	7.1	14.2	29.2	40.0	35.0
Short-Term	.3	-4.0	2.0	2.0		
Long-Term	15.2	11.1	12.2	12.2	20.0 1/	25.0 1/
Insurance Payments	-	-	-	15.0	20.0	10.0
Official Capital Inflows, Total	37.6	36.3	30.9	41.9	72.6	54.0
Disbursements of Prior Loans Unrelated to Quake	37.6	36.3	30.9	30.9	39.6	20.0
New Loans from International Institutions (excluding AID emergency loan)				11.0	33.0	34.0
Rapid Disbursement IDB Program	-	-	-	6.0	8.0	4.0
Long-Term Program IDB	-	-	-	-	10.0	15.0
Rapid Disbursement IBRD Program	-	-	-	5.0	10.0	5.0
AID, other than Emergency Loan	-	-	-	-	5.0	10.0
Total Capital Inflows (Private and Official)	53.1	43.4	45.1	71.1	112.6	89.0

* Exclusive of AID emergency assistance. 1975 figures also exclude possible new authorizations in 1974.

1/ Includes additional inflow for private housing related to AID housing investment guarantee program of $ 5 millions in 1974 and 10 millions in 1975.

January 22, 1973

Table IV F-1

Projection of External Debt Service Charges

	Debt Retirement (1)	Interest (2)	Total (3)	Exports of Goods and Services (4)	Col. (3) As Percent of (4)
1973	31.5	15.2	46.7	261.2	17.9%
1974	28.8	16.6	45.4	277.0	16.4%
1975	28.0	17.1	45.1	290.0	15.5%

SOURCE: Central Bank of Nicaragua

V. STRATEGY

The earthquake occurred at a time when the Nicaraguan economy was in a dynamic phase, notwithstanding the drought. Significantly improved export performance, coupled with fiscal and monetary restraint, had led to a substantial accumulation of reserves in 1972. The drought has caused some losses in agricultural production, including production for export, but it comes at a time of high basic commodity prices which will cushion the production losses.

While far from the most intense in recent world history, the earthquake has had a uniquely destructive effect in taking out the country's commercial and governmental core. Not only has this vastly multiplied the cost of the quake; it has also severely complicated -- and will prolong -- recovery. But Nicaragua's agricultural, industrial, and physical infrastructure bases are largely intact, and the human entrepreneurial instinct is an already widely apparent engine of recovery.

Nonetheless, it will be several years, probably 5 or more, before the recovery is complete, and the first year is sure to be the hardest. The rebuilding process in the private sector, particularly in commerce, services, and housing, will inevitably be gradual, in part because of limits on construction capacity, in part because of limits on the wherewithal to finance rebuilding. But the domestic construction industry will soon be running at full blast, builders from outside will apparently be welcomed, and a combination of foreign loans, domestic credit creation, savings, and current profits will provide substantial financial resources. The process will be accelerated by measures designed to achieve general economic stimulation.

Many of the autonomous institutions, responsible for such basic services as water, sewage, housing, electric power generation and distribution, telecommunications, and social security, are experiencing economic problems because their principal revenue base has been wiped out. Their problems are comparable to the problems of the private sector; they are problems that will require several years to resolve. Yet here, too, there is reason for some optimism: the physical losses suffered by several of the institutions were not great; moreover, their needs in many instances are likely to be met by international lending institutions, particularly where relationships are long-standing.

The problems of the central government are enormous. The regrouping process has been difficult -- there is an acute shortage of adequate buildings -- and the bureaucracy, while a little stronger each day, is still closer to chaos than to order. Yet the circumstances cry for integration of policy, decision-making, and execution, not only to meet the extraordinary problems and pressures of today, but also to plan for the unprecedentedly complicated and costly programs of tomorrow.

The 1973 budget of the Central Government is going to be severely out of kilter. As a result of the earthquake, we expect a drop in revenues of about 15-20 percent, from an originally-budgeted ₡710 million to about ₡600 million (which includes ₡140 million of revenue resulting from post-earthquake measures). Meanwhile, expenditures will increase by about 20 percent, from ₡900 million to ₡1,150 million (because of requirements to replace equipment and furniture; unanticipated rentals; the needs of autonomous and decentralized agencies suddenly deprived of large portions of their operating revenues; and some emergency programs). Against the resulting deficit of ₡550 million, about ₡170 million will be available, principally from external loans contracted prior to the earthquake. This leaves a net deficit of some ₡380 million (about $54 million) requiring extraordinary financing.

The degree to which the fiscal problem subsides will depend on the pace of overall economic recovery and the success of planned efforts to modify the tax structure so that it will produce more as national income increases.

While, at least in the short run, the fiscal picture is gloomy, the balance of payments forecast is in sharp contrast. The Central Bank projects a current account deficit of about $80 million in 1973 (compared with $7 million in 1972), the increase principally attributable to a sharp rise in imports (from $217 million in 1972 to $280 million), reflecting both the rapid expansion of public sector spending and the special needs of the private sector, including commerce, housing, and manufacturing. The net capital flow, including private loans and investment and official loans already contracted, plus estimated drawdowns on IDB and IBRD emergency loans, is plus $55 million, leaving a deficit of about $25 million. However, this deficit assumes substantial Central Bank financing of the fiscal deficit and does not include the emergency program proposed herein, nor does it include (a) any drawing on the extraordinary resources ($23 million net) IMF is prepared to make available, (b) the resources of the Central American Monetary Stabilization Fund, (c) special arrangements with Central American central banks, and (d) insurance payments on policies written or reinsured outside Nicaragua (which could be a very significant item). In light of the relatively high level of end-1972 reserves ($77 million gross, $68 million net), we conclude that it is most unlikely that Nicaragua will encounter balance of payments difficulties in 1973. Moreover, the extraordinary levels of concessional external assistance likely to be committed during the next year or two should assure that balance of payments problems do not materialize in 1974 or 1975, even with continued very high import levels.

