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NICARAGUA PRIVATE SECTOR SUPPORT PROJECT

ASSESSMENT OF PRIVATE SECTOR INITIATIVES

IQC Contract No. PCE-0001-I-00-2051-00

Delivery Order No. 2

Prepared for:
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
Managua, Nicaragua

CHEMONICS

Prepared by:
Montague Lord, Team Leader
Robert Laport
John Porges

April, 1993

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ACRONYMS

APENN	Association of Nicaraguan Producers and Exporters of Nontraditional Products
BCIE	Central American Bank for Economic Integration
BCN	Central Bank of Nicaragua
CEI	Center for Exports and Investment
CIC	Center for Commercial Information
CORNAP	*Corporaciones Nacionales del Sector Publico*
COSEP	*Consejo Superior de la Empresa Privada*
EPAI	Economic Policy and Implementation Project
GON	Government of Nicaragua
IBRD	International Bank for Reconstruction and Development
IDB	Inter-American Development Bank
IMCC	International Management Consulting Corporation
IMF	International Monetary Fund
INCAE	Central American Institute of Business Administration
INDE	Nicaraguan Institute of Development
INISER	*Instituto Nacional de Seguros y Resaseguros*
INSSB	*Instituto Nicaraguense de Seguridad y Bienestar*
MEDE	Ministry of Economy and Development
MIS	Management Information Systems
NGO	Nongovernmental Organization
PSS	Private Sector Support Project, USAID
PW	Price Waterhouse
SBN	Superintendency of Banks
SME	Small- and Medium-size Enterprises
SOE	State-owned Enterprise
UNDP	United Nations Development Program
USAID	United States Agency for International Development

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

In April 1992 the U.S. Agency for International Development (AID, or USAID) and the Government of Nicaragua (GON) initiated the $5.5 million Private Sector Support (PSS) project to create an enabling environment for private sector development. One year later, AID is re-examining the needs of the private sector in Nicaragua, and is considering amendments to the PSS project in light of changing economic conditions. This report assesses the Nicaraguan private sector generally and project progress specifically in order to recommend possible changes and additions to the three major components of PSS: trade and investment promotion; privatization of state-owned enterprises; and establishment of viable financial institutions. The report also assesses project activities under the Studies and Surveys component, and examines component interrelationships.

The assessment was conducted in March 1993 by a team of three private sector experts. In general they found that the PSS project has contributed in several important ways to improving the environment for investments and exports in Nicaragua in support of sustainable, broad-based growth. Effective support has been achieved in the divestiture of SOEs and the establishment of viable financial institutions. There have been considerable problems, however, with trade and investment promotion because of a lack of clear focus and direction in promotion methods. Overall, the private sector initiatives sponsored by the PSS project, as well as by other donors and the GON, are not supported by macroeconomic conditions, and cannot be sustained in the long run. Therefore, the team makes the following general recommendations:

1. A concerted effort must be made to incorporate linkages between PSS project components and GON macroeconomic policies to ensure that real exchange rate policies, as well as monetary and fiscal policies, are conducive to sustainable expansion of trade and investment.

2. A greater effort should be made to incorporate actual and expected feedback effects from the PSS and the Private Agricultural Services projects to assess the impact of changes in nontraditional exports and improved services on export and investment promotion needs, and the effects of trade and investment promotion on the ability and willingness of the agricultural sector to develop nontraditional exports.

Main conclusions and recommendations from the team's assessments of the three major project components follow. Remarks relating to the industrial/processing sector and the regulatory environment have been incorporated into the relevant component findings.

A. Trade and Investment

Principal PSS export and investment promotion activities are conducted through the Center for Exports and Investment. The operational effectiveness of CEI would be enhanced if it were to obtain status as an independent organization, and broaden its Board

representation in the private and public sectors. Indeed, over a period of time an effort should be made to disassociate the activities of CEI from COSEP, without necessarily reducing existing USAID support to private sector institutions through COSEP. Moreover, many of CEI's operations might eventually be funded on a fee basis.

The present mission of CEI is unclear and, as a result, support for investors and exporters remains unfocused. The scope of work under the original contract with Carana does not provide for the flexibility needed as the project evolves, and restricts the range of operations that can be undertaken in support of private sector initiatives. Amendment and expansion of the PSS program implies that the original scope of work with Carana will need to be amended. The resolution of organizational issues and a better definition of CEI's mission will undoubtedly provide a favorable environment for the work of its staff.

Recommendations:

1. CEI should be expanded for broader private and public sector participation. As an initial step the Board of Directors should be expanded to include four ministries (MEDE, Finance, Agriculture, and Tourism); four private sector organizations (COSEP, the Chamber of Industry, the Chamber of Commerce, and UPANIC); two Nicaraguan company CEOs, one multinational CEO; and the INCAE Director. Two committees should be formed as part of the Board: (1) a Consultations Committee to orient the work of CEI and provide guidelines on specific initiatives; and (2) a Donor Committee (USAID, UNDP, IDB, and IBRD) to coordinate programs or subprograms directly related to trade and investment.

2. CEI should give priority to design and implementation of its information system. A management information systems specialist, with appropriate support services, will be needed to establish and maintain the network for the database and other systems.

3. Only a core documentation center should be established, with information limited to key trade and investment directories. USAID should not support the move of the CIC facilities in MEDE to CEI. The facilities are inadequate, and would present an unnecessary burden to CEI.

4. The "one-stop" services for export processing should be made part of CEI because they facilitate exports and offer exporters direct contact with CEI.

5. Additional funding is recommended for a staff member to manage publications and promotional materials. These activities should be developed, along with direct support and training for enterprises.

6. Institution building capacity should be strengthened in the PSS project though further direct support of the member organizations of COSEP. To date, only limited support has been provided through the Initiative Fund. Strategic planning should be supported with COSEP as part of its long-term development.

7. Continued progress in reducing duplication of effort between MEDE and CEI is critical to the success of USAID's PSS project. Regular monthly meetings between the two organizations, including Carana, should address this problem.

B. Privatization

Price Waterhouse is well on the way to fulfilling its obligations under the scope of work and is where it should be at mid-term. The team received a unanimously favorable response to questions regarding PW's performance posed to each official of CORNAP interviewed. Those not directly involved in the PW-CORNAP relationship, but who are involved in the privatization process, also expressed high regard for the quality of PW's work and the results achieved to date. However, additional funding will be required to permit PW to complete its work.

Additional assistance to strengthen the private sector is sorely needed and must extend beyond the completion of the privatization program. Many of the new owners of privatized properties, primarily agricultural, do not have the skills to manage and operate their properties on a sustainable basis. There is considerable concern that numerous failures of worker and ex-combatant-owned enterprises could spoil the success that privatization has achieved to date and unbalance the present delicate political stability.

CORNAP's strategy involved privatizing the easiest SOEs first to generate transactions and to impact as many beneficiaries as possible in a short period of time. While succeeding, more complex situations involving legal and other difficulties have been left until the latter stages of the program. CORNAP needs additional personnel to provide legal assistance and marketing support to maintain the pace of the program. A source of cash for the payment of worker indemnities under the CORNAP program should also be found to enable the privatization program to proceed in an expeditious manner.

Recommendations:

1. USAID should amend and increase the PW buy-in by an amount sufficient to permit PW to complete its privatization work on the SOEs which it has been assigned and to provide other services to CORNAP. It essential that the Project Manager be funded to provide for his services through the life of project; an additional $400,000 should be sufficient.

2. USAID should consider increasing CORNAP's ability to cope with legal and marketing problems caused by the heavy workload now being generated from the IDB/INCAE effort. USAID assistance could, at AID's option, be given through: (a) an amendment increasing the PW buy-in permitting them to send an additional junior expert to Nicaragua; or (b) the trial use of CEI to help CORNAP market from three to five companies in a sector selected by USAID. If CEI were to work out, it might preclude the need to import an additional expatriate. Additional Nicaraguan legal assistance should be provided to CORNAP as well.

3. USAID should consider expanding the PSS project to include training and technical assistance for newly privatized SOEs, primarily those in the rural sector. To the degree possible, basic management and technical training should initially be provided on site. Training should last a minimum of one year and include the use of a number of geographic centers where follow-up help can be obtained.

4. USAID should consider expanding its privatization role by becoming involved in assisting the privatization of the three public sector monopolies—TELCOR, INE, and ENABAS—and the construction companies which GON plans to begin privatizing in the fairly near future.

5. The team recommends that USAID utilize counterpart funds to support the GON Treasury in meeting a portion of its cash needs for indemnity payments to workers, and for the creation of a redundancy fund.

C. Financial Services

Private banks, the Superintendency of Banks, and the Bankers' Association are new and need time to gain experience and mature. There is a need for staff training, especially for tellers, retail platform people, internal controls branch and operations managers, treasury operations (liquidity and investment) staff, and asset and liability managers. The Superintendency's greatest need is to keep its Senior Advisor in place beyond his contract expiration in June 1993. The Bankers' Association needs a minimal staff and a modest office to create a training institute and represent the banks before officialdom. It requires a code of ethics and conduct for the banks.

The Central Bank needs a fixed-term president and representation of private and state banks on its Board. It should be supervised by its own Board and not by the *Controlaria General de la República*. The stock exchange has two promoter groups who should unite. They need to prepare a financial plan with cash flow projections, volumes of activity and projected earnings before requesting start-up funding.

Nicaragua needs enabling legislation and investors to form private insurance companies and private pension plans before they can play an active part in the capital markets. When they are functioning they will need some technical assistance in investing their reserves.

Recommendations:

1. The Senior Advisor's contract with SBN should be renewed, preferably for a year.

2. USAID should fund the design and implementation of a training program for SBN field inspectors.

3. If not continued by the World Bank, USAID should consider funding the next phase of training for commercial bank staff.

4. USAID should consider updating the Price Waterhouse study on the norms and needs of the SBN, thereby providing a priority work plan for the next twelve to eighteen months.

5. USAID should consider making a one-time grant to the Bankers' Association to fund its start up, including hiring staff and preparing a priority work plan.

6. The Bankers' Association should be encouraged to establish a dialogue with the GON in an attempt to modify the new banking law in the National Assembly to make it more rational.

7. Technical assistance should be provided to the Central Bank, perhaps through the new EPAI project, to train senior staff in controlling the money supply and managing debt.

8. The two groups promoting the stock exchange should be encouraged to join forces to prepare a financial/operational plan. This should be a condition of USAID financial assistance.

9. Policy dialogue with the GON should be encouraged to hasten drafting and passage of enabling legislation for private insurance and pension plans.

10. USAID should consider sending selected managers form the Central Bank to the New York Federal Reserve Bank for on-the-job/observation training in preparation for open market operations in Nicaragua.

11. USAID should consider funding a needs assessment for small and medium enterprise development, similar to what has been done for microenterprises.

D. Studies and Surveys

The PSS project has supported the design and implementation of studies and surveys in the three major project components. Of the six studies envisioned in the project, only two studies are currently underway, and considerable effort will be needed to ensure their completion in a reasonable period of time. As funds have already been earmarked for specific projects, there is little, if any, room for flexibility within the proposed budget for other studies. More funding of studies and surveys in all three areas of the PSS project is needed because of the lack of basic information concerning existing and potential conditions in the Nicaraguan economy.

Recommendations:

1. A delivery date should be established for the trade and investment studies underway.

2. Additional funding of studies should be permitted in the amended PSS project to encourage gathering needed information for private sector development.

3. A formal mechanism should be established to determine the criteria to be used in selecting, formulating, and implementing studies. A formal review process also needs to be established. That mechanism should contain guidelines for the wide dissemination of the studies and surveys.

4. Additional staffing in USAID will be required to adequately support this component.

E. Women in the Private Sector

There are conflicting opinions regarding the status of women in the private sector. The most urgent requirement is for statistical information upon which USAID can base its assistance. Analysis is particularly needed in: mechanisms to encourage women to seek higher levels of education; flexible work schedules which permit women to attend to family obligations; and the extent to which sexual harassment exists.

Recommendation:

USAID should consider participating in studies of women in the private sector, including household surveys. USAID projects should promote women by targeting them for business training and other educational opportunities, and by disseminating promotional materials to raise women's involvement in business.

F. Program Interrelationships

Revitalization of the Nicaraguan economy will require concerted efforts to generate private investment and exports. These include, but are not limited to, the re-establishment of a viable financial system, the divestiture of state-owned enterprises, and the development of regulations, information, foreign markets, and an export reorientation of the private sector, all of which promote trade and investment. For this reason, it is vital that the major components of the PSS project move forward together.

Recommendation:

1. Distinguish between activities which directly support investment and export, and overall institutional development. Place priority on assistance for the former, but realize that institution building is an integral part of private sector development.

I. INTRODUCTION AND BACKGROUND

The main objective of USAID's Private Sector Support (PSS) project, initiated in April of 1992, is the creation of an enabling environment for private sector development in Nicaragua. US$5.5 million was allocated to the project through March 1994, apportioned as follows:

PROJECT COMPONENTS	ALLOCATION US$
Program Coordination	201,376.00
Institutional Contracts	4,282,624.00
Grant to COSEP/INDE	693,000.00
Assistance to MEDE/EIPU	295,000.00
Evaluation	15,000.00
Audit	13,000.00
TOTAL	5,500,000.00

Activities under the institutional contracts are budgeted as follows:

PROJECT COMPONENT	ALLOCATION (US$)
Trade and Investment*	1,505,000.00
Privatization	1,356,260.00
Financial Services	795,320.00
Unearmarked	626,044.00
TOTAL	4,282,624.00

* The Trade and Investment component is augmented by the assistance to COSEP/INDE and MEDE/EIPU, bringing the value of that activity to $2,493,000.00 ($1,505,000.00 + $693,000.00 + $295,000.00 = $2,493,000.00)

The PSS project is one of USAID/Nicaragua's efforts to support overall broad-based, sustained economic growth driven by the private sector. As such it complements USAID/Nicaragua's Private Agricultural Services project, which promotes nontraditional exports and improved services by members of Nicaragua's umbrella association of agricultural and livestock producers. In addition, a recently approved USAID $8 million project, which provides expertise for macroeconomic planning, is to begin implementation in three months. It will work directly with the Government of Nicaragua, specifically the Ministry of Finance, the Central Bank, the Ministry of Economy and Development and the Ministry of Social Action. The project description has not yet been released so details are unavailable at this time. Nonetheless, it is important to recognize that the current assessment of the PSS project should be considered in the context of this and the other programs of USAID and other donor agencies aimed at achieving sustained economic growth in Nicaragua.

The three main project components—trade and investment, privatization, and financial services—are closely interrelated. For example, the investment promotion component of the project should be closely coordinated with investment promotion in privatization efforts. At the same time, financial sector development provides market mechanisms to support investment and exports, and in turn promotes the privatization process.

The initial design of the PSS project addressed the immediate needs of the private sector in order to stimulate its response to a changed policy environment. It also supports the USAID/Nicaragua Country Development Strategy Statement for 1991-1996 in its objectives of increased foreign and domestic investment, competitiveness, and productivity. The first phase of the project focused on the short-term adjustment response of the private sector to the new government's economic reform program. The design was made during a period of uncertainty concerning the economy, as well as the institutional capacities of both the private and public sectors to support the economic and social rehabilitation of the country. The project provided for a mid-term assessment once economic stabilization efforts began to get underway.

Having addressed the private sector's short-term adjustment response, USAID is now re-examining the sector's needs, as well as available mechanisms to address those needs, in order to consider possible amendments to the project. Accordingly, in March of 1993 a team of three private sector experts conducted an assessment of private sector initiatives under the PSS project to determine their effectiveness in achieving Mission objectives; what changes might improve their effectiveness; and what additional areas of involvement might further support the Mission's objectives in private sector development. This report presents the team's findings, concentrating on conclusions and recommendations regarding its three major components: (a) promotion of trade and investment (Section II.); (b) privatization of state-owned enterprises (Section III.); and (c) establishment of viable financial institutions (Section IV.). Remarks and conclusions regarding the industrial/processing sector and the regulation and enforcement environment have been incorporated into the pertinent assessments of the three main project components. Findings related to the Studies and Surveys, Women in the Private Sector, and Program Interrelationships components are presented as Sections V., VI. and VII. of this report.

II. TRADE AND INVESTMENT

A. Introduction

The Trade and Investment component of the PSS project provides for technical assistance to promote and facilitate trade and investment, and aims to help selected private firms (identified by the studies and surveys component) realize their potential to increase exports and attract investment. Of the budgeted amount for these activities, the USAID contribution is $1,505,000, plus assistance to the Ministry of the Economy and Development (MEDE), and the *Consejo Superior de la Empresa Privada* (COSEP) in the amounts of $295,000 and $693,000 respectively, for trade and investment activities. This report section will also comprise the assessment team's comments on the industrial/processing sector (C4c. below) and the regulatory environment (C5. and C6. below).

The project complements activities of other donor agencies in the country in the following areas:

- **World Bank:** The Bank's emphases have been on structural adjustment issues and economic policy reforms, including trade liberalization. In October 1992, a team was sent by World Bank headquarters to investigate problems in the development of the country's private sector. The principal problems identified were: (1) a lack of clarity in laws related to doing business, particularly as they concern trade incentives, taxes, and the application of ad hoc trade barriers, despite the elimination of many non-tariff barriers to trade; (2) the divergences that often occur between laws and the application of those laws; and (3) political instability in the country (i.e., property rights and the current impasse between the legislative and executive branches of government).