What this means is that there is substantial capacity on the part of the monetary authorities to help the public and private sectors to meet their needs.

In both sectors, then, the first several months after the earthquake are certain to be both difficult and important. While the earthquake and the drought have been enormously destructive and costly, Nicaragua has several things going for it: its export agriculture currently commands high prices (most people assume that the drought will end at the onset of the normal rainy season in May); its industry and infrastructure are largely intact; and its foreign exchange reserves are ample, and likely to remain that way. In addition, Nicaragua can count on unprecedented forthcomingness by the international institutions. But most of these factors will not make themselves felt in the short run, and ways must be found to get the recovery process moving promptly.

It is in the short run, especially the next 6-9 months, that there is a particularly important role for AID emergency assistance: to help get people back to work, thereby facilitating the recovery of demand and stimulating business activity and confidence. A substantial injection, principally through the investment budget, will lead to further employment creation, the recovery of central government and autonomous institutions revenues, and a general acceleration of reconstruction. It will also reduce somewhat the size of the budget deficit,

It is apparent from two tripartite meetings with IDB and IBRD teams in Managua that both institutions are moving with unprecedented swiftness to help Nicaragua. The IDB is putting together an $18 million emergency package for telecommunications, small industry, rural credit, construction-industry expansion, and temporary shelter for two universities. Funds should be flowing by mid-April, and the IDB estimates that the disbursement period will be two years. Moreover, a substantially larger, longer range program is probable later this year.

The IBRD has singled out power, water supply, sites and services, industrial parks, and secondary schools for immediate attention and has in mind a $10-20 million package which should approximate the IDB program with respect to timing.

While both the IDB and the IBRD are moving rapidly, their assistance will have an essentially project orientation, and the resources thus made available will not enable the government to undertake a short-run employment generation program. Thus, AID program assistance, particularly if it is made available promptly, can make a unique contribution to the acceleration of the recovery process. In addition to the speed with which we can act and the flexibility of the funds we can make available, we have the special advantage of having a full-time Mission on the spot, able to adjust the program to the lessons of experience in what inevitably will be a dynamic environment, one in which the ability to seize opportunities as they present themselves can pay major dividends.

In selecting activities for AID financing, we have been guided by the following criteria: the activities can generally be begun within three months (which means either that extensive planning is already largely done or that it is not required); they will emphasize employment creation; and they will give priority to Managua and refugee areas, but will not prejudice the final decision with respect to reorientation of the city. The program we are proposing therefore largely emphasizes public works.

Although housing is among the most urgent reconstruction requirements, we consider it indispensable that any significant new housing projects, beyond the temporary housing financed by the AID $3 million grant, be undertaken within the context of a master plan for the City of Managua. Such a plan will require time to develop. Once it is developed, there should be substantial opportunities for external financing. The Housing Investment Guaranty program comes to mind as an obvious source. Here, as in so many other areas, one sees the importance of a concerted planning effort -- and the potential for waste in its absence -- and to facilitate such an effort, we are proposing that AID funds under this program be used for the activation of a high-quality planning group to guide the GON's policy-making and decision-making both in the short- and mid-term.

Finally, the planners and the international institutions must not lose sight of the process of long range development, a process which has been temporarily arrested and probably somewhat detoured, but a process which, nonetheless, will at some time in the future once again occupy center stage. For this reason, we propose to use some of the emergency program funds for financing the GON's contribution to development projects financed by AID. In addition, we urge that a vigorous effort be undertaken to identify and develop new project loans.

We have estimated a budget gap of $54 million, which this loan will help to finance. For administrative purposes we will identify our disbursements with items in the GON investment budget. (We have identified about $30 million of such activities). In addition, there are approximately $3.9 million in GON contributions of local currency to AID development loans which will be required in 1973. For the present, we propose a $15 million development loan to cover both types of requirements.

In summary, then, the U.S. Government has a unique opportunity through an AID emergency program to bridge the difficult period between disaster relief operations and a planned reconstruction effort. What we do can have an importantly favorable economic and psychological impact on the recovery process.

VI. THE PROGRAM

A. Purpose of the Program

The purpose of the assistance is to help cover an unexpectedly large budget deficit, principally in the investment component, resulting from substantial reductions in revenues and major new spending requirements, both attributable to the earthquake which destroyed most of downtown Managua on December 23, 1972.

B. The Loan

As was noted in the strategy section of this Program Assistance Paper, the earthquake occurred at a time when the Nicaraguan economy was in a dynamic phase notwithstanding the severe drought which had hit the country's principal productive sector, agriculture. Moreover, the immediate response of the country's people to the unprecedented disaster which struck them two days before Christmas, 1972, was one of courage, determination, and optimism.

Yet, just as an important contributor to the prior economic progress had been our AID assistance program coupled with its IDB and IBRD counterparts, so even more beneficial to the country's morale was the world-wide surge of effective sympathy stimulated by the earthquake, a sympathy whose effectiveness was epitomized by the United States effort that poured everything from C-Rations to C-5A delivery service into the stricken area within hours. Looking to the future, the extraordinary assistance packages being prepared by the international lending agencies plus such longer term aid as we shall make available through our normal loan channels should reasonably assure that essential progress need not be foregone for lack of outside concern.

However, as previously set forth, there is a critical intermediate period between the end of major relief efforts -- though donated food will be flowing in for many months yet -- and the beginning of the long range reconstruction cum development phase, leaving a time interval that could undermine the high morale thus far maintained.

The GCN investment budget contains numerous activites directed toward employment recovery and development in the interim which this loan will help to support. For purposes of administration we will link disbursements with these types of activities.

The following are examples:

One of the most important activities is the combined program of salvage, demolition and removal of the rubble that was once the heart of Managua.

The activity would consist of two simultaneous coordinated programs: the one of salvage, whereunder those components of the rubble that are both recoverable and reusable will be picked out by hand. The estimated budget for this is roughly $1.3 million. The other consists of demolition, where required, and removal of the remainder of the rubble, a quantity that has been estimated at 4 million cubic meters. The budget has been estimated well in excess of $5 million, but we have limited our consideration to that figure until experience provides a better basis for estimating need.

The foreseeable possible natural disaster against which we would take precautions is the flooding that could be occasioned in large parts of Managua by heavy rainfall during the wet season, which generally begins in May, overflowing drainage canals obstructed in some places by the consequences of the earthquake and in others by the inadequacies of prior maintenance efforts.

The activity would consist of cleaning, re-aligning and paving some 12 kilometers of principal drainage canals under force account over a period of some 9 months starting with signing of the Loan Agreement. The estimated budget is approximately $700,000.

Insofar as the restoration of essential services is concerned, a combination of vigorous Nicaraguan self-help efforts with IDB and IBRD assistance under ongoing projects in their traditional areas of concentration have matters well in hand -- with one glaring exception:

some 1,650 hospital beds were in facilities that have been destroyed or too heavily damaged for significant use.

As an interim relief measure, a 120 bed U. S. Army Field Hospital was donated to Nicaragua, but the onset of the rainy season is expected to have a sufficiently deleterious effect on this tent-housed facility to make its transfer to more solid quarters essential.

This activity would consist of the rather extensive remodeling of several medical facilities in both Managua and other Nicaraguan cities in order to make proper use of the U. S. - donated equipment plus that salvaged from their damaged hospitals so as to provide adequate general hospital capacity on a semi-temporary basis --say three to five years -- until the Nicaraguans can design and construct a permanent hospital system. The tentative budget allocation for this activity is $3 million.

Another activity directly related to the earthquake is the improvement and paving of numerous raods and streets in Managua and its environs. Traffic patterns have been completely disrupted by the closing of most downtown streets, and increased efficiency of transportation will be a major effect of this activity, along with the heavy employment generation flowing from the type of paving planned (adoquines or interlocking concrete blocks). The roads to be improved are generally in the "safe" areas of the city and will thus have as beneficial an effect after any reorientation as now.

The activity would consist of the paving by the City of Managua under force account and contract of up to 67 kilometers of city roads and streets over the period of the program and would cost an approximate $5 million.

Similar in concept but substantially larger in scope and differing in implementing agency (Department of Highways) and paving material (asphalt), is the program for improving, preserving and paving/repaving, at an estimated cost of roughly $7 million, some 715 kilometers of highways and trunk roads, with emphasis on the areas most directly affected by the refugee migrations, the drought, and the skewed traffic patterns related thereto.

In response to the wholesale damage to and destruction of government buildings and other facilities, the next activity would call for an immediate program of general minor repairs followed by the more complex task of making major repairs where feasible. Coupled with this widespread program would be two more particular activities: provision of temporary customs warehouses and office facilities, to restore GON revenues and expedite commerce; and the repair of damaged airport facilities. The estimated total cost would be somewhat under $4 million.

The next activity is agricultural and rural assistance in the form of necessary buildings and other infrastructure. Although the $400,000 total estimated expenditure is vastly less than the sums proposed for the Managua area, the activities would be extremely useful.

The final activity would encompass some $2 million of public works in the major cities of Leon, Granada, and Masaya. A portion of the justification for this activity lies in the short term impact on these cities of the flood of refugees. More important, however, is the longer term importance of making them sufficiently attractive places to live that they can offer a viable alternative for those who would prefer not to return to Managua.

The entire illustrative list is included as Table VI-1.

Also to be funded under the loan are $3.9 million equivalent for local counterpart funds to back up the next year's estimated disbursements under four AID Development Loans as shown in Table VI-2. These funds will assure the use of $8.7 million in project loans. These are all vital components of the long term Nicaraguan development program and fully worthy of this additional temporary support.

Although the types of activities with which disbursements will be linked, as set forth in the Illustrative List (Table VI-1) total some $28 million, the very nature of that list makes it inevitable that some will drop by the wayside, even as new activities appear. Authorization is currently being sought for $15 million in loan funding. Of this total, some $4 million would cover the local counterpart for AID loans and $11 million would be used to finance the budget deficit through linkage of disbursements with activities of such nature as those on the Illustrative List. An estimated $2 million out of this $11 million would be for Code 941 procurement and the remainder for local costs.

Employment Effects

As has been set forth previously, one of the major factors in selection of activities for our Illustrative List (Table VI-1) was immediate potential employment generation. Although the estimates submitted by the various agencies often vary considerably in the relationship of employment to cost, even in activities where closer correlation might be expected, nevertheless the total employment effects of the proposed loan, which we have factored down to about 10,000 man/years, are most impressive.

Table VI-1

Illustrative List of Activities

Activity Title	GOM Agency	Cost ($000)	Employment (Man Years)
A. Direct Emergency Measures			
1. Rubble Material Salvage	Public Works	8,700	(7,000)
2. Rubble Demolition & Removal	Public Works	35,000	( )
B. Provision of Temporary Hospital Facilities	Public Works	21,000	1,500
C. Restoration of Major Drainage Canals	City of Managua (DN)	5,000	1,000
D. Managua City Roads/Streets (TOTAL)	City of Managua (DN)	35,000	2,350
	(kilometers)		
1. By-Pass Road	3.5		
2. Colonia Centro America Road	10.0		
3. Santo Domingo Road	1.0		
4. 35th Avenue	2.5		
5. 27th Avenue	6.0		
6. Miscellaneous Road Portions	5.0		
KILOMETER SUBTOTAL	28.0		
7. Barrio San Judas Streets	15.0		
8. Lezianso - LaCeibita Streets	11.0		
9. Ducuali, Sta. Barbara, Meneses Streets	13.0		
KILOMETER SUBTOTAL	39.0		
KILOMETER TOTAL	67.0		