- **Inter-American Development Bank:** The only project of this institution related to the trade and investment component on the PSS project is the Nicaragua Trade and Finance Adjustment Loan approved in 1991. It provides balance of payments support in exchange for certain conditionality. The loan does not provide for specific activities in the export sector.

- **United Nations Development Program (UNDP):** The major project of this institution is the financial support being given to MEDE through the *Programa de Apoyo al Desarrollo del Comercio Exterior y las Inversiones en Nicaragua.* The initial phase provides $5 million for technical assistance and later financing of the development of seven nontraditional agricultural projects: melons, cassava, black beans, peanuts, onions, baby corn, and shrimp farming (approximately $25 million). This project is discussed below in the context of the activities of MEDE in trade and investment.

B. Background

The national policy for investment and export promotion was initially based on the establishment of an appropriate economic environment through the adoption of macroeconomic stabilization policies and structural reforms in trade liberalization, tax reform, privatization, and financial system reform.

In 1992, the economic environment in Nicaragua began to improve. Real GDP increased, although per capita income once again fell. Overall economic activity is expected to expand moderately in 1993; inflation last year was in the single digits. Recent developments, however, point to a continued need for macroeconomic initiatives. The wage-price spiral has nearly offset the recent devaluation, putting the country's exports at a competitive disadvantage relative to competing suppliers in foreign markets. Depressed prices in coffee and sugar, combined with domestic labor disruptions, have reduced foreign exchange earnings by 25 percent of their level at the time the Chamorro Government came into power. Consequently, there remains an urgent need to establish conditions conducive to an export-driven economic recovery in the country.

In an effort to stimulate exports and economic activity, the Government has adopted a second stage initiative aimed at promoting investments and exports. According to the MEDE Minister, Pablo Pereira, the Government's program of export promotion and investment consists of the following four basic initiatives:

- **Legal Framework**: Establish the guarantees and incentives for investments and exports through (a) the Foreign Investment Law; (b) the Export Promotion Law; and (c) the Industrial Free Zones Law.

- **Institutional Framework**: Develop the institutional capacity for the stimulation of investments and exports, through the following private or mixed institutions: (a) National Commission on Investment; (b) National Commission of Export Promotion; (c) National Corporation of Free Zones; (d) Center for Exports and Investments (CEI), (e) Association of Nicaraguan Producers and Exporters of Nontraditional Products (APENN); (f) Association of Nicaraguan Melon Producers (APROMELON) and other producer associations for onions, cassava, and baby corn.

- **Credit**: Establish the system for financing investments and exports through the Superintendency of Banks and other institutions, which allows for the growth of private banks, redefines the size of the state bank and, because of the low level of domestic savings, uses the Nicaraguan Investment Fund (FNI) as a mechanism for financing the country's development.

- **Export Consciousness**: Develop an export-oriented mentality throughout the economy via promotional material, including COSEP's television segment "Export," direct contacts with producers, and presentations in foreign countries concerning investment possibilities in Nicaragua.

The PSS project specifically complements the Government's program in the area of investment and export promotion. Moreover, it generally complements the overall macroeconomic policy of the Government insofar as it provides sector and industry-specific support within the framework of the country's changing economic environment. At this time, the main focus of the project is the renewal of sustainable economic growth.

C. Assistance Under the PSS Project

C1. Outputs Defined in the Project Paper

The principal activities of this component of the PSS project consist of the establishment and operation of the Center for Exports and Investments; the support of COSEP as the private sector umbrella organization, along with its member associations; and the provision of customized trade and investment assistance to potential exporters and investors.

The CEI operates under a joint affiliation with COSEP and MEDE. The private consulting firm Carana Corporation is the principal advisory body for activities related to trade and investment activities. CEI was established in July 1992 primarily for the purpose of assisting individuals and firms wishing to undertake investments and exports from Nicaragua. The current activities for CEI under the PSS project are:

- Streamlining procedures concerning export and investment.
- Review and reform policies and regulations on exports and investments.
- Provide information to potential exporters and investors.
- Prepare contracts between the Government and potential investors.

At the time the PSS project was designed, CEI had not been established. Consequently, COSEP was assigned most of the export and investment promotion activities. At present those activities are being performed by CEI. The seven activities specified for COSEP in the PSS project were:

- Trade and investment initiatives to attract both foreign and local investment, to be carried out by a trade and investment specialist based at COSEP.

- Finance-related activities to ensure that the appropriate policy and regulatory reforms take place, to be carried out by a COSEP finance and credit specialist.

- Policy analysis and review of selected trade and investment related topics for the assessment of trade and investment policies, to be carried out by a policy specialist based in COSEP.

- Advocacy and communications activities through a series of awareness seminars, addressing national needs and the role of the private sector in leading the country towards economic revitalization, especially via trade and investment, to be carried out by a COSEP communications specialist.

- Institutional and human resource development geared toward various activities envisioned for COSEP and its member associations, to be carried out by an institutional/human resources development specialist based in the Nicaraguan Institute of Development (INDE).

- Information services geared toward an information clearinghouse system that determine specific data needs of prospective investors and exporters, and other activities of a public relations nature.

- Association-specific initiatives under which funds are provided directly to the associations in support of sector-specific activities related to the promotion of trade and investment.

In addition to the assistance provided to the private sector through public and private associations, direct customized assistance is to be provided to selected firms and individuals demonstrating short-term potential for substantially increasing non-agricultural exports, as well as selected entities that are potential investors in Nicaragua, as identified in the studies and surveys component of the PSS project.

C2. The Contractor's Scope of Work

The scope of work calls for 59 person-months of intermittent and short-term technical assistance to all PSS project components. Export and investment activities are:

- **Trade and Investment Assistance to the Public Sector:** The contractor is to provide assistance to MEDE in establishing the CEI. Specific activities in support of this component are listed in the contract.

- **Trade and Investment Assistance to Private Sector Associations:** The contractor is to provide assistance to COSEP and its member private sector associations in order to strengthen the business community's capacity to serve as a policy advocate for private sector needs and interests in order to increase trade and investment activities in Nicaragua.

- **Customized Services to Private Sector Companies:** The contractor is to provide direct assistance to specific Nicaraguan companies in order to demonstrate some early successes in Nicaragua. This component also envisioned limited assistance to foreign investors interested in Nicaragua.

- **Support Activities:** The contractor is to act as a purchasing agent for specific equipment for the project.

- **Studies and Surveys:** The contractor is to conduct as many as four studies to help identify emerging opportunities, examine alternatives for future project activities, and other similar activities.

Carana Corporation, as principal contractor, has in its scope of work the potential to support all three project components, but early on it was determined that Carana's activities should be concentrated on trade and investment.

C3. The Center for Exports and Investments

C3a. Organization and Management

The initial organizational structure had two individuals acting as Executive Director, one being COSEP's representative, the other MEDE's representative. The shared management proved to be difficult and caused impediments to the project. With the departure of the second MEDE representative/executive director in December 1992 (the first MEDE representative left in September 1992), authority was centralized in the COSEP representative, which has improved the working situation. MEDE supports the appointment of a single general manager, and selection will occur through a publicized search procedure that has already been agreed upon.

The establishment of CEI under the purview of COSEP and MEDE has the advantage of joining private and public sector interests, but it has also brought with it complications. There is little doubt that the support of both the public and private sectors makes CEI more operationally effective, and this benefit must be weighed against the disadvantage of introducing too much bureaucracy and political influence. COSEP has a cooperative agreement with USAID, through which $403,000 is earmarked for CEI operations.

At some stage, CEI needs to obtain status as an independent service organization in the eyes of its end-users. It should be allowed to develop as a service center similar to the Mauritius Export Development and Investment Authority (MEDIA) and Hong Kong's Trade Development Council (TDC). It is recognized that CEI is likely to remain largely dependent on USAID and MEDE for funding. However, this situation could be altered over time so that CEI functions are fee-based. Moreover, because of the political orientation of COSEP, it is recommended that over a period of time an effort be made to disassociate the activities of CEI from COSEP, without necessarily reducing the existing direct USAID support to private sector institutions through COSEP.

Additionally, a Board of Directors should be established to include a wide association of participants, and to augment its respect by the Nicaraguan community. A proposal that appears to be favored by CEI, as well as Carana and MEDE, envisions a Board of Directors for CEI composed of COSEP, MEDE, and other representatives from the private and public sectors. A possible structure could be as listed on the following page.

BOARD OF DIRECTORS

Public Sector
Minister of Economy and Development
Minister of Finance
Minister of Agriculture
Minister of Tourism

Private Sector Organizations
COSEP Director
Chamber of Industry Director
Chamber of Commerce Director
UPANIC Director

Private Sector Representative Firms
Two (2) Nicaraguan company CEOs
One (1) multinational CEOs

Academic Institution
Dean, Central American Institute for Business Administration

On an ad hoc basis, other ministries would be included to deal with specific issues related to their operations. USAID and Carana would have observer status.

Two committees would be attached to the Board of Directors:

- **Consultations Committee:** Responsible for orienting the work of CEI and providing guidelines on specific initiatives, which could be composed of rotating Board members.

- **Donor Committee:** Composed of USAID, UNDP, IDB, and IBRD; attended by CEI and MEDE with observer status. Members would coordinate programs or sub-programs directly related to trade and investment in the country.

The Board of Directors would advise the Executive Management, which would be composed of MEDE and COSEP. The Managing Director of CEI would respond to Executive Management. The General Manager would direct the operation of the two principal units of CEI: the Export Department and the Investment Department. He or she would also supervise units handling information systems, fairs, promotion, training and seminars, policies, technical services, the information center, "one-stop" services, administrative matters, and special projects.

C3b. CEI Activities

The present role of CEI is unclear and, as a result, support for investors and

exporters remains unfocused. Current activities and services include: providing copies of rules and regulations governing investors and exporters upon request; conducting sector studies; supporting participation in trade fairs; and designing seminars on promotion of exports and investment. Two areas to be strengthened as a natural process of CEI's development are: (1) expansion of its activities through both internal growth and closer operational linkages with other institutions, and (2) greater specificity of its work. Provision of all assistance through a single contract does not provide for the flexibility required as project needs evolve, and thus restricts the range of operations that can be undertaken in support of private sector initiatives. With amendment and expansion of the PSS project, it is expected that the original scope of work with Carana will need to be amended, and additional funds adapted to the changing needs of the private sector. This redefinition is essential to ensure accountability and allow for effective project management.

There are currently eight professional staff members in CEI, comprising the director and various export and investment officers. The CEI is currently directed by the COSEP representative with somewhat reduced authority relative to the level originally intended, particularly towards staff associated with MEDE. Among staff members, considerable effort has been made to integrate those from COSEP (four members) and MEDE (four members) into the CEI. Nonetheless, as is to be expected, there remains a clear consciousness by each staff member of his or her institutional origin. The institution building component of the project needs resolution in order to progress toward productive technical assistance. The reorganization is a preoccupation of the majority of the staff members, as are their relatively low salaries. Nonetheless, they are generally well motivated and have technical expertise in their respective areas. Some of the staff members are exceptional and are highly driven in their desire to see CEI succeed, and these are likely to provide a favorable demonstration effect to the other staff members. The resolution of organizational issues and a better definition of CEI's mission will undoubtedly provide a favorable working environment.

C3c. Database on Investment Opportunities

CEI has embarked on the development of a computerized information database containing information for individuals and companies exploring the possibility of investing or doing business in Nicaragua. The aim of the information database is a system which can maintain and make readily available to interested parties up-to-date information in a simple format, to be used by investors in their analyses. There are no funds for this activity in the 1993 budget, as current expenses for these activities are built into the Center's overhead.

A series of about 40 information categories is being identified for early development by CEI. These categories represent the information most requested by investors. In addition to the items mentioned on that list, it is recommended that the initial phase of the information database include the following:

- Doing business in Nicaragua: customs, business hours, proper dress, and other similar information that appears in UNDP country documents.

- Requirements to set up a company in the country, including a synopsis of existing laws in plain English and Spanish.

- Regulations governing repatriation of profits, including recent experiences of companies (e.g. TANIC).

- Minimum salary (industry, services, agriculture) and major labor unions (included in current "labor cost" entry).

- Tariff rates that apply to utilities (power, water and sewage, telephone).

- Operating permits or licenses required in specific industries, construction permits, procedures for approval of plans.

- Environmental laws and regulations.

An expanded list should be compiled of the more detailed information needed to support the decision-making capacity of clients in a broad range of areas.

The database is currently being developed as outlined in the approved work program, rather than as a systematic approach based on a target project. In order to effectively undertake this project, it is recommended that two professional staff members be added to support the database. The first would develop and maintain the database; the other would manage the network and develop software capabilities related to both the database and the integrated system design used in CEI. The database will require a professional staff member who, at least in the first year, will be fully dedicated to this task. Maintenance and updating of the database should also be given a high priority in CEI's program of work. To formalize the operations of this activity and prevent its absorption by other activities in CEI, an Information Database Unit should be established within the support services of CEI.

In support of this and other CEI functions, a management information systems (MIS) specialist will need to establish and maintain the network on which the database and other system information needs are based. It is difficult for one person to maintain expertise in both statistical information systems and management information systems. For this reason it would be preferable if separate functions were assigned to individuals with the required expertise in these areas. To formalize the operations of this activity, a Management Information Systems Unit should be established within the support services of CEI. This unit could be attached to the Information Database Unit in order to provide it with priority services over other needs of the Center.

C3d. Technical Information Center

The present work program envisions a technical information center, analogous to the Center for Commercial Information (CIC) house in MEDE, which would occupy an annex of the main building housing CEI. The center would transfer the existing personnel and facilities of CIC located in the MEDE to the new location. According to estimates by CEI,

the projected first year cost of this component of the project is $164,139, of which USAID would contribute $125,055. One-third ($55,235) of the amount would be directed to the relocation of the facility and the purchase of equipment. Future operating costs and salaries would be paid by MEDE. Therefore USAID's support would be in the form of a one-time contribution to the Center.

The present CIC facilities located in the MEDE are inadequate. The market price information, for instance, is received on hard copies and entered into the database by hand, a process that is time consuming and inefficient. The hard copy materials are limited and often outdated. The directory of exporters is incomplete in its coverage (key contacts should be included) and already had a number of outdated entries at the time of its release. Furthermore, current staff members would require considerable training before they could provide services to clients.

To make CIC useful, additional documents should be acquired, including key trade and investment directories; strict control of document circulation needs to be instituted; a revamping of the computerized information system will be required; and a high level of service orientation and commitment ingrained into its staff. Given these requirements for the effective implementation of a useful information system, it is recommended that (a) the transfer of CIC to CEI not be approved; and (b) a core documentation center be established with information limited to key trade and investment directories only.

C3e. "One-Stop" Services

A proposed "one-stop" services unit ("*ventanilla unica*") would centralize the functions of all institutions involved in export processing. This service was initially contemplated as part of the functions of the Central Bank but, with the relocation of this institution, limited physical facilities have prevented its implementation there. The service is currently proposed to be housed in the first floor of the building.

C3f. Export Processing

CEI proposes to help facilitate a one-stop service for exports greatly facilitating the processing of export activities and, at the same time, bringing to CEI the facilities needed by potential investors and exporters. Centralization reduces the amount of time and money spent by exporters in processing paper work and presents an opportunity to simplify as well as automate the process. As such, it provides an opportunity for statistical information to be gathered, and it eliminates divergent statistics that often arise in trade (statistics from central banks, customs, and ministries such as MEDE are notoriously at variance).

Establishment of one-stop services entails three initial steps:

1. **Preparation:** Identification of steps necessary for processing export documents.

2. **Rationalization:** Consideration is given to those activities that involve

duplication of efforts by different Government agencies.

3. **Centralization:** The service facility would be staffed by 8 individuals from different government agencies: MEDE (1 person), the Central Bank (1 person), the Ministry of Finance (1 person), IRENA for forestry (1 person), the Ministry of Agriculture (2 persons), and Customs (2 persons).

Subsequent to its establishment and operation, additional steps can be made to increase efficiency:

4. **Further rationalization:** Eliminate permits and merge steps. This also entails elimination of functions and certain staff positions.

5. **Paperwork simplification:** The eventual design of a single form eliminates the need for individual permits and forms from different Government agencies. Copies of the single form are distributed to each agency for statistical and other purposes.

6. **Additions of port locations:** The establishment of one-stop services in shipping ports and airports allows the exporter to send the product with the export documents directly to the point of departure, and process the paperwork there. Automation of the system facilitates the monitoring functions of the services.

The benefits of these services are likely to outweigh problems that can arise from mixing a promotional role with the administration of one-stop services, although the importance of defining the mission of CEI at this point in its development should not be underestimated. One-stop services will initially require funding in the amount of $100,000 for physical items such as desks, personal computer hardware and software, and technical advice on the operation of the system. Some of the cost could be covered through rental changes to participating Government offices.

The establishment of one-stop services for investments could eventually be considered, once Section 599 no longer constrains USAID activities in this area, or once CEI is able to operate in a self-sufficient mode.