Illustrative List of Activities

Activity Title	GON Agency	Cost(¢000)	Employment (Man Years)
E. Highways & Trunk Roads (TOTAL)	Dept. of Highways	49,000	7,300
	(kilometers)		
1. Santa Rita - Masachapa	30	(10,000)	(1,900)
2. Masaya - Tipitapa	20	(6,000)	(1,100)
3. Managua - Sabana Grande	10	(3,500)	(600)
4. Piedra Quemada - Las Mercedes	15	(5,000)	(700)
5. Masaya Highway - Las Nubes	20	(5,000)	(700)
6. Las Nubes - Masaya	20	(4,500)	(800)
7. Betterment of Selected Highways	600	(15,000)	(1,500)
KILOMETER TOTAL	715		
F. Repair of Damaged Public Bldgs.			
1. Immediate General Minor Repairs	Public Works	800	60
2. CY 1973 General Major Repairs	Public Works	18,000	2,500
3. Provisional Customs Headquarters	Public Works	1,500	250
4. Airport Facilities Repairs	Defense	5,400	400
G. Agricultural/Rural Assistance			
1. Regional Storehouses	INCEI	900	100
2. People's Supply Centers	INCEI	700	80
3. Assistance to Various Settlements	IAN	1,300	200
H. Municipal Improvement Projects	Cities of Leon, Granada Masaya	15,000	1,500
TOTALS		197,300	24,240

Table VI-2

Estimated Local Counterpart Needs for AID Loans

AID Loan	Local Counterpart ($000 equivalent)	Amount thus Supported ($000)
024 -- Feasibility Studies	100	1,500
025 -- Rural Elec. Coops	1,500	3,220
026 -- Feeder Roads	900	2,000
027 -- Education Sector	1,400	2,000
TOTAL	3,900	8,720

VII. Loan Administration

A. Implementation Plan

With respect to those activities with which our disbursements are to be identified, we will insist that the GON adhere to the type of procedures outlined in our various A.I.D. guidelines. In this way, we can identify our funds with well-implemented, reasonably priced activities.

We will, however, permit the GON to depart from these guidelines where requirements of the program require greater flexibility. For example, small business notification will not be required, nor will formal advertising be required for procurement of consulting services under a value of $100,000. Formal competitive bidding for any contemplated procurement of goods and/or services under $50,000 may be dispensed with if U.S.A.I.D. concurs. For larger procurements, AID/W concurrence will be required.

The overall disbursement period for the bulk of this program is projected at 12 months from the first disbursement or roughly through the end of February, 1974, with a Terminal Disbursement Date of June 30, 1974. It is projected that following an initial build-up of disbursements in the months of March, April, and May, 1973, the disbursement curve should flatten out in the neighborhood of $2.0 million equivalent per month. However, it should be emphasized that as a result of the destruction of facilities and loss of records occasioned by the earthquake, the GON will not be able to act with full efficiency, so some lag in this timing would be neither unlikely nor indicative of any lack of general capacity to respond to normal administrative requirements.

A draft Loan Agreement has been prepared for AID/W review. Copies will be furnished the USAID along with the necessary Delegation of Authority in time for an early signing. Given the urgency of the situation it is anticipated that the agreement will be signed within approximately ten days from the date of authorization. It is expected that the conditions precedent to the initial disbursement can be met within a week from the date of signature. Due to the urgency of commencing certain of these activities as far as possible in advance of the May start of the rainy season, the Loan Agreement will provide: "Except as A.I.D. may otherwise agree in writing, no goods or services may be financed under the Loan which are procured pursuant to orders or contracts firmly placed or entered into prior to January 25, 1973."

B. Conditions Precedent

(a) The Borrower shall repay the loan to AID in U.S. dollars within 40 years from the date of first disbursement under the loan including a grace period not to exceed 10 years. The Borrower shall pay interest at the rate of 2 percent per annum during the grace period and 3 percent thereafter.

(b) Prior to the release of any resources under the loan, the Borrower must provide AID with:

(i) an acceptable opinion of counsel concerning the validity of the loan agreement, and

(ii) a statement of authorized GON representatives for purposes of the loan and their specimen signatures.

(iii) evidence satisfactory to AID of the formation, staffing, and assignment of authority to an implementational body to coordinate and control GON implementation of this program and the activities to be carried out hereunder.

(c) Prior to each individual disbursement, Borrower must provide in form and substance satisfactory to AID a request for funds (LCFDR) accompanied by the following: (i) evidence that the funds requested have actually been expended and not previously reimbursed (ii) evidence that said expenditures have been made pursuant to plans approved by the implementational body and fall within the purview of this program.

The Loan will be subject to such other terms and conditions as AID may deem advisable.

C. Target Implementation Dates

It is projected that the program will be carried out on the following schedule:

Loan Authorized	-- February 9, 1973
Loan Signed	-- February 20, 1973
Conditions Precedent Satisfied	-- February 28, 1973
First Disbursement	-- March 1, 1973
Final Disbursement	-- June 30, 1974

D. A.I.D. Financing Procedure

In accordance with the purpose of this program the primary financing procedure to be utilized is the direct purchase of local currency with dollars, the local currency there to be used to reimburse the GON for authorized expenditures. The disbursement of program dollars (except for direct dollar procurement which will be handled by a Letter of Commitment to be established as and when the need is recognized) will be tied basically to the properly documented cordoba expenditures for the prior month. Starting with satisfaction of the conditions precedent to initial disbursement, borrower may at that time and at the end of each calendar month thereafter submit documentation in satisfaction of conditic precedent for disbursement to reimburse some or all program expenditures made on or after January 25, 1973, and not previously reimbursed.

Dollar checks will be presented by the Regional Disbursing Office to the Central Bank which will in turn deposit the equivalent amount in local currency in a special RDO account in the Central Bank.

E. Procedures for Linking Activities With AID Funding

The initial document in this linking procedure will be a Proposed Activity Summary Presentation (PASP) signed by an authorized representative of the GON and presented to the USAID. The PASP includes:

(a) activity description
(b) explanation of how activity fits within overall program objectives
(c) estimate of total activity cost

(d) cost of individual activity elements
(e) estimated disbursement schedule

If the activity set forth in the PASP fulfills, to the satisfaction of AID, the criteria established under the program, AID shall notify the Borrowers by Implementation Letter of its intention to disburse.

In order to receive disbursements in reimbursement for GON expenditures, which must have covered a period of one calendar month or more, the GON will submit a Local Currency Funds Disbursements Request (LCFDR), a written request from the GON requesting a release of funds from the special account. Along with the LCFDR the GON will submit an Activity Progress Report (APR) to the USAID. APRs will be submitted at the end of each calendar month. The APR describes progress-to-date, defines problems impeding progress (if any), and indicates total funds received and expended on the activity and amounts pending. The overall activity budget is updated as well in order to provide a current picture of the entire estimated activity cost.

When approved by the Mission, this LCFDR becomes the authority for the Central Bank to release the funds. The above procedure continues until all funds are disbursed at which time a final progress report is required.

Coordination and Control

In order to coordinate and control the entire recovery/rehabilitation program including self-help efforts, international agency assistance and bilateral aid, the GON is considering setting up a central coordinating group to which we shall, if requested, give both TA and financial support.

The GON shall set up, either within this broader coordinating group or, if such be not created, separately a special implementation body to coordinate and control the activities linked to AID disbursements, in ways to be covered in Implementation Letters.

Monitoring Procedures

The basic Mission monitoring tools are the PASP's and the APRs. Through these the USAID is capable of initially assuring appropriate activity selection and proper allocation of funds and monitoring the actual use of funds.

In dealing with the GON implementational body, a major thrust of USAID monitoring activities will be to keep responsibility for direct administration of the program within said body. Day to day supervision of the activities linked to AID disbursements will be carried out by the body which will review and approve each activity proposed by a sponsoring agency for financing prior to preparation of the PASP. This review process is designed to assure technical soundness including adequate engineering plans and specifications where required as well as conformance with terms of the A.I.D. Loan Agreement, and Implementation Letters. Where necessary the body will engage consultants to prepare adequate plans and provide other engineering services. Where funds are to be relent by the GON the body as well as the USAID will review lending terms to assure that these do not run contrary to the basic loan objectives. The body will also review the APRs prepared by the agencies and vouchers submitted therewith for compliance with the activity agreement. Upon approval, the vouchers will be kept in the body's files and a formal request for additional disbursement will be attached to the APR. Certification thereof by the body will constitute evidence satisfactory to AID--subject only to audit--of the validity of the material certified.

In those instances where extensive engineering will be required, the USAID's engineering office will assist in reviewing plans and specifications prior to the mission clearing off on the PASP covering the activity. This same office also inspects activity reports through site visits. Because the body staff has primary responsibility for project monitoring, the USAID engineering inputs are not used to control approval of disbursements, but rather to provide AID with a first-hand knowledge of loan progress and identification of possible problem areas which should be brought to the attention of the GON.

The GON Tribunal de Cuentas will be requested to carry out quarterly audits of the program. AID Auditor General personnel will also carry out audits from time to time. Finally, personnel from USAID Controller's Office will visit the body periodically to review program documentation and operating procedures.

As a result of the substantial workload that will necessarily be undertaken by USAID/Managua in order to implement this program under chaotic conditions expeditiously and effectively, an increase in staffing will be necessary, especially in the Capital Development, Engineering, Program and Controller's Offices. Details will be submitted by the USAID when the full personnel needs arising out of the entire set of changed circumstances in Nicaragua have been evaluated.

CHECKLIST OF STATUTORY CRITERIA

(Alliance for Progress)

In the right-hand margin, for each item write answer or, as appropriate, a summary of required discussion. As necessary, reference the section(s) of the Capital Assistance Paper, or other clearly identified and available document, in which the matter is further discussed. This form may be made a part of the Capital Assistance Paper.

The following abbreviations are used:

FAA - Foreign Assistance Act of 1961, as amended.

App. - Foreign Assistance and Related Agencies Appropriations Act, 1971.

MMA - Merchant Marine Act of 1936, as amended.

COUNTRY PERFORMANCE

Progress Towards Country Goals

1. FAA Section 208; Section 251 (b).

A. Describe extent to which country is:

(1) Making appropriate efforts to increase food production and improve means for food storage and distribution.

(1) The GON has made appropriate efforts to increase food production and improve food storage and distribution facilities. Nicaragua used to import a substantial portion of its basic grain needs. Since 1969 Nicaragua has increased production of grain with the assistance of financing from AID Loan 524-L-022 (Basic Crops) and started to export rice and beans. In 1970 and 1971 Nicaragua was practically self-sufficient in corn and sorghum. The GON has built up its food storage facilities and capacity increase to 189,000 tons in CY 1971 and is projected at 209,000 tons at the end of 1972. In addition, the GON is carrying out a USAID Grant TC Program in marketing and distribution to improve food storage and distribution system.

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(2) Creating a favorable climate for foreign and domestic private enterprise and investment.	(2) The GON has created a favorable climate for foreign and domestic private enterprise and investment. Only the size of the markets and the scarcity of skilled human resources can be considered as limiting the participation of the foreign and domestic private investors.
(3) Increasing the public's role in the development process.	(3) The public's role in the development process has been considerable in Nicaragua and the GON is actively attempting to stimulate further participation therein. This loan will increase the Nicaraguan public's role through involvement in efforts to recover from the earthquake.
(4) (a) Allocating available budgetary resources to development.	(4) (a) The GON allocates a significant portion of its National Budget to activities related to Development. It has achieved substantial levels of self-financed investment in recent years.
(4) (b) Diverting such resources for unnecessary military expenditure (See also Item No. 16) and intervention in affairs of other free and independent nations. (See also Item No. 14)	(4) (b) Nicaragua does not appear to be making unnecessary military expenditures nor preparing to intervene in the affairs of any other free and independent nation. Total military expenditures amount to approximately 9.1% of the National Budget.
(5) Willing to contribute funds to the project or programs.	(5) The GON will mobilize a significant proportion of its resources for the recovery and reconstruction effort. See Section IV of the Program Assistance Paper.
(6) Making economic, social and political reforms such as tax collection improvements and changes in land tenure arrangements, and making progress toward respect for the rule of law, freedom of expression and of the press, and recognizing the importance of individual freedom, initiative, and private enterprise.	(6) Nicaragua has initiated various programs tending to social and political reforms, tax collection improvement, additional taxes, changes in land tenure, reliability on property records. AID Loan No. 524-L-012 (Tax Improvement) has been a great help. Nicaragua allows for freedom of expression and of the press as well as individual freedom, initiative and private enterprise.