C3g. Direct Support of Enterprise Training

CEI is to provide direct assistance to specific Nicaraguan companies, as well as limited assistance to foreign investors interested in Nicaragua. To date, CEI has provided very limited support for enterprise development and training, and there remains considerable scope for expanding technical assistance to potential investors and exporters with additional funding. Some areas of action include providing short-term visits for Nicaraguan business persons to neighboring countries to visit industries; and training seminars either directly with contracted specialists, or though joint work with other organizations who have technical expertise in production, marketing, management, and with available support services.

C3h. Publications and Promotional Activities

There are presently several proposed projects to develop and disseminate information: bulletin; investors' guide; brochure on Nicaragua; pamphlet on CEI; posters; and videos on both the CEI and exports and investments in the country. These projects are undertaken by one person in CEI (Maria Isabel Zuniga) who also handles public relations. Another individual is needed to maintain these activities. Generally, these activities represent a one-time investment and therefore the amount of effort required will eventually decline. As the activities in this field are reduced, increased attention can be given to the needed training functions of the Center.

Priority must to be given to the *Investor's Guide*, which should contain abstracts of the foreign investment law and export promotion law, along with general guidelines on agricultural and industry regulations, and fiscal information. The bulletin should be published on a quarterly basis to reduce drainage of staff capacity from other projects.

In a sense, the CEI's absence of a clear mission reflects the country's general lack of direction. One enters the CEI offices without seeing posters, bulletins of traditional or nontraditional agricultural products and industries, tourist brochures, privatization opportunities, or investment areas. As a promotional institution, the Center should develop its image by posting on its walls promotional graphics, showing top traditional products, newly emerging products, industries, tourist areas, and others. Lists of studies and surveys completed and underway by the Center, by the Central American Institute for Business Administration (INCAE), and by other institutions should be readily available and visible to clients entering the facility. Finally, a trained receptionist should be hired to service clients visiting or telephoning the facility.

C3i. CEI's Relations with APENN

A discussion of CEI's relations with MEDE appears in Section V.F. At present, there is duplication of effort by CEI and APENN. CEI is presently developing in-house know-how in specific industries such as hides and skins and fisheries. To the extent that the technical expertise of APENN could be utilized in agricultural industries, CEI could focus its capacity development in industries where expertise is currently unavailable. Indeed, the issue of technology application in Nicaragua is one that APENN wants to develop in relation to agriculture, which would improve the country's competitive position in foreign markets. To the extent that duplicate or overlapping capabilities can be combined, economies of scale could be achieved in the areas of technical assistance capabilities, and technical assistance in the promotion of exports and investment in specific industries.

The separation of APENN and CEI activities inhibits the use of the respective expertise of each of these institutions. One way to strengthen CEI's private sector support facilities and operations would be to develop a closer liaison with the work of APENN. Initially, this liaison could be achieved through the inclusion of APENN in the Board of Directors of CEI.

C4. The *Consejo Superior de la Empresa Privada*

The PSS project provides $693,000 plus assistance to COSEP and its member private sector associations in order to strengthen the business community's capacity to serve as a policy advocate for private sector needs and interests, thereby increasing trade and investment activities in Nicaragua. Of this amount, $290,000 is budgeted for a Special Initiative Fund charged with making sub-grants to COSEP member organizations. Since 1975 COSEP has been generally regarded as the legitimate representative of the private sector, and it was initially envisioned in the project as capable of policy implementation or advocacy for project objectives. However, it's hard-line position against the *Sandinistas* suggests a degree of inflexibility that may be difficult, if not impossible, to overcome. For this reason, it is appropriate to assess at this point the possible modification of the PSS project at it relates to COSEP.

C4a. Organization Framework

For COSEP to succeed as a business organization, it must redirect its political orientation considerably. Such a reorientation might occur through a training program. At issue is whether such a reorientation can indeed take place, or whether it would be more efficient to redirect attention to other organizations. In the short-run, the murder of one of COSEP's key board members on November 23, 1992, and the bombing of the COSEP offices on December 2, 1992, have inhibited progress. It is clear that the process of change should be viewed from a long-term perspective. For this reason, this issue should be considered well beyond the March 1994 end of the PSS project.

C4b. Initiative Fund

Through the COSEP Cooperative Agreement, the Initiative Fund provides for $290,000 to five COSEP member organizations. To date, only one project in the amount of $50,000 has been carried out. Five others are currently under consideration: two from INDE, one from the Chamber of Commerce, one from the Chamber of Industry, and one from COSEP.

The relatively small disbursement of funds to date has been attributable, for the most part, to the difficulties that eligible organizations have had in formulating projects. Many project proposals have been qualitative in nature, and descriptive in their proposed coverage, rather than providing useful analytical information based on quantitative survey or study methods which would generate applicable information relevant for the development of the private sector. In order to strengthen the design and implementation of the projects, USAID would need to work more closely with the member associations in this area. Considerable effort has already been made by USAID staff members, but there is not additional capacity under the existing USAID staff level to provide the support. Consequently, additional assistance will be needed to effectively undertake this part of the project.

C4c. Expanded Activities in the Industrial/Processing Sector Under the Initiative Fund

If additional staffing were obtained to adequately identify, monitor, and assess projects undertake under the Initiative Program, expanded support could be given to the industrial and processing sectors through project-related activities. Specifically, USAID could provide assistance to COSEP member organizations undertaking studies on investment constraints and opportunities in industry and pre-export processing of agricultural goods. Detailed information on specific rules and regulations affecting local industries both at home and abroad would provide potential investors and exports with essential decision-making information.

Initially, the focus of these studies should be the three major manufacturing subsectors in the economy: foods, beverages, and tobacco; textiles, clothing and leather; and chemicals. According to the most recent IDB and IBRD country reports on Nicaragua, nearly one-half of the manufacturing value added in the manufacturing sector comes from the food, beverage, and tobacco industries. Another 15 percent of the value added in the manufacturing sector comes from the textiles, clothing and leather industries. Most of this value added is generated by textile production. Chemicals, petroleum, and plastic products produce around 10 percent of the value added of the manufacturing sector.

Concurrent work should be undertaken to promote investment in industries producing capital goods, which account for about 15 percent of the total value of imports, and are a critical part of the industrial production process of the country. The dependence of the country on imports of capital goods severely impacts upon investments in the industrial sector when exchange rate adjustments raise the cost of needed capital and intermediate goods. Fertilizers and farm chemicals represent 80 percent of the imported intermediate goods for agriculture, and intermediate goods account for over 10 percent of total imports.

The two major constraints on local manufacturing and processing of goods currently imported are the lack of domestic production capacity, and the lack of price and non-price competitiveness of domestically produced goods relative to foreign products, some of which are attributable to tariff and non-tariff barriers to trade in both the Nicaragua and potential foreign markets.

The domestic industries have until recently been protected from foreign competition by import duties, a selective consumption tax, and the shortage of foreign exchange. With the liberalization of trade and exchange rate adjustments, many domestic industries have had difficulty in adjusting to foreign competition, both at home and abroad. Not only is this reflected in the pricing policies of these industries, and consequently on their relative prices, but it also appears in their non-price competitiveness related to marketing abilities, ties with foreign markets, and other factors that impact upon the differentiation of the products from those of foreign suppliers.

The wide range of constraints currently affecting the manufacturing and agricultural processing sectors suggests that action taken by USAID to increase investment and exports

by alleviating barriers in one area could be offset by other constraints.

In general, the expanded support of the Initiative Fund to projects related to the industrial/processing sector by each of the five COSEP members promotes both trade and investment opportunities and institutional strengthening capabilities. In order to avoid duplication of effort on the part of the individual projects in each COSEP member, as well as in CEI and MEDE, COSEP would need to play an active role in developing and reviewing the individual projects of its member organizations.

C4d. Major COSEP Activities

The PSS Project Paper specified seven principal activities for COSEP: trade and investment; finance; policy analysis and review; advocacy and communications; institutional and human resource development; information; and association-specific activities. A review of accomplishments so far suggests that there has been little progress in any of these activities.

Human Resource Development. The design of the PSS Project Paper recognized that development of private sector initiatives was essential to stimulate investment. To this end, the PSS Project Paper stated that COSEP would review the human resource development needs of its members, design appropriate corrective curricula, and coordinate delivery of training to its membership. Specifically, it was envisioned that COSEP would undertake the following tasks:

- Conduct sector-specific training needs assessments, develop corresponding training plans, and contract for relevant interventions.
- Sponsor state-of-the-art seminars and workshops for professionals and technicians.
- Interface with the Government and schools to develop pre-vocational and vocational curricula to meet specific private sector needs, especially in trade-related industries.
- Develop and manage the Junior Achievement program.

To date, only the Junior Achievement program has been successfully undertaken. Other activities have not materialized, or have been absorbed into the work program of CEI.

Funds have yet to be identified for training business persons in Nicaragua. Training would include activities such as short-term missions to other countries to visit companies, specific management skills, specialized marketing, production methods, and pricing policies.

COSEP does not have the capacity to undertake these functions, and such a role might best be included as part of the ongoing training seminars of CEI. Activities related to the Initiative Fund Program should have priority, however, over these activities because of the need to provide direct support to member organizations of COSEP.

Finance. In finance, the Project Paper laid out the following activities to be carried

out by COSEP in its work related to the reform of the banking and credit system:

- Identification of constraints to private sector financing.
- Development of policy and regulatory reform packages, and lobbying for their adoption.
- Coordination with private bank interests seeking to do business in Nicaragua.
- Coordination with programs such as OPIC, LAAD, TCIP, and CDC.

These activities are now being carried out through other activities of the PSS project described in Section III.

Policy Analysis. In policy analysis, the Project Paper specified the following tasks for COSEP:

- Develop and maintain an ongoing policy dialogue with the Government.
- Review and develop positions on free trade agreements.
- Analyze barriers to trade.
- Prepare sub-sector analyses and pre-feasibility and feasibility studies, as well as analyses of production costs and opportunities for new technologies.
- Provide input to the Government through CEI on trade and investment policy issues.

COSEP has lobbied the Government forcefully for the interests of its members. For example, on February 25, 1993, it issued a press release demanding that the Government resolve legislative issues, guarantee autonomy to the Supreme Court, limit the power of the military, eliminate alleged preferential treatment of *Sandinistas*, and return land to the people. Activities related to the other aforementioned tasks have been absorbed in the work program of CEI. Indeed, COSEP could have provided the indicated input on trade and investment issues of the Government through CEI by providing project direction and guidelines during the monthly meetings that CEI has with MEDE, COSEP, and USAID. However, neither the President of COSEP nor a representative of that organization has attended recent meetings; consequently COSEP has had little, if any, input to Government policies on trade and investment through the work of CEI.

Information. In the area of information, the Project Paper determined that COSEP, in conjunction with MEDE, would develop an information clearinghouse system to meet the needs of prospective investors and exporters, which would be complemented by the publication of trade and investment-oriented policy analyses. These activities are now in the work program of CEI.

So far these areas of COSEP activities have not received sufficient attention. To remedy the situation, a plan would need to be developed with COSEP laying out the scope of that organization's program for the next five years; it could also contain financial and business planning as an adjunct.

C4e. Strategic Planning

The political nature of COSEP's activities has overshadowed its work in support of the economic development of Nicaragua's business sector. Indeed, there continues to be little, if any, concern on the part of COSEP about its role in fostering economic progress in Nicaragua. In an effort to reverse its present direction, COSEP is scheduled to hold a strategic planning session in April (it was originally planned for December, but was postponed after the murder of a Board member).

Notwithstanding the long-term evolution of COSEP as an institution, it is important at this stage of the PSS project to consider the future role of COSEP as the private sector arm of CEI. Undoubtedly, COSEP is the only existing representative organization of the private sector (as an alternative, INDE only embodies the social interests of the private sector and does not have the capacity to represent the economic needs of that sector). The alternatives that can be considered are: (a) attempt to alter the direction of COSEP towards economic development objectives; (b) establish a new institution capable of representing the economic interests of the business community; or (c) provide for greater autonomy for CEI.

A new institutional representative of the private sector would drain resources needed for private sector development. As indicated earlier, the establishment of CEI has already absorbed considerable resources that need to be redirected from institution building to proactive trade and development programs. At the same time, the effort needed to make COSEP an effective representative of the private sector is likely to be greater than that required to create a new organization, since that requires not only new activities, but also redirection of ongoing activities. Consequently, because they draw scarce resources away from projects that actually promote Nicaragua's investments and exports, neither of the first two alternatives above support the PSS project. It is therefore preferable that direct support be given to COSEP's members through the Initiative Fund, and that CEI disassociate its activities from COSEP and obtain status as an independent service organization.

At the same time, USAID should continue to support the activities of COSEP that improve the country's trade and investment environment. These activities include human resource development in the business community, and policy analyses regarding GON activities in trade, investment, and privatization. However, considerable support in the form of additional human, financial and organizational resources will be needed for these activities. Initially, more modest objectives should be established that aim to support COSEP's ability to service its member organizations.

C5. The Ministry of Economy and Development

MEDE has generally supported investment and export promotion activities, both at the Ministerial level and at the departmental level dealing with trade and investment in the country. In particular, it has supported studies and analyses of industries, as well as the development of one-stop services. Nonetheless, there remains a serious problem concerning duplication of activities. This duplication includes a database for exporters and investors, sector studies, an investor's guide, trade fairs, and agricultural promotion.

The existence of duplicate services has created demands on the MEDE staff members who have also been assigned to work at CEI. These staff member continue to have additional responsibilities at MEDE; moreover, those staff members are sometimes pulled away from the CEI project in order to work on assignments for MEDE.

A recent Government decree established a Regulations Unit in MEDE with a mandate to streamline regulations affecting trade and investment. Although information on the activities of this unit is pending, its existence suggests that there is favorable disposition on the part of the Government toward reducing regulations, and that analyses in this area might be undertaken within MEDE. As duplication of activities is a problem in the operations of CEI and MEDE, the activities of MEDE in this field need to be examined closely before CEI undertakes specific studies in the area. Until the corresponding activities of each agency are clearly defined, it would probably be preferable if CEI's efforts were directed towards other technical assistance functions for exporters and investors.

One approach to minimize duplication of efforts and contribute to a supporting relationship between the two organizations is to separate the functions of the two institutions along clear guidelines. MEDE, for example, should focus on policies and regulations regarding Nicaraguan exports and investments. Similarly, it should address issues related to the regulation of laws governing foreign investment and export promotion. Undoubtedly, MEDE should undertake activities related to the coordination of macro- and microeconomic policies, statistics, agreements between the Government and investors, strengthening Government services to exporters in research, inspections, and permits. In these areas, CEI should limit its participation to providing parallel information that promotes investments and exports. At the same time, the activities of COSEP and its member organizations should complement the work of CEI in the areas of trade and investment, finance, policy analysis and review, advocacy and communications, institutional and human resource development, and information.

Each organization has interests in similar study areas. Because of the fundamental need for information related to trade and investment, studies and surveys by all organizations should be encouraged as long as there is funding. In order to avoid duplication of activities and maximize the scope of the complete set of studies and surveys, it will be important to establish clear communications among participating organizations. One way to effectively achieve this coordination is through the proposed composition of CEI's Board of Directors.

C6. Section 599 of Fiscal Year 1993 Foreign Assistance Act

The recent decisions by USAID in response to legislation passed by the U.S. Congress to eliminate support to production-oriented firms with operations in the United States directly impacts the PSS project generally and the Trade and Investment component particularly. USAID/Nicaragua's implementation procedures related to CEI practices will require (a) that no assistance be given to potential investors with U.S. production activities, or firms located in Nicaragua wishing to communicate with production facilities in the United States; (b) that no USAID assistance be provided for any aspect of investment-oriented trade fairs or establishment of investment promotion offices in the United States; (c) that no

support be given to firms with planned or ongoing activities in free trade zones, or to *maquila* operators; and (d) that no support be provided to microenterprises and informal businesses.

This legislation affects all CEI investment promotion activities providing assistance to firms with U.S. production facilities. CEI will need to evaluate whether a firm requesting assistance has U.S. production facilities prior to providing USAID-funded support. In export promotion trade fairs, each participant funded by USAID will need to certify compliance with Section 599.

The issue of Section 599 implementation will likely create difficulties in the operations of CEI in terms of the restrictions it imposes. Not only will it add further formalities to the processing mechanism in CEI, but it will impact upon USAID's support mechanism. If all activities prohibited by Section 599 are deferred elsewhere by CEI, then it is probable that MEDE will continue, and even expand, its duplication of trade and investment operations provided for CEI in order to support operations prohibited at CEI because of a lack of non-USAID resources. In contrast, if activities prohibited by Section 599 are allowed at CEI, then USAID financial support of CEI will need to be limited to those activities that do not involve the prohibited activities. As long as funding by USAID is not directed at "prohibited" activities, availability of resources from other sources for CEI could provide the basis through which the institution can support all activities relating to the promotion of trade and investment.

As CEI is funded largely by USAID, additional contributions by MEDE and other donors to support the organization would permit all investment and export activities to be conducted by CEI. The development of alternative sources of support would allow CEI to conduct the full range of promotional activities.

D. Conclusions

Investment and export promotion in Nicaragua requires a strategy, an institutional structure, and good management. Sectors should be targeted in which the GON wishes to actively promote foreign and domestic investment, as well as markets from which it intends to draw foreign investment and direct export. Investment and export promotion should build Nicaragua's image, directly attempt to generate more investment and export absorption, and provide crucial related services.