(7) Adhering to the principles of the Act of Bogota and Charter of Punta del Este.

(7) The Borrower is adhering to the principles of the Act of Bogota and the Charter of Punta del Este.

(8) Attempting to repatriate capital invested in other countries by its own citizens.

(8) In following a course of political stability and in its efforts to promote economic development, Nicaragua gives an incentive to its own citizens to repatriate capital.

(9) Otherwise responding to the vital economic, political, and social concerns of its people, and demonstrating a clear determination to take effective self-help measures.

(9) Account has been taken of the Borrower's responsiveness to the vital economic, political and social concerns of its people. Nicaragua is further improving its educational system with AID assistance. Public health services and electrification through rural cooperative organization programs, financed with the assistance of AID loans, have been established by the GON in response to the vital economic, political and social concerns of its people. These programs have demonstrated effective self-help measures.

B. Are above factors taken into account in the furnishing of the subject assistance?

Yes

__Treatment of U.S. Citizens__

2. __FAA Sec. 620(c)__. If assistance is to government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) debt is not denied or contested by such government?

2. The Borrower is not known to be indebted to any U.S. Citizen in any such manner.

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3. FAA Sec. 620(e)(1). If assistance is to a government, has it (including government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?	3. The GON has not taken any such action.
4. FAA Sec.620(o); Fishermen's Protective Act, Sec. 5. If country has seized, or imposed any penalty or sanction against any U.S. fishing vessel on account of its fishing activities in international waters.	4. The GON has not seized or imposed any penalty or sanction against any U.S. fishing vessel on account of its fishing activities in international waters.
(a) Has any deduction required by Fishermen's Protective Act been made?	(a) Not applicable.
(b) Has complete denial of assistance been considered by A.I.D. Administrator?	(b) Not applicable.

Relations with U.S. Government and Other Nations

5. FAA Sec.620(d). If assistance is for any productive enterprise which will compete in the U.S. with U.S. enterprise, is there an agreement by the recipient country to prevent export to the U.S. of more than 20% of the enterprise's annual production during the life of the loan?	5. Not applicable.
6. FAA Sec.620(i). Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction by mob action, of U.S. property?	6. Nicaragua has not permitted this and has taken adequate measures to prevent such damage or destruction.

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7. FAA Sec.620(l). If the country has failed to institute the investment guaranty program for the specific risks of expropriation, inconvertibility or confiscation, has the A.I.D. Administration within the past year considered denying assistance to such government for this reason?

7. The GON has instituted the investment guaranty program in which guaranties were issued for operations amounting to more than $36 million by the end of CY 1971.

8. FAA Sec.620(q). Is the government of the recipient country in default on interest or principal of any A.I.D. loan to the country?

8. No.

9. FAA Sec.620(t). Has the country severed diplomatic relations with U.S.? If so, have they been resumed and have new bilateral assistance agreement been negotiated and entered into since such resumption?

9. Nicaragua maintains diplomatic relations with the U.S.

10. FAA Sec.620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the A.I.D. Administrator in determining the current A.I.D. Operating Year Budget?

10. Nicaragua is not delinquent on its U.N. obligations.

11. FAA Sec.620(a). Does recipient country furnish assistance to Cuba or fail to take appropriate steps to prevent ships or aircraft under its flag from carrying cargoes to or from Cuba?

11. Nicaragua does not furnish assistance to Cuba and has taken appropriate steps to prevent trade with Cuba.

12. FAA Sec.620(b). If assistance is to a government, has the Secretary of State determined that it is not controlled by the international Communist movement?

12. The Secretary has so determined.

13. FAA Sec. 620(f). Is recipient country a Communist country?

13. No.

14. FAA Sec. 620(i). Is recipient country in any way involved in (a) subversion of, or military aggression against the U.S. or any country receiving U.S. assistance, or (b) the planning of such subversion or aggression?

14. No.

15. FAA Sec. 620(n). Does recipient country furnish goods to North Viet Nam or permit ships or aircraft under its flag to carry cargoes to or from North Viet-Nam?

15. Available information reveal no case of trafficking or permitting trafficking with North Viet Nam.

16. FAA Sec. 481. Has the government of recipient country failed to take adequate steps to prevent narcotic drugs and other controlled substances (as defined by the Comprehensive Drug Abuse Prevention and Control Act of 1970) produced or processed, in whole or in part, in such country, or transported through such country, from being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents, or from entering the U.S. unlawfully?

16. Nicaragua has taken adequate steps to prevent these activities AID, through its Public Safety Pr[illegible]gram, is assisting the GON in this matter.

Military Expenditures

17. FAA Sec. 620(s). What percentage of country budget is for military expenditures? How much of foreign exchange resources spent on military equipment? How much spent for the purchase of sophisticated weapons systems? (Consideration of these points is to be coordinated with the Bureau for Program and Policy Coordination, Regional Coordinators & Military Assistance Staff (PPC/RC).)

17. Approximately 9.1% of the budget goes for military expenditures. Foreign exchange resources spent on military equipment is minimal. No expenditure is made for the purchase of sophisticated weapons systems.