The principal activities of the PSS project in the promotion of exports and investments relate to the establishment and operation of CEI. The establishment of CEI under the purview of COSEP and MEDE has the advantage of joining private and public sector interests, but it has also brought complications. The operational effectiveness of CEI would be enhanced if it were to obtain status as an independent organization, and to broaden its Board representation in the private and public sectors. Indeed, over a period of time an effort should be made to disassociate the activities of CEI from COSEP, without necessarily reducing the existing USAID support to private sector institutions through COSEP. Moreover, many of CEI's operations might eventually be funded on a fee basis.

The present mission of CEI is unclear. The scope of work under the original contract with Carana does not provide for the flexibility needed as the project evolves, and thus restricts the range of operations that can be undertaken in support of private sector initiatives. With the amendment and expansion of the PSS project, the original scope of work with Carana will need to be amended. The resolution of organizational issues and a better definition of CEI's mission will undoubtedly provide a favorable environment for staff work.

The CEI database is currently being developed as a reflection of the work program, rather than as a systematic approach based on a target project. In order to effectively undertake this project, separate and clearly defined functions must be established for its work. Another MIS task, a technical information center analogous to the CIC housed in MEDE, would have little if any use if transferred to the CEI.

The proposed one-stop services would centralize the functions of all institutions involved in export processing. It would greatly facilitate the processing of export activities and, at the same time, bring to the CEI facilities potential investors and exporters. Eventually, consideration could be given to similar services for investment.

Direct support and training by CEI for enterprises have been very limited, and there remains considerable scope for expanding technical assistance to potential investors and exporters with additional funding. Priority should be given to the *Investor's Guide*, which should contain abstracts of the foreign investment law and export promotion law, along with general guidelines on agricultural and industry regulations, fiscal information. Finally, as a promotional institution, the Center needs to develop its image by posting on its office walls promotional graphics, as well as providing easy access to bulletins, studies, and other information services.

PSS project activities related to COSEP show that considerable redirecting of that organization's political orientation is needed. Such a reorientation could take place through training programs that occupy the bulk of the organization's activities, but this is a long-term process.

Section 599 of Fiscal Year 1993 Foreign Assistance Act has a direct impact on USAID support of CEI operations. However, as long as funding by USAID is not directed to prohibited activities, joint USAID/MEDE funding of CEI will provide the basis through which the institution can support all activities.

E. Recommendations

1. In the organization and structure of CEI, broader private and public sector participation should be encouraged through the expansion of the Board of Directors to 12 persons. This proposal, which is generally backed by MEDE, would include four ministries (MEDE, Finance, Agriculture, and Tourism); four private sector organizations (COSEP, the Chamber of Industry, the Chamber of Commerce, and UPANIC); two Nicaraguan company CEOs, one multinational CEO; and the INCAE Director. Two committees would be attached to the Board of Directors: (1) a

Consultations Committee responsible for orienting the work of CEI and providing guidelines on specific initiatives, and (2) a Donor Committee (USAID, UNDP, IDB, and IBRD) to coordinate programs or sub-programs directly related to trade and investment in the country. The Board of Directors would advise the Executive Management, which would be composed of MEDE and COSEP. The Managing Director of CEI would respond to Executive Management. The General Manager would direct CEI operations.

2. In CEI activity related to the information database on doing business in Nicaragua, priority should be given to the design and implementation of the information system, recognizing that its development must be viewed as an ongoing project. Additional items specified in the main body of this document need to be included in the first phase of the project. It is further recommended that an expanded list should be developed which contains more detailed information needed to support the decision-making capacity of clients in a fairly broad range of areas.

   The database will require a professional staff member who, at least in the first year, must be fully dedicated to this task. An Information Database Unit is needed within the support services of CEI. In support of this and other functions, a management information systems specialist will be needed to establish and maintain the network on which the database and other system information needs are maintained, and this function should be carried out by a Management Information Systems Unit.

3. In other information services, it is recommended that only a core documentation center be established with information limited to key trade and investment directories only. USAID should not support the move of the CIC facilities in MEDE to CEI. The facilities are inadequate, and they would present an unnecessary burden to CEI.

4. One-stop services for export processing should be added to CEI because they facilitate exports and offer a means by which exporters can have direct contact with CEI.

5. The programmed activities of CEI in the area of direct support or training for enterprises, and publications and promotional activities need to be encouraged. However, because of resource limitations, a newsletter should be issued on a quarterly basis. Even then, an additional staff member is required for publications and promotional material, and funding for this position is recommended.

6. An institution building capacity would be strengthened in the PSS project though further direct support of the member organizations of COSEP. To date, only limited support has been provided through the Initiative Fund, and more active support should be forthcoming. Strategic planning should be supported with COSEP as part of its long-term development.

7. Continued progress in reducing duplication of activities in MEDE and CEI is critical to the success of USAID's PSS project. Regular monthly meetings between the two organizations, including Carana, should address these issues.

III. PRIVATIZATION

A. Introduction

The Privatization component of the PSS project has as its objective the provision of technical assistance to the ongoing GON divestiture program (begun in 1990). USAID joined the UNDO and the IDB to support *Coporaciones Nacionales del Sector Publico* (CORNAP), formed by Presidential Decree in April 1990, to absorb and take control of 351 state-owned enterprises organized into 23 corporations. CORNAP is charged with: (a) liquidating; (b) divesting through sale or lease; (c) returning to former owners; or (d) restructuring firms for transfer to an appropriate ministry in an expeditious manner. It has been successfully carrying out is mandate since inception.

This assessment of the privatization component was conducted in the context of CORNAP's overall divestiture activities. USAID-funded technical assistance, as agreed between USAID and CORNAP, has been limited to the preparation of: (1) diagnostic studies on each of the larger, more complex SOEs in the CORNAP portfolio; (2) valuations; (3) privatization documentation, including prospectuses and bidding documents; and (4) identification and pursuit of potential investors. Price Waterhouse (PW) was contracted to provide the requisite technical assistance. Initial planning among CORNAP, USAID, and PW proposed that PW take on transactions in the tourism, sugar, and port sectors as well as for the national cement company. Since then, the responsibility for the port sector has been moved from CORNAP to the Ministry of Transportation and Construction. In addition, PW was charged to assist CORNAP with the overall planning of the privatization system and with specific advice, as requested.

INCAE, under a US$1.9 million IDB program, is responsible for preparing similar studies on 68 small and medium-size SOEs which, with subsidiaries, number about 100 companies. In addition, INCAE is performing nine sectoral studies.

B. Background

B1. Summary of Activities

CORNAP has managed and executed the divestiture of two-thirds of the 351 selected state-owned enterprises (SOEs) between June 1990 and mid-December 1992. The political situation in 1990 following the election of President Chamorro, including the disbanding of the armed resistance and the reduction of the Government's armed forces, required fast action to increase possibilities for employment. The GON felt, correctly, that speedy divestiture of SOEs, particularly those involving agricultural assets, might provide a safety-valve for high tensions of the moment. In addition to the need to expand the productive employment base, the GON was, and is, faced with meeting expectations of workers, many of whom are *Sandinista* union members; and former owners of properties expropriated by the *Sandinistas* during the 1979-1980 period.

Under the authorization of a Presidential Decree, but without the benefit of an Assembly-approved law, CORNAP has, with a small staff of professionals, completed 1,184 divestiture "actions" involving 233 SOEs as of December 16, 1992. The fact that assets belonging to a particular SOE have been divided and divested separately in a number of "actions" by the CORNAP staff explains the greater number of "divestiture actions." The disposition of the 233 SOEs as of mid-December 1992 is as follows:

Restructured and retained by Government	27
Liquidated	39
Returned to Previous Owners	64
Sold or Leased to Third Parties	60
Sold or Leased to Previous Owners	43
Total SOEs Divested	233

Divided into individual divestiture "actions" comprising the above, which number 1,184, their disposition has been as follows:

Restructured and Retained by Government	59
Liquidated	46
Returned to Previous Owners	436
Sold or Leased to Previous Owners	101*
Sold or Leased to Workers	298*
Sold or Leased to Ex-combatants	215*
Other Sales or Leases	29*
Total Divestiture Activities	1,184

* Of these 643 transactions, 329 were sales and 314 were leases.

CORNAP made, and has carried out, a decision to follow the path of expediency by divesting the simplest agricultural properties and commercial firms first. Timeliness and the speed of the divestiture were deemed essential to preserve a more or less stable political situation. In so doing, they have left many more complex SOE divestitures for nearer the end of the process. A small number of substantial firms, such as the Coca-Cola bottling company, were divested by returning them to their former owners.

To save time and expense, CORNAP has valued all properties for lease or sale mainly through negotiation rather than public tender. Terms of sale are generous, with small downpayments and eight-year repayment from future business earnings. Leases are for one year, renewable, with an option to buy. The leases, equal to seven percent of the "value" of the property, are payable annually (farm properties) or monthly (commercial enterprises).

As of December 16, 1992, CORNAP has calculated the number of beneficiaries of the program at 20,375, comprised of 17,834 workers, 1,936 ex-combatants, and 605 entrepreneurs.

CORNAP's two goals of divesting SOEs rapidly to satisfy political requirements and reduce the drain on the public treasury have been achieved to a considerable extent. However, according to CORNAP management, the GON's third objective—realization of significant revenue to permit the redemption of bonds given to former owners for confiscated properties—has not been accomplished. The GON hopes that these resources will come from the proceeds of divestiture of the larger SOEs remaining, and eventually, the privatization of the GON's principal public sector monopolies. (In this connection, we understand that three entities—TELCOR, INE, and ENABAS—have been asked to present privatization plans to government).

CORNAP's portfolio of receivables from leases and sales, as of November 30, 1992, along with their collection experience to date, looks as follows:

	Leases	*Sales*	*Total*
Amount of Sale or Lease	$C 55 M*	$C 27 M	$C 82 M
Total Payments Received	$C 15 M	$C 2 M	$C 17 M
Amounts Past Due	$C 3 M	$C 7 M	$C 10 M
Percent Past Due	8.9 %	26.5 %	15.96 %

* $C = US$0.17

B2. Major Problems

Politically, the activities cited above have produced considerable conflict; the absence of a privatization law has been vexing to both the left and right, in and out of the Assembly. However, the conflicts can now largely be characterized as centering more upon individual aspects of CORNAP's program, or on individual cases, rather than questioning whether there should be a divestiture program. A very vocal problem involves the payment of compensation for confiscated properties. Debate concerning the requirement that workers receive 25 percent of properties divested continues, particularly over the question of how the 25 percent is to be constituted (overall, sectoral, or of each property). The existence of unions other than those affiliated with the *Sandinistas* has been largely disregarded in this debate. Problems of title to property continue to surface and are both difficult and time-consuming for CORNAP to deal with. Questions of the rights, or lack thereof, of former owners and, especially, the valuation of appropriated properties are also contentious.

A second and potentially major problem was identified by Dr. Carlos M. Vilas in his report for the UNDP, *El Proceso de Reordenamiento Patrimonial del Estado en Nicaragua* of August 1992. Dr. Vilas highlights the fact that many of the newly divested properties, particularly those sold or leased to workers or ex-combatants (which number 513 cases of the

1,184 cited above, or 43 percent), are in a weak financial condition, are now operated by unskilled managers, and do not have access to formal sector credit. There does not appear to be a mechanism or program to assist these owners to learn to manage their properties nor to prepare them to become creditworthy. While it is a basic tenet of a free market economy that those that cannot compete must be allowed to fail, the wholesale failure of worker or ex-combatant-owned properties created under the divestiture program could have grave political consequences.

The problem of the failure of new owners is one thing. CORNAP—or whichever government unit assumes the residual caretaker responsibilities for the program, the collection of amounts owed, and so on—may be faced with re-privatizing a substantial number of properties or enterprises. When a lessee decides that he/they have had enough, and do not wish to buy the property or renew the lease at its maturity, the effect will be a reversion of the property to the state to be re-privatized. The assessment team heard of plans to have collection responsibilities turned over to the Ministry of Finance. However, no plans for the continuation of a privatization capability relating to CORNAP properties were discussed.

Dr. Vilas also noted that CORNAP has not yet made a serious effort to monitor the economic costs and benefits of the divestiture program. Since his report was drafted, CORNAP has initiated a program to determine, in a non-scientific manner, "before and after" statistics on thirty or forty companies; nine have been completed thus far. As of February 16, 1993, the aggregate "bottom line" of the nine studied, which include five companies returned to former owners and four privatizations, shows:

- Employment up from 1,225 to 2,309
- Sales up from US$26 million to US$92 million
- National taxes paid up from US$3.3 million to US$25.3 million.

Divestitures in the rural sector, especially to workers and ex-combatants, are the most financially precarious, and therefore the most questionable in terms of long-run viability.

C. Assistance Under the PSS Project

C1. Outputs Defined in the Project Paper

The Divestiture of Public Enterprises segment of the overall project listed five objectives:

1. Establishment of criteria and procedures for preselecting firms to be divested.
2. Reliable profiles and prospectuses prepared for at least twenty firms.
3. Restructuring analyses (if restructuring is contemplated) for at least five firms.
4. Establishment of a system for tracking the status of properties confiscated under the Sandinista regime.
5. Establishment of a system for identifying and providing appropriate information to potential investors.

Commentary on the achievement of these objectives to date, keeping in mind that this is a mid-term assessment, is contained in Section 3 below.

C2. The Contractor's Scope of Work

Due to a number of circumstances, primarily the time between the preparation of the project paper and formalizing the contract with PW, during which CORNAP sped ahead with its divestiture program, some of the objectives in the Project Paper are no longer relevant. The key individual involved in the PW contract had spent considerable pre-project time assisting CORNAP to establish privatization criteria and the system for identifying potential investors. These, therefore, no longer needed specific mention in the scope of work.

The scope of work calls for the application of 12 person-months of effort by the principal advisor, and the use of short-term experts for a total of 30 person-months. The advisors prepare, in each case, a "diagnostic study and business valuation," and assist with the promotion and final sale of the company(ies) or assets. For each assigned SOE, the contractor undertakes the following specific tasks:

- Brief market analyses of the corresponding industries and their potential, both at the national level and in the Central American marketplace.

- Review of the operations of various industries (capacity utilization, performing assets, etc.), their market position, human resources management, and legal status.

- Financial analysis of each assigned enterprise, including:
  -Estimation of adjusted book value at the time they became SOEs and today
  -Comparative analysis of balance sheet and profit or loss statements for the last 3-5 years
  -Comparative analysis of selected financial ratios and profitability for the last 3-5 years

- Business valuation of each assigned enterprise as a going concern, utilizing appropriate methods (cost, market, income or discounted cash flow approach, for example).

- Preparation and promotion of a divestiture strategy including:
  -Analysis and recommendation of most appropriate privatization strategy
  -Pre-sale restructuring analysis
  -Preparation of prospectus and profile
  -Identification of and initial contact with potential investors and/or buyers
  -Preparation of negotiation strategy and respective sales and transaction documentation

CORNAP, in consultation with USAID, determines priorities for assignments among enterprises. The scope of work also requires the delivery of diagnostic reports for each SOE

studied, and at least three meetings with CORNAP personnel during the course of each privatization.

C3. Component Outputs

At the time PW became active under PSS, the CORNAP divestiture program was in full swing. As mentioned above, changed circumstances and the pre-project work done by PW's Project Manager Jorge Segura, and by Joe Borgatti under a previous pre-project contract (with Ernst & Young), account for the divergence between the objectives set forth in the Project Paper and the tasks set forth in the scope of work. Prior to project start-up, the Project Manager had assisted in the preparation of CORNAP's strategy development which split responsibility for industrial and agricultural privatizations; the division of areas of donor responsibilities (IDB, UNDP, and USAID); the preparation of a privatization transaction check list; and a design for restructuring and cleaning-up the legal and other problems inherent in most transactions. The pre-project work was accomplished between September 1991 and February 1992.

At the present time, Price Waterhouse has completed:

- Profiles on six of the ten companies for which transactions were originally planned.

- All studies and documentation for the Montelimar Beach Resort. The CORNAP Board has approved, and the divestiture and bidding for the property has taken place. The Barcelo Group from Spain won the bid and is now in negotiation with CORNAP over the final details.

- All studies and documentation for the Intercontinental Hotel. The CORNAP Board has approved, and bidding commenced mid-December. Five bids were expected by mid-March 1993.

- All background work and CORNAP Board approvals have been obtained for the privatization of two sugar mills. The properties were put out for bid in November, and responses were expected February 26 and March 1 respectively (political difficulties led to extensions of these dates). There is a possibility that the assets of the mills will be sold, as opposed to their sale as "going concerns."

In addition, tasks presently underway are:

- Diagnostic study on Hotel Barlovento completed and work begun on valuation and privatization strategy when CORNAP returned the hotel to its former owners.

- Diagnostic study on the Hotel Las Mercedes has recently been begun.

Work on diagnostic studies and valuations of the ports is pending the completion of a study presently being prepared by the World Bank. PW may begin work after the Bank report has been delivered and reviewed by the GON and if CORNAP so agrees, and after PW has completed a few of the deals described above.

A number of questions surround the future of the cement company which is about fifty years old and involves the high-cost "wet" process. The GON has offers for assistance from the U.S. and others to finance a feasibility study for modernizing the plant—which will be very costly—and for a study to determine the extent of remaining limestone reserves. The GON could proceed with the studies, but another school of thought counsels immediate privatization of the company as it is. The GON is reviewing its options at this time and has not yet made a determination on its course of action.

PW is handling its privatization cases from start to finish, as suggested in the scope of work. While maintaining close coordination with CORNAP and following approval of the valuation and privatization strategy by the CORNAP Board, PW identifies potential investors, prepares bidding documents, publicizes the offer, and solicits bids. Negotiations with the winning bidder are handled by CORNAP with advisory assistance from PW.

The level of effort which PW has expended, according to its latest monthly report covering the period from inception to December 31, 1992, is 714 person-days of a total of 1,233 (or 58 percent). *However, the Project Manager has only 54 days remaining within this number.* The budget of the privatization component, as of December 31, 1992 is:

	Total Cost	*$ Spent*	*$ Left*
Labor	$ 693,000	$428,000	$265,000
Travel & Transport	$ 230,000	$ 55,000	$172,000
Other Direct Costs	$ 121,000	$ 62,000	$ 59,000
TTA + ODC	$ 351,000	$117,000	$231,000
Total Project Costs	$1,395,000	$662,000	$727,000

In contrast, IDB's contractor, INCAE, as a university, does not go beyond diagnostic studies and valuations which are prepared and delivered to CORNAP. Once CORNAP's Board approval is obtained, CORNAP privatization managers are on their own with regard to the rest of the privatization process. At the present time, INCAE is producing completed documentation more quickly than CORNAP can complete the privatization process, so CORNAP, with its limited manpower, is falling behind.

The fact that the limitations imposed by the INCAE methodology are now placing a burden on CORNAP is instructive for future reference. Contract methodology should take into account the client's staff resources. The time consuming aspects of privatization occur after the preparation of prospectuses and valuations. Finding prospective buyers, conducting bids, and negotiating take the most time. There is no question that CORNAP needs additional legal and marketing assistance now that the more difficult industrial companies in IDB/INCAE's roster of firms are ready to be privatized.

C4. Additional Needs

The GON is handling privatization on an institution-by-institution basis rather than as a centralized program under the direction of a "privatization Czar" empowered, at the most senior level of government, to oversee the privatization process government-wide. The latter is the doctrinaire approach.

What problems surface as a result of the approach taken by the GON? While "productive" SOEs, both industrial and agricultural, were folded into CORNAP at the time of its creation, and CORNAP was charged with their divestiture, there are a number of public monopolies, primarily TELCOR (Telecommunications), INE (electric power), and ENABAS (buying, selling, and storage of basic grains), which do not fall within CORNAP's mandate. There are also a number of construction companies belonging to the Ministry of Construction and Transportation slated for privatization. Each sector is the responsibility of a different ministry.

Two immediate problems become evident: (1) the privatization know-how and experience within the GON is restricted to the now experienced privatization managers and senior officials of CORNAP; and (2) while the GON will require financial assistance from donors to effect these and possibly other privatizations, there will be not one but four or more separate entities with which a prospective donor must deal. There is no centralized control. While the latter does not pose insurmountable problems, establishing a program and controlling the process becomes more difficult and time consuming.

We understand that the public monopolies mentioned above have received instructions from the Ministry of the Presidency to prepare privatization plans. The Cabinet has received presentations from both TELCOR and INE regarding their respective plans. At least in the case of TELCOR, a Presidential Decree authorizing its privatization in one form or another is expected to be forthcoming soon. Given the fact that the GON's privatization talent is centralized in CORNAP at the present time, the know-how will have to be made available to these entities in some fashion, or responsibility for privatization will have to be centralized in CORNAP. USAID might be helpful if it were it interested either to expand the PW buy-in, or to amend PSS project to enable it to contract with another firm to assist in this process. We were told that PW has had experience in privatizing telephone companies in other countries.

A second area of concern, identified but not quantified, is the lack of post-privatization assistance to clear up legal problems, conduct worker and manager training, and address other needs which are fundamental to achieving sustainable results for the newly privatized companies. As far as we can determine, neither the GON nor donors have made provisions for this aspect of a privatization program. This need was mentioned extensively in Dr. Carlos Vilas's UNDP report, and has also been emphasized by many of those interviewed for this assessment.

The third problem, stressed at length by both Eduardo Belli, Privatization Manager for the tourism sector of CORNAP, and Ricardo Barrios, advisor in the Ministry of the

Presidency of the Republic, is the desperate need for cash to (1) make payments to workers prior to a privatization taking place; and (2) make payments in compensation for *Sandinista* confiscations of property where the injured party does not want the return of the property. Both are commitments of the incumbent administration.

The CORNAP program has succeeded, in spite of considerable social unrest, largely due to an agreement reached with labor whereby the GON will pay an indemnification to workers (three to six months salary) in exchange for the peaceful transfer of ownership or status of the SOE. In addition, workers are guaranteed job stability for one year. This procedure applies to all situations except the return of confiscated properties to former owners. Cash will also be needed to establish a worker retrenchment or redundancy fund, as the larger industrial firms and public monopolies are privatized. Lack of funds to pay these costs is slowing the privatization effort at the present time.

There is similarly great pressure from the private sector, and COSEP in particular, to indemnify the former owners of confiscated properties in cash rather than in bonds. According to Mr. Barrios, the estimated total amount needed to satisfy this group is between $400 and $500 million.

Both COSEP and Mr. Barrios suggested the concept of a bridge loan against the future privatization of TELCOR, a profitable entity, and the other public service companies, as a means of raising immediate cash. The bridge loan would be repaid in the future from the proceeds of the sale of these entities. Mr. Barrios mentioned a mechanism used in Costa Rica which might be useful in Nicaragua if adapted to the situation.

D. Conclusions

Price Waterhouse is well on the way to fulfilling its obligations under the scope of work and is where it should be at the mid-term. Two completed cases were reviewed, both of which were well and thoroughly written. Further, the team received a unanimously favorable response to questions regarding PW's performance posed to each official of CORNAP interviewed. Those not directly involved in the PW-CORNAP relationship, but who are involved in the privatization process, also expressed a uniformly high regard for the quality of PW's work and the results which they have achieved to date. However, additional funding will be required to permit PW to complete its work.

The CORNAP privatization program has been unexpectedly successful given the precarious political environment at inception and, to a somewhat lesser degree, throughout implementation. The emphasis placed on speeding the divestiture of agricultural and commercial properties lent some social and political stability to the situation as those affected were able to see results. The GON has done its best to live up to commitments to workers, ex-combatants, and former owners of confiscated properties. The fact that the GON has made pre-privatization payments to workers has undoubtedly been a factor in the success of the program thus far.

However, the privatization program is only the first step in the re-creation of a strong private sector. Additional assistance to strengthen the private sector is sorely needed and must extend beyond the completion of the privatization program. Many of the new owners of privatized properties, primarily agricultural, do not have the skills to manage and operate their properties on a sustainable basis. There is considerable concern that numerous failures of worker and ex-combatant-owned enterprises could spoil the success of the privatization program to date and unbalance the present delicate stability.

Given the number of properties which were privatized using the lease mechanism, we conclude that there is potential that a number of lessees will eventually decide that they neither wish to extend their leases nor purchase the properties. Instead, they will be returned to the state at the maturity of the leases. The planned disappearance of CORNAP will require that the GON maintain a privatization capability in some unit which will be able to re-privatize the properties which have been returned.

CORNAP's strategy involved privatizing the easiest SOEs first to generate numbers of transactions and impact as many beneficiaries as possible in a short period of time. While succeeding, it also implies that more complex situations involving legal and other difficulties have been left until the later stages of the program. CORNAP needs additional personnel to provide legal assistance and marketing support to maintain the pace of the program.

A source of cash for the payment of worker indemnities under the CORNAP program should also be found to enable the privatization program to go forward in an expeditious manner. Cash is also needed for the establishment of a worker retrenchment fund. The suggestion that a "bridging" facility of some sort might be arranged, once the GON's commitment to privatize the public sector monopolies has been made, merits further study. An alternative source of cash which deserves consideration is the use of counterpart funds from other USAID programs. It is conceivable that assistance in alleviating GON's cash needs to assist the privatization program and the establishment of a worker retrenchment/compensation fund may assist the indemnification of former owners of confiscated properties as well.

E. Recommendations

1. USAID should amend and increase the PW buy-in by an amount sufficient to permit PW to complete its privatization work on the SOEs which it has been assigned and to provide its other services to CORNAP. We consider it essential that the Project Manager be funded to provide for his services through the life of project. We estimate that an additional $400,000 should be more or less sufficient.

2. USAID should consider increasing CORNAP's ability to cope with legal and marketing problems in the privatization process caused by the heavy workload now being generated from the IDB/INCAE effort. USAID assistance could, at their option, be done through (a) an amendment increasing the PW buy-in which would permit them to send an additional junior expert to Nicaragua, or (b) the trial use of CEI to help CORNAP in marketing from three to five companies in a sector selected

by USAID. If CEI were to work out, it might preclude the need for the importation of an additional expatriate. Additional Nicaraguan legal assistance should be provided to CORNAP as well.

The advantage to trying CEI is the availability of some funding within their contract which otherwise would probably go unused. CEI also has personnel in-country who would be used to implement the tasks assigned by CORNAP. However, CEI's privatization expertise, particularly marketing Nicaraguan enterprises to third parties, is untried.

PW would be obliged to transfer a second junior professional to Nicaragua. However, since USAID's buy-in should be increased, per the first recommendation above, the addition of approximately $100,000 to effect this move does not increase USAID's administrative workload. Funding additional local legal assistance for CORNAP should not exceed $50,000 in local currency funds.

3. USAID should consider expanding the PSS project to include a training and technical assistance component to assist newly privatized SOEs, primarily those in the rural sector. To the degree possible, particularly in the rural environment, basic management and technical training should be provided on-site initially. The duration of this component should be a minimum of one year and include the use of a number of geographic centers where follow-up help can be obtained.

   Cooperation with the Ministry of Agriculture's extension service should be sought since, in part, the services recommended would complement those provided by an agricultural extension service. Planning, budgeting, bookkeeping, and marketing would be the skills taught in addition to the basic agricultural skills. Local consultants can be utilized and, possibly, field people based in agricultural extension offices. Desirable contractor skills (agriculture as compared to business) would be determined by the quality and level of assistance which the GON would be willing to supply through the extension service. We estimate that between $250,000 and $300,000 will be required the first year with coverage in Managua and four outlying offices (depending on the number and cost of vehicles required).

4. USAID should consider expanding its privatization role by becoming involved in assisting the privatization of the three public sector monopolies—TELCOR, INE, and ENABAS—and the construction companies which the GON plans to begin privatizing in the fairly near future.

   If USAID is satisfied with the GON's commitment to privatize the public monopolies, we recommend the amendment and extension of the PSS project to support other ministries in the privatization process. However, only TELCOR and INE are likely to result in sales which will contribute significantly to the Nicaraguan treasury. We recommend, therefore, that USAID concentrate its assistance on the TELCOR privatization, which is most likely to be the first, and that it be left to other donors to assist the privatization of the remaining public sector monopolies.

Taking advantage of PW's in-country knowledge and experience will be more timely and cost-effective than introducing a new contractor into the situation. The team suggests that time and cost estimates to accomplish these additional tasks be discussed with PW, if appropriate. We estimate roughly that between $150,000 and $250,000 would be required if undertaken in isolation from other project functions.

5. The team recommends that USAID utilize counterpart funds to support the GON Treasury in meeting a portion of its cash needs for indemnity payments to workers, and for the creation of a redundancy fund. Payments to former owners of confiscated properties do not have priority within the purview of this evaluation. The bridge loan concept is difficult to structure under USAID procedures as understood by the team. The guarantee mechanism is not available in advance of a privatization, but only as a part of a privatization transaction. This precludes its use for raising immediate cash.

   We are not in a position to comment on an amount to which USAID might participate in this manner since it would be subject to other programs which generate counterpart funds. We are also not privy to Mission plans for the use of these funds, nor Mission priorities. However, if agreeable in concept, we recommend that a dialogue with GON officials take place at the appropriate time to further define possibilities. The equivalent in *cordobas* of about $20 million (2,000 workers times $10,000, or 4,000 workers times $5,000) should be considered.

These recommendations are designed to preserve and advance the gains made in strengthening the private sector through the GON's privatization program thus far, and to further and expand the privatization program. PW will be in a position to operate at its present strength of talent through the life of project. CORNAP would receive additional staff support, much needed at this time in the privatization program, to enable it to maintain rapid progress. A one-year program of technical assistance and training in the rudiments of business and agricultural practices should help a substantial number of new owners to survive and, eventually, become bankable. USAID involvement in the TELCOR privatization is recommended as this should be a successful, high-profile transaction, both in terms of the GON treasury and the improvement of service to consumers. PW is in place and can call upon experienced telecommunication privatization experts. USAID might consider involvement with the other two. Lastly, while bridge loans or guarantees do not appear practicable, USAID would be in a position to assist the GON's cash shortage for worker indemnifications and the formation of a redundancy fund if the concept of using counterpart funds for these purposes is acceptable to USAID, and if programs which generate counterpart funds exist in sufficient amount to cover these and other requirements.

IV. FINANCIAL SERVICES

A. Introduction

The Financial Services component of the PSS project aims to strengthen the once highly-regarded Nicaraguan financial system so that it can provide a broad range of services to its clientele. The principal task of the component is establishment and operation of a new Superintendency of Banks (SBN). Specific activities include organizing and defining SBN operations, reviewing and approving criteria for new private financial institutions, developing a strategy for dealing with existing public sector banks, and defining needed information and methods for acquiring it. Long-term and intermittent short-term technical assistance is being provided to the Superintendent of Banks for start-up operations.

A second task of this PSS component is technical assistance in establishing new private financial institutions in Nicaragua, thereby limiting the predominant role of the state in the banking system. Technical assistance is being channeled through the SBN, the Central Bank, and/or COSEP to seven newly established private financial institutions.

It is anticipated that by the end of the project, the Superintendency of Banks and other financial institutions will be able to play a fair and constructive role in supervising and regulating the operations and practices of the country's private and public banks. At a minimum, it is anticipated that the structure and the operations of the Superintendency will be established, criteria for chartering new private financial institutions designed and implemented by the Superintendency, and the flow of information between public and private financial entities institutionalized.

The following assessment reviews the success of the project to date, and identifies the areas in which USAID can provide future support to this sector.

B. Background

This component of the PSS project was designed with sufficient flexibility to address emerging needs in the financial sector. Nicaragua, during the Somoza era, had one of the more developed private banking and financial systems in Central America. The goal of USAID and the Government of Nicaragua is to re-introduce private, profit-seeking banking and financial services to Nicaragua. It is rightly felt that a private financial system offering a full range of services and products is essential for the full economic recovery of the country. Moreover, a private banking system will help provide access to international donor financing not currently available in Nicaragua.

The Financial Services component has evolved into activities to support the establishment and effective operation of a Superintendency of Banks, including systems for operations, approval of new private financial institutions, reporting mechanisms, and establishment of new private financial institutions. The GON has enacted a law allowing

creation of private banks and re-establishing a Superintendency of Banks and other financial institutions, although progress has been slow. A main objective of the current financial services component of the PSS project is to speed up this institutional development process.

The Project Paper identified a third task under this component: a banking training program among the course offerings of the Central American Institute of Business Administration (INCAE). This task has been superseded by a World Bank-sponsored training program for private bank managers. This training program is underway; once complete, USAID will revisit the task to determine what further actions are required.

At this point, no other international donor agency is providing assistance to restructure state banks or to establish new private banks. The Inter-American Development Bank (IDB) has authorized US$3 million to the SBN to develop a Management Information System (MIS) and for selective training of SBN personnel, as part of institution strengthening. Of this amount, $.5 million has been disbursed. The IDB has also authorized US$3 million to the Central Bank (BCN), together with the International Monetary Fund (IMF), for the purchase of computer hardware and software for an MIS, and for long-term consultants to assist in the implementation of the MIS. It has also been indicated that the IDB will be providing US$30,000 to cover start-up expenses for a Stock Exchange (*Bolsa de Valores*). The IDB does not currently have any plans to assist private banks.[1]

The World Bank has done very little to provide direct support to the financial sector; they are mainly concerned with promoting structural economic adjustments, i.e. prices, exchange rates, and interest rates. In October 1992, a country economic memorandum, which addresses financial sector issues among others, was prepared by the World Bank, but it is not currently available. The World Bank is financing a training program for private bank managers, which is currently in progress (January 15-April 15); the program covers managerial topics in domestic and international banking.

C. Assistance Under the PSS Project

C1. Overview

In January 1992, USAID hired Price Waterhouse under an IQC to advise the SBN on its proper role and function; to draft the necessary legislation to re-establish the SBN; to assist the private banks in establishing a Bankers' Association (one has been set up); and to determine the feasibility for establishing a Stock Exchange, a private insurance industry, and a private pension fund system. In May, 1992, Carana Corporation subcontracted with the International Management Consulting Corporation (IMCC) to provide a resident advisor to the SBN and for short-term technical assistance in the financial sector. In October 1992, USAID, independent of this project, commissioned a study on Financial Sector Reform and the Commercial Banking System; this study was completed by a team under the supervision of J.L. Daly.