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CONDITIONS OF THE LOAN

General Soundness

18. FAA Sec. 201(d). Information and conclusion on reasonableness and legality (under laws of country and the United States) of lending and relending terms of the loan.	18. The proposed loan is legal under the laws of Nicaragua and the U.S. and its terms are considered reasonable for Nicaragua.
19. FAA Sec. 251(b)(2); Sec. 251(e). Information and conclusion on activity's economic & technical soundness. If loan is not made pursuant to a multilateral plan, and the amount of the loan exceeds $100,000, has country submitted to A.I.D. an application for such funds together with assurances to indicate that funds will be used in an economically and technically sound manner?	19. The Borrower has made an application for assistance, coupled with assurance that the funds will be used in an economically & technically sound manner.
20. FAA Sec. 251(b). Information and conclusion on capacity of the country to repay the loan, including reasonableness of repayment prospects.	20. There are reasonable prospects of repayment. Refer to the economic section of the Program Assistance Paper.
21. FAA Sec. 611(a)(1). Prior to signing of loan will there be (a) engineering, financial, and other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the United States of the assistance?	21. Yes.
22. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purposes of loan?	22. Additional legislation is not required in order to execute this project as planned. The Loan Agreement will require congressional ratification but this is not expected to interfere with timely execution.

23. FAA Sec.611(e). If loan is for Capital Assistance, and all U.S. assistance to project now exceeds $1 million, has Mission Director certified the country's capability effectively to maintain and utilize the project?

23. Not applicable.

24. FAA Sec.251(b). Information and conclusion on availability of financing from other free-world sources, including private sources within the United States.

24. Financing from other free world sources, including other U.S. sources, is not available for financing proposed emergency recovery and reconstruction loan.

Loans Relationship to Achievement of Country and Regional Goals

25. FAA Sec.207; Sec.251(a). Extent to which assistance reflects appropriate emphasis on: (a) encouraging development of democratic, economic, political, and social institutions; (b) self-help in meeting the country's food needs; (c) improving availability of trained manpower in the country; (d) programs designed to meet the country's health needs, or (e) other important areas of economic, political, and social development, including industry; free labor unions, cooperatives, and Voluntary Agencies; transportation and communication; planning and public administration; urban development, and modernization of existing laws.

25. The major purpose of the loan is to assist Nicaragua to recover from the immediate physical, financial and economic effects of the earthquake.

26. FAA Sec. 209. Is project susceptible of execution as part of regional project? If so why is project not so executed?

26. No. The primary earthquake effects were localized in Nicaragua.

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27. FAA Sec. 251(b)(3). Information and conclusion on activity's relationship to, and consistency with, other development activities, and its contribution to realizable long-range objectives.	27. Recovery and reconstruction from a disaster of such magnitude is a prerequisite for fulfilment of developmental activities and longer range objectives.
28. FAA Sec. 251(b)(7). Information and conclusion on whether or not the activity to be financed will contribute to the achievement of self-sustaining growth.	28. This recovery and reconstruction is essential for the achievement of self-sustaining growth.
29. FAA Sec. 281(a). Describe extent to which the loan will contribute to the objective of assuring maximum participation in the task of economic development on the part of the people of the country, through the encouragement of democratic, private, and local governmental institutions.	29. This program will assist people and institutions from every level in their performance of the tasks necessary for recovery and reconstruction.
30. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in skills required for effective participation in governmental and political processes essential to self-government.	30. The project is in response to a demonstrated need and desire of the people of Nicaragua and is a prerequisite for the process of institution building and to effective participation in the governmental and political processes of Nicaragua.
31. FAA Sec. 601(a). Information and conclusions whether loan will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices (e) improve technical efficiency of industry, agriculture, & commerce; & (f) strengthen free labor unions.	31. This loan is primarily intended for disaster recovery and reconstruction and other benefits are incidental.

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32. FAA Sec. 619. If assistance is for newly independent country; is it furnished through multilateral organizations or plans to the maximum extent appropriate?	32. Nicaragua is not a newly independent country.
33. FAA Sec.251(h). Information and conclusion on whether the activity is consistent with the findings and recommendations of the Inter-American Committee for the Alliance for Progress in its annual review of national development activities.	33. The earthquake took place subsequently to the regular CIAP meeting and the urgency of this program precludes awaiting any CIAP emergency meeting.
34. FAA Sec.251(g). Information and conclusion on use of loan to assist in promoting the cooperative movement in Latin America.	34. Not applicable.
35. FAA Sec.209; Sec.251(b)(8). Information and conclusion whether assistance will encourage regional development programs, and contribute to the economic and political integration of Latin America.	35. By promoting Nicaragua's recovery and reconstruction, this loan will enhance her ability to participate in regional activities.

<u>Loan's Effect on U.S. and A.I.D. Program</u>

36. FAA Sec.251(b)(4); Sec.10[illegible] Information and conclusion on possible effects of loan on U.S. economy, with special reference to areas of substantial labor surplus, and extent to which U.S. commodities and assistance are furnished in a manner consistent with improving the U.S. balance of payments position.	36. Being largely for local currency expenditures, this loan will have little direct effect on the U.S. economy. However, Nicaraguan recovery should result in increased imports from the U.S.

37. FAA Sec.601(b). Information and conclusion on how the loan will encourage U.S. private trade and investment abroad and how it will encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

37. To the extent that the Nicaraguan economic situation recovers, U.S. private trade & investment opportunities should be augmented.

38. FAA Sec.601(d). If a capital project, are engineering and professional services of U.S. firms and their affiliates used to the maximum extent consistent with the national interest?

38. Not applicable.

39. FAA Sec.602. Information and conclusion whether U.S. small business will participate equitably in the furnishing of goods and services financed by the loan.

39. Only very selective U.S. procurement will be involved, if any. Because of the emergency nature of the program, a blanket small business waiver is being sought.

40. FAA Sec.620(h). Will the loan promote or assist the foreign aid projects or activities of the Communist-Bloc countries?