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1 Information provided by Mr. Joel Riley, IDB Representative in Nicaragua.

As of December 31, 1992, the Financial Services component had a balance of US$333,000 remaining from its allotment. The subcontract with IMCC has a total value of US$169,000; currently $60,000 remains, representing 93 working days. The Price Waterhouse buy-in has a total value of US$280,194; currently US$70,000 remains, representing 71 working days.

C2. The Superintendency of Banks

The primary effort of USAID/Managua under the financial services component has been the creation of a Superintendency of Banks to regulate and oversee the banking industry. Based on the initial efforts funded under the Price Waterhouse buy-in, the needs and norms for the SBN were identified, and a temporary advisor was assigned to the Superintendency. The necessary legislation was approved for the establishment of the SBN in April 1991, based on the initial study by PW.

The PSS Project Paper recommended that an experienced Superintendency Expert be provided for the life of the project to counsel and assist the Superintendency. This expert would help the SBN carry out its functions, in particular:

- Establish and apply regulations, licensing and other corporate activities, and lending limits
- Prevent and, if necessary, punish insider loan offenders
- Conduct asset classification and provisioning
- Establish guidelines to guard against the submission of false financial information by borrowers
- Develop guidelines for enforcement powers
- Assist in addressing problem of failed banks
- Determine permissible and prohibited activities
- Determine scope, frequency and content of the audit program

Under the IMCC subcontract, an experienced senior banker and former Superintendent of Banks of Peru was hired as Senior Advisor to the Superintendent; he has been working with SBN since June 1992. Everyone interviewed, starting with the Superintendent, is in agreement that the Advisor has done an outstanding job, and is complying with the intended scope of his activities.

With the assistance of the Senior Advisor and the Superintendent, also an experienced banker, the SBN has rapidly taken on the functions of an effective professional regulatory body. A new banking law has been drafted and is currently before the National Assembly for approval. The limitations imposed by the former banking law regarding lack of penalties and sanctions applicable to the banks which violate the law or regulations have been remedied in the new banking law. The new banking law also provides broader activities available to the commercial banks such as leasing, factoring, and trust and investment management departments.

In addition, the SBN Senior Advisor has been instrumental in drafting the following official norms:

- Credit Concentration
- Evaluation and Quality Analysis of Loan Portfolios
- Procedure for Reserving for Bad Debts
- Capital Adequacy
- Registry of External Auditors
- Terms of Reference for External Auditors
- Deferral of Expenses

As of 31 December 1992, the Senior Advisor, together with the Superintendency, had completed such other tasks as:

- Preparation of draft regulations for the Stock Exchange
- Outline for norms to permit the functioning of private insurance companies in Nicaragua
- Establishment of a mechanism to allow permanent coordination with the Central Bank of Nicaragua regarding regulation and coordination of the banking system
- Financial analysis of each of the private banks regarding solvency, liquidity, profitability and operating practices
- Improvements to the format and content of the Informative Bulletin of the Superintendency

All of the above has been accomplished during the six months the Senior Advisor has been on the job, working very closely with the Superintendent. The current contract of the Senior Advisor will expire in June 1993. There is general consensus that, if possible, the Senior Advisor's contract should be renewed, preferably for one year.

The Price Waterhouse study on the norms and needs of the SBN, although dated February 1993, was completed before June 1992. It is now considered out-of-date and according to the Senior Advisor does not address the current needs of the Superintendency. It would be helpful if this study could be updated, particularly in view of the changing economic conditions of the country.

The Superintendency is concerned that it does not have sufficient trained staff to conduct its current portfolio of activities, as well as those that it will be charged with once the new banking law is passed. In particular, it needs to train its bank inspectors to conduct field inspections in risk assessments, asset and investment analysis, and in leasing, factoring, and trust administration. Further, if the Stock Exchange becomes functional, and the private insurance companies and pension funds are formed, then the inspectors will require training in overseeing and regulating these areas. New regulatory functions connected with the Stock Exchange, insurance companies, and pension plans will have to be developed and incorporated into the functions of the SBN, and appropriate staff must be identified and trained.

C3. Private Financial Institutions

The second major activity of the Financial Services component of the PSS project is the provision of technical assistance to the private financial sector, in particular to establish private financial institutions.

C3a. Private Banks

Prior to 1979 Nicaragua had one of the most developed private financial systems in Central America. In 1979 the private banking system was nationalized, and subsequent government decrees reduced the banking system to one of primarily dispensing subsidized credit to favored borrowers. Combined with a lack of inter-bank competition for loans and deposits, poor loan monitoring and recovery practices, and high inflation, the asset and deposit base of the financial system was eroded.

USAID, correctly recognizing that a sound private banking system will provide a stimulus to the growth of the economy and the private business sector, has been extremely proactive in pressing the GON for legislation to re-establish and create a private banking system and a Superintendency of Banks to regulate them. As a result of this active lobbying effort, and support provided under the PSS project, there are now seven private commercial banks operating in Nicaragua. The financial situation of the seven private banks, as of December 31, 1992, is shown below (in millions of *cordobas*):

Total Assets	674.5	
Total Deposits	553.3	(of which 284.9 in local currency and 268.3 in US$)
Total Loan	342.9	(mostly short-term: 318.2)
Net Capital & Reserves	85.6	
Accumulated Expenses	1.4	
Net Earnings	2.5	

While the private banks have 37 percent of the country's total bank deposits, they only have 19 percent of total loans as of December 31, 1992. The earnings of the Banks (in thousands of *cordobas*) in 1992 were as follows:

Banco de América Central	5,468.3
Banco Mercantil	-622.9
Banco de la Producción	602.6
Banco de Crédito Centroamericano	745.0
Banco de Préstamos	-2,242.9
Banco de Exportación (Ban Expo)	60.7
Banco Intercontinental	-1,488.5

The above shows that three banks—Mercantil, Préstamos and Intercontinental—are losing considerable amounts of money, and Ban Expo's earnings are nominal. Since several of the banks have only been in operation for one year, an annual comparison with 1991 is

not possible. Most of the bank lending is short-term due to a lack of confidence by the banks and the public in the immediate future of the country, and by the lack of medium- and long-term deposits with which to match loans. To remedy this situation, it has been agreed that the private banks will issue US$50 million in seven-year bonds, which will then be purchased by the Central Bank.

The private banks are extremely conservative and cautious in their lending operations, as they should be. They need time to gain experience and to mature. As new banks with small capitalization they cannot afford to make many mistakes. They feel that one of their greatest needs is in the areas of training, in particular in the following:

- Training of tellers (cashiers): promotion skills, how to open accounts, and how to project the right image in dealing with clients. (It appears this attitude has been lost during the *Sandinista* regime)

- Training for branch and operations managers in establishing internal controls

- Training of loan officers to make medium-term loans (three to five years) assuming that the bond issue will provide medium-term resources. This requires knowledge in assisting clients to prepare business plans, cash flow projections, interrelationship of working capital and investment needs, and the interpretation of and preparation of yearly budgets with quarterly revisions, in order to accurately judge how the business is going and to avoid or remedy problems before it is too late.

The private banks also would like to have greater flexibility from the Central Bank in the types of operations they can do, in particular trying new or innovative operations. Some private banks feel that the Central Bank has not been sufficiently responsive in furnishing liquidity, which is now a major problem for the private banks since they have lost their government deposits. Finally, some private banks feel the Central Bank favors state banks, and does not give private ones equal treatment.

The future growth of private banks rests, in the medium term, on the provision of working capital loans in certain agricultural areas—cattle, bananas, and coffee. These areas are major foreign exchange earners through exports, and justify loans in dollars. Also, agroindustry can be a good source of loans to convert agricultural products and export some of them. For example, Argentina is preparing TV dinners for some of the large U.S. importers. The private bankers therefore require training in medium-term lending techniques.

C3b. Loans to Small and Medium Enterprises

As in many Latin American countries, private banks in Nicaragua generally do not favor loans to small businesses as they are perceived to be risky (due to lack of sufficient guarantees), expensive to service (labor intensive) and often not profitable. Loans to medium-size businesses are more acceptable since guarantees are better and larger loan

amounts are less expensive to manage.

At present, there are several sources for loans to small and medium-size enterprises (SMEs) in Nicaragua. The Central American Bank for Economic Integration (BCIE) offers one program, known as *"El Papic"* (Program of Support for Small and Medium Industry of Central America). These loans provide working capital for one year maximum at a rate of 14 percent per annum; and provide for the purchase of fixed assets for up to four years at a rate of 18 percent per annum. Maximum amounts to small enterprises are US$25,000 and to medium-size enterprises US$100,000. Private commercial banks have indicated that they have not used this program, nor are they promoting it, as the interest rate determined by the BCIE is too low and does not cover the costs of servicing the loans. The current rate for short-term loans to business is in the range of 22 to 24 percent per annum. Consideration should be given to the feasibility of increasing the current BCIE interest rate to more accurately reflect the cost of borrowing money and servicing a loan.

Another loan program, supported by donor funds to the Central Bank, is known as *"El Pyme"* (Support Program for Small and Medium Industry). Lines of credit up to a maximum of US$40,000 are available to small industry for one year for working capital and up to four years for fixed asset purchases. Lines of credit, up to a maximum of US$100,000, are available for medium industry for the same purpose and time periods.

Another program, *"El Faim,"* is available through commercial banks to industrial manufacturers for the purchase of imports related to their operations. Terms for lines of credits are up to US$50,000 for small firms at 13 percent per annum and up to US$500,000 for medium-size firms at 18 percent per annum.

Finally, the microenterprise sector has a facility available, known as *"El Pamic,"* which is a national program designed to provide financial support to this sector. The maximum amount of financial support is US$1,000 for the productive sector and US$800 for merchants. Interest rates are 18 percent per annum for the former and 30 percent per annum for the latter. Terms are for six months (presumably renewable). These loans are provided through nongovernmental organizations (NGOs) and through the *Banco Popular*, a government-owned bank.

The private commercial banks have stated that some US$60 million is available in the Central Bank to support the funding of the above-mentioned programs (*El Pyme, El Faim* and *El Pamic*). However, use of these programs is not promoted nor their availability well publicized by the commercial banks, since the rates are considered too low and the risk too high. The state-owned banks, which normally would promote such programs, are suffering from an excessive number of bad loans and are currently being bailed out by the Central Bank.

There is a widely perceived need for alternatives to commercial banks for sources of credit for small and medium-size enterprises. This need has not been examined nor documented. Prior to establishing new sources of credit, there is an immediate need to carefully and thoroughly examine the requirements of SMEs, in particular credit. Based on

this analyses, concrete steps and actions can then be taken to address the sustainable development of the small and medium industry.

C3c. The Bankers' Association

A separate USAID initiative under this component has been the formation of an association of private banks, or a Bankers' Association. The General Managers of the private banks currently meet once a week to discuss mutual problems, such as how to harmonize standards, develop a code of ethics and present a united front in requesting government modification of regulations or laws.

Although valuable discussion and identification of mutual needs have taken place in these weekly meetings, there is no formal organization to support or follow-up the recommendations of the group. Unfortunately, not all of the banks are earning sufficient revenues (three of the seven are not at break-even) to contribute to the Association. As a result, the Association has no office nor can it afford to hire an executive director, secretary, or a messenger.

One of the General Managers estimated the expenses (in *cordobas*) for a small staff and a modest office as follows:

Executive Director:	$5,000 per month (an experienced director)
Secretary:	$ 600 per month
Office rent:	$ 750 per month
Telephone:	$ 500 per month
Rent of Office machinery:	$1,150 per month
Total:	$8,000 per month

Therefore, one of the immediate needs of the Association is funding for an office and staff. Other needs identified include the establishment of a training institute and a library resource center, although these are of secondary importance. The Association also needs assistance in the drafting of a code of ethics and conduct for the private banks. USAID might wish to consider making a one-time grant to the Bankers' Association to allow it to become functional and to address the training needs of the banks.

C3d. The Central Bank

Although the *Banco Central De Nicaragua* (BCN) has made great strides in restructuring itself to become a modern central bank, much remains to be done. It has relinquished its role as a commercial bank and is liberating interest rates and foreign exchange regulations. However, it does not currently have a stable fixed-term president guiding its operations. Instead, it is supervised by the General Controller (*Controlaría General de la República*), with support from a Board of Directors. Further, the current Board is not representative of the private and state banking community.

In addition, the commercial banks feel that there are not enough experienced personnel in the BCN to efficiently carry out its function. They highlight long delays in receiving foreign exchange (up to 40 days) to pay for imports, even after local currency deposits have been made to pay for the foreign exchange. In general, there is a perceived need to hire experienced bankers as managers. There is also a need for some form of dialogue between the BCN and the new private financial institutions to establish the framework for a better working relationship between the BCN and the private banks.

USAID has just approved an $8 million project—Economic Policy and Implementation project (EPAI)—to be initiated in the next three months. This project is scheduled to provide expertise in macroeconomic planning, and will work directly with the GON through the Ministry of Finance, the Central Bank, the Ministry of the Economy, and the Ministry of Social Action. The project has not yet been released so further details are not available, although it is believed that some concerns of the commercial banks will be addressed under this project.

In the meantime, the BCN requires assistance in further restructuring its operations, and in training its staff to run open market operations.

C4. Possible Expansion of Private Financial Services

Under the Price Waterhouse buy-in, USAID/Nicaragua has been addressing other areas in the Nicaraguan financial sector. These activities are briefly described below, focusing on those areas where interrelationships with the Financial Services component of the PSS project exist.

C4a. Stock Exchange (*Bolsa de Valores*)

The formation of a stock exchange has been a goal of USAID for some time. In 1991 it commissioned Price Waterhouse to conduct a study outlining the steps required for the formation of a stock exchange; the Mission has since been encouraging the government to establish such an exchange. It is anticipated that the private sector will use the exchange to expand its capital base, probably by using debt issues at the beginning, later by issuing equity shares.

The legislation establishing the exchange has now been approved by the National Assembly, and is currently with the President for signature. Upon signature, the exchange will become a corporate entity ready to operate.

Two distinct groups have been formed to promote and manage the future stock exchange. One prominent group consists of four private banks: BanPro, BAC, Banco de Préstamos, BanCentro, and the Pellas group, which includes Raul Lacayo Solorzano and other prominent Nicaraguans. Another group, headed by Ernesto Fernandez Holmann, has also been formed; IMCC and Carana have been approached to supply direct technical assistance to this latter group.

It is recommended that the two promoter groups be brought together in order to present an unified front in promoting and forming the exchange. Since all banks will be excluded from the Board of Directors and managerial roles, more prominent industrialists (including those from neighboring Central American countries) should be encouraged to become promoters. Once this group is consolidated, they should be encouraged to prepare an initial financial plan, detailing anticipated cash flow projections, activity volumes, and projected earnings. This activity should ideally be done before start-up funds are requested; USAID will then be in a position to decide what types of assistance are necessary.[2]

In addition, the SBN will require assistance once the exchange is established, primarily in training its staff in regulation, to confirm transparency in its operations, and to ensure that ethical practices are established and monitored.

While the initial transaction volume of the exchange may be small and slow in starting, this period can be used constructively to train personnel, install computerized operations and management systems, and establish professional procedures. Initial transactions will probably use government instruments, which are described in greater detail in Appendix E (Capital Markets).

C4b. Private Insurance Industry

Price Waterhouse was asked to assess the feasibility of a private insurance industry and a private pension fund system. Before either can be developed, the appropriate enabling legislation will need to be drafted and investors identified. These two issues must be addressed before private insurance companies and private pension plans can play an active role in the stock and capital markets.

The creation of a private insurance industry is complicated by the fact that the *Instituto Nacional de Seguros y Resaseguros* (INISER), the government insurance monopoly, is the only one permitted by the Constitution. INISER was created in 1979 through the nationalization of seven private insurance companies. It is currently bankrupt and, at present, the SBN has not been able to ascertain where INISER holds its reserves, reputed to be approximately 100 million *cordobas*. INISER cannot be privatized until the Constitution is changed.

To establish a private insurance industry to compete with INISER will require creative techniques such as the granting of "concessions" to establish private insurance companies by special decree or other legal means. Once private insurance companies become operative INISER, as it is currently structured, will become non-competitive and most likely will cease to operate. In this transition phase, it will be very important to protect INISER's clients, in particular by ensuring their policies are honored and taken on by the new companies. Most likely the Superintendency of Banks will be called upon to regulate the new private insurance

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2 USAID has already been requested to provide approximately US$245,000 to cover start-up expenses of the Exchange. The IDB has indicated it will authorize US$30,000 help defray some start-up expenses.

companies. This additional role will require some initial assistance.

Private insurance companies will play an important role in the formation of the Stock exchange as they will be in need of short, medium, and long-term financial instruments and mechanisms to invest their reserves, and to plan for their long-term actuarial needs. The companies will also need assistance in forming their operating and investment policies, particularly relating to their reserves. This assistance could be obtained from other private insurance companies in Central America and Chile, for example.

C4c. Private Pension Funds System

To create a private pension fund system, pension fund law has to be drafted and corporation law reformed to guarantee transparency and provide information to the public. The Central Bank must draft guidelines to issue long-term financial instruments so that these can be offered by financial institutions as pension fund and insurance company investments. The SBN is the appropriate entity to control and regulate the pension fund system. However, the system should be managed by an administration company, similar to how it is done in Chile.[3] In the Chilean case, the pension fund has an affiliated insurance company to provide life and disability insurance to the contributors. IMCC has indicated it can provide Chilean consultants for assistance in establishing private insurance companies and pension funds.

Once the pension funds are sufficiently capitalized they will be a major investor in the stock exchange. As a result, they will provide a large demand for short, medium- and long-term investment.

C4d. Social Security System (*Instituto Nicaraguense de Seguridad Social y Bienestar*)

The Instituto Nicaraguense de Seguridad Social y Bienestar (INSSB) was created by decree of the *Sandinista* government in February 1982. The system includes welfare, national health care, and a pension fund. The health care system is financed by a nine percent contribution from employers and is available to all Nicaraguan citizens. At present, it is bankrupt due to high expenditures and inefficient operations. The system needs new worker and employer contributions to make it viable.

Current pension fund activities of INSSB were not covered in the PW report. The World Bank is discussing with INSSB the possible sale of health care services to private suppliers.

D. Conclusions

The Financial Services component of the PSS project has provided effective support in re-establishing the operations of the Superintendency of Banks and in the creation of

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[3] Chile had been the phenomenal success in this area in the Latin American region.

potentially viable private financial institutions. USAID has concentrated on those priority areas in the economy that have required immediate financial assistance and guidance. The studies and activities commissioned by USAID to Price Waterhouse and to J.L. Daly have produced useful guidelines as to what actions need to be taken. In this way, USAID has successfully encouraged the beginning of the transformation of Nicaragua to a free market economy.

The problems of the different entities discussed above, such as the Superintendency, the private banks, and the Bankers' Association, stem from the fact that they are new and need time to mature, to train their staff, and to become professional. The other organizations, such as the Central Bank, require further restructuring and support. However, more importantly, the Central Bank needs a stable and non-rotating president and senior staff who are experienced bankers. Other organizations such as the stock exchange, private insurance companies and pension funds, have to be created from scratch, which is a greater challenge from organizational, regulatory, and legislative points of view.

The primary needs of the private banks involve training of personnel, in addition to the World Bank-sponsored training. This includes training of tellers, retail platform people, people in internal controls, branch and operations managers, training operations (liquidity and investments) and people responsible for asset and liability management. In addition, senior bank officers must learn how an interbank funds market functions, since it will be important to establish one (as opposed to the sporadic trading that exists now) as a cornerstone of the planned open market and capital market systems. The staff also need training and guidance in promoting and carrying out a medium-term lending program. Finally, a fully operational professional Bankers' Association would be a great help to the private banks, not only as a forum to discuss combined training needs of their personnel but also as a means to improve their relationship with the Central Bank and the Superintendency.

The Superintendency's greatest need is the keep its Senior Advisor in place beyond the expiration of his contract in June of 1993. It's second greatest need is to train bank inspectors, in particular field inspectors, in risk assets, investments, and in addressing proposed new changes that will be authorized in the new banking law, such as licensing, factoring, and trust investment.

The creation of the stock exchange, private insurance companies, and pension funds in the future will require that SBN inspectors are qualified to analyze the specific activities of these operations, since the SBN will be in charge of regulating them.

It is important that the Bankers' Association be able to represent the private banks before the Superintendency, the Central Bank, and the National Assembly, where legislation is pending regarding their interests. Therefore, the Association must become fully functional, develop a workplan, and prepare a code of ethics and conduct which will be adhered to by its membership.

The Central Bank needs a President for a fixed term and representation of private and state owned banks on its Board of Directors. It needs to be supervised by its own board and

not by the *Controlaría General de la República*. A Senior Advisor to the President is needed who is an experienced central banker to help transform the BCN into a modern central bank, able to control the country's financial situation. The Central Bank also needs to train its staff in money market operations, particularly managing the money supply in open market conditions, and how to conduct audits and debt issues.

The stock exchange has two promoter groups who wish to manage it. These two groups should be encouraged to join forces rather than work against each other. The promoter group should also be required to prepare an operational and financial work plan, indicating cash flow projections, transaction volume estimates, and revenue projection before it be provided with start-up financing.

Private insurance companies and private pension plans require enabling legislation, promoters, investors, and contributors to form them before they can be an active part of the capital markets. For further information on this issue, see Appendix E.

E. Recommendations

The following recommendations are made to improve this component of the PSS project:

1. The contract of the Senior Advisor to the SBN should be renewed, preferably for one year, although IMCC recommends an extension through March 1994 in keeping with the original contract which covered 18 months. This is a very high priority recommendation.

2. USAID should consider funding the design and implementation of a training program for SBN field inspectors.

3. If not continued by the World Bank, USAID should consider funding the next phase of the training of commercial bank personnel.

4. USAID should consider updating the Price Waterhouse study on the norms and needs of the SBN, thereby providing a priority work plan for the next twelve to eighteen months.

5. USAID should consider making an one-time grant to the Bankers' Association to fund its initial start-up operations, including the hiring of its staff and the preparation of a priority work plan.

6. The Bankers' Association should be encouraged to establish a dialogue with the Government in an attempt to modify the new banking law in the National Assembly to make it more rational.

7. Technical assistance should be provided to the Central Bank to train senior personnel in controlling the money supply and managing its debt. This could be funded by the

new EPAI project. A full-time banking senior advisor perhaps can be funded from this source as well.

8. The two promoters of the proposed stock exchange should be encouraged to join forces and to prepare a financial/operation plan. This should be a condition of USAID considering providing financial assistance. Further, USAID should coordinate with the IDB, which has also indicated its intention to provide some start-up funds for the operation of the stock exchange.

9. USAID should give attention to encouraging the establishment of private insurance companies and pension plans. As part of this activity, policy dialogue should be encouraged with the Government in order to hasten drafting and passage of the appropriate enabling legislation.

10. USAID should consider sending selected managers of the Central Bank to the New York Federal Reserve Bank for on-the-job/observation training in preparation for managing Central Bank operations within an open market system in Nicaragua. The New York Federal Reserve Bank is equipped to do this type of training in New York or could send appropriate personnel to Nicaragua. It is recommended that USAID make initial contacts with Mr. Gerald Cryman, President of the New York Federal Reserve Bank, to discuss how best to proceed.

11. USAID should consider funding the design and implementation of needs and requirements study, credit and otherwise, of the small and medium-size enterprise sector in Nicaragua, similar to what has already been done for the microenterprise sector. Based on this analysis, priority needs can be identified and appropriate actions taken.

V. STUDIES AND SURVEYS

A. Introduction

The PSS project provides financing for studies which will develop the information needed to devise appropriate policies, take advantage of emerging opportunities, and design future project and non-project assistance to the private sector in Nicaragua. Funds for these studies are incorporated in the project's individual institutional contracts

B. Assistance under the PSS Project

The original design of the PSS project was based on the expectation that information needs would become clearer as the project progressed, and that new areas to be investigated would be identified. However, an initial scope for studies and surveys which could be financed by the PSS project was provided, suggesting the following:

- Assessments of Nicaragua's industrial and trade sectors.
- Comparisons of Nicaragua's business environment with those of its competitors.
- The role of Nicaraguan private sector associations in fostering market-led economic growth.
- Case studies of exporters and investors.
- Market studies of the feasibility of new financial services.
- Actual and potential sources of credit for microenterprises.

C. Findings Related to Studies and Surveys

Sector studies focus on the identification of areas and industries in which Nicaragua has comparative advantages, as well as on determination of domestic and foreign market conditions and prospects. These studies are of particular importance to investors and exporters in light of recent changes in Nicaragua's economic conditions.

The design and supervision of studies and surveys is currently undertaken by Carana. There are several studies either underway or completed which aim to help identify emerging opportunities, examine alternatives for future project activities, and other issues related to private sector development. In the area of financial markets, studies have been completed on establishing banking norms and reporting systems. Regarding privatization, a study has been completed on private sector insurance operations, and Carana has another underway on establishing business pension programs. Carana has two studies underway on trade and investment. The first is an industrial survey for the Department of Managua; the other is a comparison of Nicaragua with other Central American countries as a site for investment.

- **Industrial Sector Study:** Carana has contracted a consultant (Roger Lacayo) to carry out this study based on a scope of work approved by USAID/Nicaragua. Based on the terms of reference contained at the end of the study, the first phase of the project represents only a small portion of the total study. The considerable amount of work that remains to be done would require about two months of dedicated time to the project. Yet the consultant is involved in a number of other projects, which inhibit progress in the study.

- **Incentives Study:** This study is being undertaken directly by Ned Kelly, the Trade and Investment Counsellor of the Nicaragua PSS project. He is utilizing contacts in other countries to gather information. Tables for the study have been completed, according to Mr. Kelly, but analysis of the data has not been initiated. As with the Industrial Sector Study, Carana is behind on this one due to efforts in other areas of CEI operations.

Early in the formulation of the USAID program it was recognized that there was an urgent need for studies and surveys to gather information needed for investment and export activities. Consequently, several studies were funded through INCAE in an earlier project. Recognizing the urgency of developing information, USAID should make every effort to ensure the completion of these and other studies. To this end, a delivery date for the studies should be established for Carana. Should that deadline not be met, the funds should be used to support studies by others.

Four other studies and surveys have been proposed. Carana has presented proposals for three studies on meat processing facilities, formulation of a COSEP business plan, and development of a trade fair manual. ENABAS has proposed to conduct a privatization pilot study.

As funds have already been earmarked for other activities, there is little, if any, flexibility in the existing proposed budget for additional studies. Yet considerably greater funding of studies and surveys in all three areas of the PSS project are needed because of the lack of information concerning existing and potential conditions in the Nicaraguan economy. In addition to those studies already earmarked for funding, consideration should be given to the following:

- Tourism
- Fisheries, including environmental impact assessments
- An organization plan for a stock and bond trading market
- Exports of agroindustrial tropical foods and conversion of tropical food products (mangos, guavas) into packaged process goods
- The impact of export initiatives on income distribution.

There is no clear mechanism to determine which studies are undertaken, the general guidelines for determining the scope of such studies, whether a sector approach is preferable to industry studies, how they are to be allocated among the different production and marketing stages, and what percentage of them are to have linkages to social, environmental,

or income distribution issues. Nor is there a clearly defined mechanism for determining what individuals or organizations should undertake studies, how intellectual capacity should be exploited in the country, and whether there should be a program to encourage visiting scholars to study topics in their areas of expertise.

D. Conclusions

Considerable progress has been made in two of the three study areas. For the financial markets component, studies have been completed on establishing banking norms and reporting systems. For privatization, a study is being conducted on private sector insurance operations, and the establishment of business pension programs. In the area of trade and investment, the two studies are still underway.

There is little doubt that these and other studies can help to devise policies, analyze emerging opportunities, and determine needed private sector support. Once these studies are completed, there must be greater dissemination and promotion of the results through published synopses, seminars, and greater distribution of the findings.

E. Recommendations

1. For the trade and investment studies underway, a delivery date should be established.

2. Additional funding of studies should be permitted in the amended PSS project in order to encourage the development of information needed for private sector development.

3. A formal mechanism should be established to determine the criteria for selecting, formulating, and implementing studies. A formal review process should also be established. That mechanism should contain guidelines for the wide dissemination of studies and surveys.

There remains additional scope in the overall PSS project for examining private sector support in relation to both macroeconomic and sector policies. Specifically, the ability of the project to succeed in its support of private sector development, directly or through the establishment of mechanisms to facilitate that development, is closely related to macroeconomic conditions affecting domestic production and trade initiatives and the competitiveness of the country in foreign markets.

VI. WOMEN IN THE PRIVATE SECTOR

A. Introduction and Background

According to unofficial USAID sources, there are no major barriers to women entering the private sector in Nicaragua. However, to gain access to professional jobs, they must be politically and personally (through family) well-connected. In general, women do not work their way up the organizational ladder, but are placed directly in their positions. Once they are in place in an organization they appear to perform satisfactorily and are accepted by their male counterparts. The fact that the nation's President is a woman does not appear to influence the role of women in the private sector.

Conclusions of INCAE studies and recent IDB reports on the role of women in development conflict with the above. These studies say that despite the increased participation of women in the workforce, they continue to exhibit higher rates of unemployment and lower overall levels of income than men. These trends exacerbate the economic situation in Nicaragua, where the poverty level is among the highest in Latin America.

For women to successfully operate in the private sector, and in the economy in general, it will be necessary to guarantee the benefits and policy achievements now only available to select groups of women to a broader cross-section of female workers. To this end, the female labor force as a whole should have increased real income and employment conducive to their professional development.

USAID should, either directly with the private sector or through the GON, support programs that increase the capacity and quality of women in the labor force. At the same time, it should promote services for infants and children that could lead to an increase in the productivity of family-related work.

B. Conclusions and Recommendations

The most urgent need at this time is the development of statistical information to support identification of opportunities for USAID assistance. INCAE has advanced its work on case studies of women in management, of male and female students with work experience in public and private organizations, and of women managers in public and private sectors in Nicaragua. The recent work of INCAE indiactes that the following areas require further analysis:

- Mechanisms that can be used to identify and encourage females to seek higher levels of education.
- Opportunities to institute flexible work schedules to permit women to attend to family obligations.
- The extent to which sexual harassment exists among professional women.

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USAID should consider participating in studies that will improve the information on women in the private sector. Household surveys should be undertaken and updated regularly to determine specific programs needed to monitor progress. Moreover, USAID should incorporate into private sector development projects specific components aimed at the promotion of women in this sector of the economy. Examples of such components include:

- Promotion of non-household work through educational opportunities.
- Training in business start up and operation targeted for women in the private sector.
- Design and implementation of on-the-job training programs, coupled with child care services.
- Information dissemination, through chambers of commerce and government channels, targeted at promoting women's involvement in business.

Such studies and projects could help to promote structural changes currently underway in Nicaragua, while improving the living and working conditions of the female work force. While the promotion of women will be the focus of these advances, the entire population will experience positive repercussions.

VII. PROGRAM INTERRELATIONSHIPS

A. Introduction

The PSS project has contributed in several important ways to the improvement of the environment for investments and exports in Nicaragua, generally supporting sustainable, broad-based growth. The privatization component has been unexpectedly successful and the financial services component has, for the most part, been effectively supported. Although advances have been made, the trade and investment component continues to have significant problems stemming from a lack of focus and direction in implementation measures. The difficulties experienced in this project component are also attributable to the considerable work that remains to be done in establishing an appropriate economic environment to attract domestic and foreign investors, and making the country competitive in foreign markets.

PSS project activities to date have concentrated on privatization of state-owned enterprises through CORNAP, promotion of trade and investment through COSEP and MEDE, and support to the private banking sector through the Superintendency of Banks. The amended PSS project should coordinate closely with other USAID activities in macroeconomic stabilization and exchange rate policies to help stimulate an export-driven economic recovery in the country.

B. Conclusions

Undoubtedly the revitalization of the Nicaraguan economy will require a concerted and multi-pronged effort to generate private investment and exports, and therefore the major components of the PSS project move forward together. Initiatives should support re-establishment of a viable financial system; divestiture of state-owned enterprises; and development of regulations, information, foreign markets, and an export re-orientation of the private sector. Establishment of viable financial institutions will provide the much needed credit facilities to support investment and exports.The PSS privatization component will not only diminish the role of the government and promote private sector initiatives in the economy, but will restore and bolster investor confidence and, in many cases, encourage expansion of exports. Finally, the promotion of trade and investment will support the restoration of economic growth, and afford an opportunity to import capital goods and semi-manufactured products to expand the agricultural and industrial bases of the economy. This expansion will, in turn, put new pressure on financial services and on further opportunities to invest throughout the economy.

Even with the close interrelationship of its major components, the PSS project and other efforts to develop the Nicaraguan private sector depend critically on improvement in the overall economic state of Nicaragua. GON measures to stabilize the economy have succeeded in ending hyperinflation. But the currency remains overvalued, and despite a recent devaluation, the wage-price spiral has all but eliminated the initial improvement in the real exchange rate that followed. As a result, Nicaragua's exports remain non-competitive

relative to most other foreign suppliers to its major export markets. For this reason private sector initiatives from the PSS project and other donor and GON programs are not supported by macroeconomic conditions, and cannot be sustained in the long run. It is clear that the future success of the PSS project depends not only on the joint progress of its component programs, but also on bringing the real exchange rate to a level that makes exports competitive and investment attractive.

C. Recommendations

The recommendations of this assessment distinguish between direct support to investment and export activities and institutional development support. Because of the urgency of trade and investment activities in Nicaragua, priority should be given to those activities that directly impact upon investment and export promotion. It is nonetheless recognized that creation of a healthy trade and investment environment requires institution building, which is an important part of private sector development in general and the PSS project in particular.

1. A concerted effort must be made to incorporate linkages between the PSS project components and GON macroeconomic policies to ensure that real exchange rate policies, as well as monetary and fiscal policies, provide an economic environment conducive to a sustainable expansion of trade and investment.