40. There is no foreign assistance being given to Nicaragua by Communist-Bloc countries.

41. FAA Sec.621. If Technical Assistance is financed by the loan, information and conclusion whether such assistance will be furnished to the fullest extent practicable as goods and professional and other services from private enterprise on a contract basis. If the facilities of other Federal agencies will be utilized, information and conclusion on whether they are particularly suitable, are not competitive with private enterprise, and can be made available without undue interference with domestic programs.

41. It is not contemplated that direct technical assistance will be financed by the loan.

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42. FAA Sec.252(a). Total amount of money under loan which is going directly to private enterprise, is going to intermediate credit institutions or other borrowers for use by private enterprise, is being used to finance imports from private sources, or is otherwise being used to finance procurements from private sources.	42. The local currency generated under the loan will be utilized primarily in public investment activities. The dollars made available will support the level of foreign exchange reserves and thus enable Nicaragua to maintain its import level.

Loan's Compliance with Specific Requirements

43. FAA Sec.201(d). Is interest rate of loan at least 2% per annum during grace period and at least 3% per annum thereafter?	43. Yes.
44. FAA Sec.608(a). Information on measures to be taken to utilize U.S. Government excess personal property in lieu of the procurement of new items.	44. This loan will not lend itself to utilization of excess property in view of small amount of out of country procurement.
45. FAA Sec.604(a). Will all commodity procurement financed under the loan be from the U.S. except as otherwise determined by the President?	45. Any procurement will be local, U.S., or A.I.D. Geographic Code 941.
46. FAA Sec.604(b). What provision is made to prevent financing commodity procurement in bulk at prices higher than adjusted U.S. market price?	46. No bulk commodity procurement is contemplated under this loan.
47. FAA Sec.604(d). If the cooperating country discriminates against U.S. marine insurance companies, will loan agreement require that marine insurance be placed in the United States on commodities financed by the loan?	47. Nicaragua does not so discriminate.

48. FAA Sec.604(e). If offshore procurement of agricultural commodities or products is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity?

48. No agricultural commodities or products will be procured with this loan.

49. FAA Sec.611(b);App. Sec.101. If loan finances water or water-related land resource construction project or program, is there a benefit-cost computation made, insofar as practicable, in accordance with the procedures set forth in the Memorandum of the President dated May 15, 1962?

49. Not applicable.

50. FAA Sec.611(c). If contracts for construction are to be financed, what provision will be made that they be let on a competitive basis to a maximum extent practicable?

50. The loan agreement will provide that contracts for construction will be awarded on a competitive basis, to the maximum extent practicable.

51. FAA Sec.620(g). What provision is there against use of subject assistance to compensate owners for expropriated or nationalized property?

51. The program is so structured that funds cannot be used for this purpose. See Program Assistance Paper, Section VII.

52. FAA Sec.612(b);Sec.636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the United States are utilized to meet the cost of contractual and other services.

52. Due to the effects of the earthquake, the levels of local currency contribution by the government will be according to availability. This loan being largely in the form of budget support, local contribution is expected to be difficult for the Government.

53. App.Sec. 104. Will any loan funds be used to pay pensions, etc., for military personnel?

53. No.

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54. App.Sec. 106. If loan is for capital project, is there provision for A.I.D. approval of all contractors and contract terms?	54. Not Applicable
55. App.Sec.108. Will any loan funds be used to pay U.N. assessments?	55. No.
56. App.Sec. 109. Compliance with regulations on employment of U.S. and local personnel for funds obligated after April 30, 1964 (AID Regulation 7).	56. Regulation 7 will be complied with to the extent applicable.
57. FAA Sec.636(i). Will any loan funds be used to finance purchase, long-term lease, or exchange of motor vehicles manufactured outside the United States, or any guaranty of such a transaction?	57. No.
58. App.Sec.501. Will any loan funds be used for publicity or propaganda purposes within the United States not authorized by the Congress?	58. No.
59. FAA Sec.620(k). If construction of productive enterprise, will aggregate value of assistance to be furnished by the United States exceed $100 million?	59. No.
60. FAA Sec.612(d). Does the United States own excess foreign currency and, if so, what arrangements have been made for its release?	60. No.
61. MMA Sec.901.b. Compliance with requirement that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liner, and tankers) financed with funds made available under this loan shall be transported on privately owned U.S.-flag commercial vessels to the extent that such vessels are available at fair and reasonable rates.	61. All such requirements will be complied with and the Loan Agreement shall so require.

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ANNEX B

INFORMATION FOR COMPLETION OF PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

1. PAAD No.:
2. Country: NICARAGUA
3. Category: US and Local Currency Financing
4. Date:
5. To: Administrator, A.I.D.
6. OYB Change No:
7. From: Herman Kleine, Deputy U.S. Coordinator, Latin America Bureau
8. OYB Increase:
9. Approval Requested for Commitment of: $15,000,000
10. Appropriation - Allotment:
11. Type Funding: Loan
12. Local Currency Arrangement: Direct dollar conversion
13. Estimated Delivery Period: 3/1/73 - 6/30/74
14. Transaction Eligibility Date: 1/25/73
15. Commodities Financed: Direct purchase of local currency with dollars. Selected LFW goods and services dollar financed.
16. Permitted Source: LFW - $5,000,000; Cash - $ 15,000,000
17. Estimated Source: Local - $10,000,000; Other - $ 8,000,000 (941)
18. Summary Description:

The objective of the Program is to provide financing (a) for supporting a portion of the Nicaraguan investment budget requirements related to the earthquake of December 23, 1972, and (b) for local currency contributions required to be made by Nicaragua under authorized A.I.D. loans. The bulk of the Program will involve local currency financing although some selected dollar financing may be required.

1. Repayment of the loan will be in U.S. Dollars within forty (40) years from the date of the first disbursement under the loan, including a grace period of not to exceed ten (10) years. The Borrower shall pay to A.I.D. in U.S. dollars on the outstanding disbursed balance of the loan, interest of two percent (2%) per annum during the grace period and three percent (3%) per annum thereafter.

2. The loan shall be subject to such other terms and conditions as A.I.D. may deem advisable.