2. A greater effort should also be made to incorporate actual and expected feedback effects from the PSS project and the Private Agricultural Services project in an effort to assess the impact that changes in nontraditional exports and improved services would have on export and investment promotion, and the effects that trade and investment promotion have on the ability and willingness of the agricultural sector to develop nontraditional exports. Such an effort could initially occur through the joint monitoring of these projects in USAID's Strategic Objective and Indicators project (PRISM) as well as closer interaction between APENN and CEI through the participation of each at the Board of Directors level.

Joint efforts in sector-specific and economy-wide programs will provide for mutual reinforcement of individual project initiatives to provide an enabling environment for private sector development. It will further provide the capacity to measure feedback effects likely to arise from individual initiatives, and allow policies and programs to be tailored more closely to the overall needs of the private sector.

APPENDIX A: EVALUATION SCOPE OF WORK

BACKGROUND

A. Overview of the Nicaraguan Economy and Private Sector

The Chamorro government took office in April 1990 with the backing of a broad-based coalition called the National Opposition Coalition (UNO) in opposition to the Sandinista National Liberation Front (FSLN). A ten year period of economic mismanagement and the effects of war and the U.S. economic embargo had left the Nicaraguan economy in shambles. The Nicaraguan GDP declined by 37.8% from 1977 to 1989 and the standard of living declined by 58.2% for the average Nicaraguan. Monetization of central government deficits led to hyper- inflation (peaking at over 33,000% in 1988) which was compounded by efforts to fix exchange rates and control interest rates. Exports deteriorated steadily throughout the 1980's and the financial system was decimated by devaluations. Nationalization of banks, control of credit, and preferential loans to state-held enterprises devastated the banking sector. State-owned enterprises dominated key areas of the economy and were often grossly mismanaged. By 1998 external debt levels totaled almost $10 billion; arrears alone totalled $3.1 billion for an economy with an estimated GDP of $1.6 billion. High arrears to the IDB and IBRD had closed those sources of development financing.

The Chamorro government has generally supported revitalization of the private sector and sees major increases in investment and export as prerequisites for economic growth in Nicaragua. Due to ten years of state dominance of the economy, a highly politicized business environment, and economic policies destructive to private enterprise, the Nicaraguan private sector found itself powerless and without resources. Nicaragua is at competitive disadvantage vis-a-vis its neighboring countries, and has a highly politicized and divided private sector.

The government has been able to stabilize the economy largely through generous amounts of external assistance including large levels of balance of payments assistance from the U.S. The government has also been largely able to end much of the fighting in the countryside and put in place a series of economic and political reforms. Critical issues such as property rights, disposition of confiscated property, and wages are still subjects of bitter political dispute that have sometimes erupted into civil disorder. The principal obstacles to private investment appear to be the political controversy over unresolved property claims against the Government of Nicaragua, a lack of a fully-developed financial infrastructure, restrictive laws and regulations, shortages of needed expertise, and the continuing outside perception of Nicaragua's political instability.

The government's economic stabilization program has been successful in reducing monthly inflation to single digit levels. Inflation has averaged near zero since mid-1991 as a result of stringent fiscal and monetary policy measures. Central government revenues have exceeded their target levels.

The government has divested, liquidated, sold to private owners, or placed under private management over 200 state-held enterprises. As part of a scheme to compensate former owners in settling property disputes, the government has also proposed privatization of the state owned entities handling telecommunications (TELCOR) and electricity (INE).

The government of Nicaragua has begun to liberalize the foreign exchange market and the financial system by allowing privately owned exchange houses and banks to operate and by reducing the Central Bank's role in controlling imports. The Chamorro Administration passed legislation in June 1991 guaranteeing foreign investors the right to remit 100% of current net profits. A Superintendency of Banks has been established, seven private banks are operating, and a private bankers association has been established. The weaknesses of the private banks (some less than a year old) in providing credit for reproductive purposes include the lack of rural branches, limited capital, perceived risks, conservatism and a lack of extension work. Conservatism in private bank lending has limited the availability of medium and long-term credit and the provision of private credit to some sectors. The Superintendency is hampered by a undertrained staff, lack of certain regulatory frameworks for new financial markets (such as share and bond trading and social security systems), and a shortage of qualified examiner personnel.

B. USAID/Nicaraguan Strategy Support for Private Sector Revitalization

U.S. economic assistance to Nicaragua resumed in 1990 following the election of Violeta Chamorro to the presidency and negotiated end to civil conflict that had continued for most of the 1980's. USAID/Nicaraguan opened as a "permanent" Mission in July of 1990 to administer a program of assistance that had obligated over $675 million as of December 1992. Early U.S. assistance was heavily oriented toward balance of payments support associated with economic policy reforms designed to help stabilize an economy in shambles after ten years of economic mismanagement and war. Balance of payments support was designed to help the Nicaraguan government confront sustained hyperinflation and create a framework for economic growth to help create jobs and raise the standard of living for the average Nicaraguan. In addition, USAID/Nicaragua provided project assistance designed to meet such urgent needs as temporary employment, medicines and medical supplies, school textbooks, and treatment of war-related health needs. At the same time, USAID/Nicaragua began design of a portfolio of projects to address critical long-term development needs in various sectors in line with an overall strategy outlined in the Country Development Strategy Statement (CDSS) approved in July of 1991. The CDSS also proposed the use of continued balance of payments assistance to address key policy areas and help maintain economic stability.

Strategic objective outlined in the CDSS for support of the overall goal of broad-based, sustainable economic growth targeted development of a vigorous private sector by focusing on 1) increased investment and 2) increased competitiveness, diversification, and participation in the economy. The Mission supports these objectives through a combination of

balance of payments assistance associated with economic reforms and project assistance to the private sector. Designed to stimulate a private sector response to such a changed policy environment, the Private Sector Support project is one of the primary vehicles for providing such assistance to the private sector and those institutions critical to the proper functioning of a market economy. The project also complements assistance to the agricultural sector through the Private Agricultural Services project which promotes non-traditional exports and improved services by member associations of Nicaragua's umbrella association of agricultural and livestock producers.

C. The Private Sector Support Project

The goal of the Private Sector Support Project (PSS) is to increase foreign and domestic investment in support of sustainable, broad based growth. The project's purpose is to improve the environment for investments and exports in Nicaragua.

The original design of the Private Sector Support project was difficult because of numerous uncertainties involving stabilization of the economy, the institutional strengths and weaknesses of potential private sector and government counterparts, and the role of other donors. The project was seen as an interim response to private sector needs with a relatively short implementation period in expectation of a major reassessment of project directions and activities once the economic situation was somewhat more settled. The project involves three major substantive components (plus a studies component). Current activities under the project's major components include the following:

1. Establishment of Viable Financial Institutions - This component of PSS was designed with sufficient flexibility to address emerging needs in the sector and evolved into activities to support establishment and effective operation of 1) a Superintendency of Banks, including systems for operations, approval of new private financial institutions, and reporting mechanisms and 2) establishment of new private financial institutions complemented by a bankers training program with the Central American Institute of Business Administration (INCAE). Technical assistance has been provided to the GON Superintendency of Banks to improve its monitoring and regulation of the Nicaraguan financial sector. Studies have been done on setting up a private banker's association (one has been established), on the potential for pension programs, and on initiating private insurance companies. Through contractors (Price Waterhouse and IMCC) providing a resident advisor and short-term technical assistance, AID has helped the Superintendency establish bank licensing criteria and a bank financial reporting system. Seven private banks have started operations with over $18 million in capital. USAID/Nicaragua's CDSS also proposed activities to help develop a stock exchange and proposed assistance to non- Bank, credit organizations as a means of expanding credit opportunities to a broader spectrum of the population than that likely to be reached by private banks. These activities have not, to-date, been a part of the project but are under consideration.

2. Privatization of State-Held Enterprises - The Privatization component was designed to assist the GON in formalizing and activating the divestiture process. Through prior short- term consultancies and a project by-in with Price Waterhouse, USAID has worked closely with Corporaciones Nacionales del Sector Publico (CORNAP) in the privatization of over 205 state-held enterprises to date. A project-funded contactor, Price Waterhouse (PW) has taken the "lead" in preparing prospectuses and handling bidders on privatization for hotels and sugar mills. Future efforts include privatization of ports and cement plants. Price Waterhouse has helped CORNAP improve its analytical capability, record-keeping and ability to handle the overall divestiture process and strategy. Although the privatization process has been plagued by political problems, privatization activities have gone forward; of the 350 firms in the CORNAP portfolio, over 57% have been divested.

   In discussions with the World Bank during the past year on the next economic recovery credit, the GON agreed to privatize certain autonomous entities, among them the state- owned telecommunications agency (TELCOR) and the state-held electric power company (INE). In other discussions related to a process of resolving property disputes, it was proposed that shares of these privatized entities would contribute to the pool of resources available for a compensation fund. Whether on not assets of the privatized entities contribute to the pool of compensation resources it still being discussed. In any event, related privatization activity would require considerable technical assistance. Initial project design did not contemplate these privatizations though they could be incorporated into a project amendment to complement World Bank Activities.

3. Promotion of Trade and investment - PSS Trade and Investment activities are expected to develop the umbrella private sector association's capability to promote and facilitate trade and investment, improve the private sector's capability to advocate policies with the GON and general public, and establish capacity within the Ministry of Economy and Development to reform policies and regulations that would streamline investments and exports. The component addresses the need for information and contacts for potential exporters and investors and for specialized export and investment assistance in selected areas. Under PSS, agreements have been signed with the Consejo Superior de la Empresa Privada (COSEP) and with the Ministerio de Economia y Desarrollo (MEDE). The private consulting firm CARANA was contracted primarily to manage USAID/Nicaragua trade and investment activities. The principal feature of these agreements has been to support the establishment and operation of the Center for Export and Investment (CEI). Work was initiated in July 1992 and key personnel are now operating out of offices rented from COSEP. CEI provides assistance to people and firms who wish to invest in Nicaragua and to people/firms mak exports from Nicaragua. To do so, CEI required a trained s , equipment, understanding of trade and investment policies and

possibilities, and cooperation from the GON and Nicaraguan business community. To support COSEP members (five major bodies including chambers and associations), an initiative fund (mini-project) program was designed. One grant to "Young Entrepreneurs" (Junior Achievement) for training has been awarded.

In the first six months of these activities, CEI has begun to provide assistance to investment and exporting firms, studies and analyses have been undertaken, staff training has started, and necessary equipment and furniture have been procured and installed. However, all staff are not yet in place, and operational systems have not been formalized. Some efforts have been overshadowed by the murder of one of COSEP's key board members and the bombing of the COSEP (and CEI) offices (Nov. 23 and Dec. 2 respectively). Support for exporters and investors to date has been fairly general: making contacts, providing copies of regulations and assistance with documents, exploring potential. In-depth analyses of particular business sectors have not yet been undertaken nor has expertise at the individual or firm level yet been provided. No specific, targeted training has yet been developed for the service sector.

Recent decisions by AID/W and the U.S. Congress to limit certain trade activities (per Section 599 of the FY93 FAA) have required review of planned trade and investment activities. USAID/Nicaragua is limiting assistance to U.S. investors and will not provide assistance to free trade zones. Major changes in activities in the investment area may be required.

4. Studies and Surveys - As an activity supporting initiatives in the three principal areas (trade and investment, financial markets, and privatization), the studies and surveys component was designed to help devise policies, take advantage of emerging opportunities, and determine future assistance to the private sector. It was envisioned that up to six studies would be performed in the first eighteen months. To date, studies have been done on establishing banking norms and reporting systems, private sector insurance operations, establishment of a banker's association and establishment of business pension programs. Two studies are now being drafted: an industrial survey for the Department of Managua and a comparison of Nicaragua with other Central American countries as a site for investment. Other possible studies include various profiles of certain business sectors, a strategy piece for support to microenteprises, and an organization plan for a stock and bond trading market.

Further information on these activities is available through review of grant agreements and contracts, through the Project Paper of the Private Sector Support Project (PSS), through quarterly reports, and through the Mission's Semi-Annual Reports (SARs).

ARTICLE I - TITLE

PD&S: Assessment of Private Sector Initiatives in Nicaragua

ARTICLE II - OBJECTIVE

The objective of this Delivery Order is to assess current activities in USAID/Nicaragua in light of the Mission's overall strategy to determine; 1) if current initiatives being undertaken through the Private Sector Support Project appear to be effective means of achieving Mission objectives, 2) what changes to current activities might improve their effectiveness, and 3) what additional areas of involvement or potential activities might further support achievement of the Mission's objectives to increase investment in Nicaragua and competitiveness, diversification, and participation in the economy.

ARTICLE III - STATEMENT OF WORK

In conducting the assessment, the Contractor shall use the following guidelines:

A. Financial Services

How can the ongoing assistance provided by USAID/Nicaragua to the financial sector be improved to meet project purposes? Are the contracted services through IMCC meeting the needs of the Superintendency of Banks? Are there changes to the institutional agreements that would help improve the effectiveness of this assistance? Are applicable inputs, outputs, and indicators in the logical framework of the Project Paper (PP) still relevant? Do other planned activities (such as banker's training) appear to be appropriate means of meeting other needs in the financial sector?: How can USAID assistance help improve the effectiveness of the private banks in offering financial services to a broad range of clients?

Are there other areas of critical need in the financial sector that USAID/Nicaraguan should address to promote its strategic objectives of increasing investment and increasing participation, competitiveness, and diversification in the economy? For example, is the lack of commercial (i.e. non-subsidized) credit a constraint to investment in Nicaragua? Is there a way (or ways) in which A.I.D. could help mobilize savings and expand the availability of non-subsidized credit to sectors of the economy that lack access to such credit? What would be the advantages and disadvantages of such an approach? Are there any financial services that USAID could support to promote broader ownership of productive assets? If so, what are those services, and how might USAID go about supporting them? What would be the advantages and disadvantages of such support?

To answer these questions the assessment team will:

1. Review the financial sector study (written by J.L. Daly, Inc., PD&S funded), contractual arrangements under the project, the feasibility studies on private insurance and pension plans, and proposed assistance to a new stock market;

2. Interview the Superintendent of Banks, the IMCC contractor working with the Superintendency, representative private bankers, potential business clients (through COSEP), USAID economist and private sector staff, and other donors (especially the IDB);

3. Analyze the effectiveness of current activities in the financial sector and recommend ways of improving current USAID assistance, as well as changes/curtailment of ongoing activities; and

B. Privatization

How can the ongoing assistance provided by USAID/Nicaragua to GON privatization efforts be improved jto meet project purposes? Is the current support to CORNAP under the Price Waterhouse Buy-In through the Privatization and Development Project (PRE/EM) meeting the needs of CORNAP and contributing to project objectives? Are any changes required? Are the indicators of progress in the logframe in need of adjustment? What is the range in cost of taking companies through the entire privatization process (e.g., diagnostic study, valuation, privatization strategy, public tender solicitation, and award and transfer)? Is there an economy of scale by handling an entire sector (e.g., sugar mill, hotels)? What is the estimated cost and timeline to complete to complete the CORNAP portfolio of privatization and what donor assistance has been lined up to accomplish it? Are there ongoing or planned activities that should be changed, limited, or curtailed?

Are there ways USAID/Nicaragua could support additional privatization? What type and level of future assistance would be required to support potential privatization of GON entities dealing with infrastructure such as TELCOR (telecommunications) and INE (electricity)? What are other donors planning to provide as support in these areas? Is there a role for A.I.D. to play supporting these or other privatization efforts? If so, how might such USAID assistance be structured?

The assessment team will:

1. Interview key CORNAP personnel, representatives of the IDB, World Bank, and Price Waterhouse, USAID economists and private sector staff, and representatives of the major institutions being considered for future privatization to discuss progress, USAID support, and possible future requirements.

2. Summarize and assess the privatization efforts undertaken by Price Waterhouse based on existing reports and interviews with individuals mentioned above. Recommend improvement, changes in, or elimination of existing privatization assistance as appropriate.

3. Outline technical assistance needs and other support required by the GON to undertake privatization of TELCOR, INE, and other state-owned infrastructure entities. Propose areas for potential USAID involvement including cost estimates and possible implementation arrangement.

C. Trade and Investment Support

How can USAID improve its support for investment and exports in a manner consistent with recent U.S. legislation? What ongoing activities appear to have the most potential for facilitating investment and exports? Are the indicators, outputs, and inputs shown in the PP logframe still reasonable or should they be changed? Given restrictions on USAID involvement in some areas, what other activities could AID consider to promote increased levels of investment and exports? Have contractors and grantees been able to deliver the services expected of them? Are personnel and equipment the most suitable for performance of the required tasks? Are the project Initiative Funds to chambers and associations seen as appropriate mechanisms for assistance and are they contributing to innovation and development of the private sector? Are the institutional and working arrangements satisfactory for carrying out the work? If not, then how can rectification be made?

The assessment team will:

1. Interview representatives of the Nicaragua private sector including the President of COSEP and the Chambers of Commerce and industry, representatives from the Ministry of Economy and Development, CARANA personnel, potential investors who have expressed interest in Nicaragua, companies considering exports, and USAID economists and private sector officers;

2. Review the INCAE studies as noted in the Appendix;

3. Review mechanisms to provide assistance to improve private sector capability to analyze potential investment opportunities and to prepare feasibility studies and accompanying funding requests to carry out investment projects;

4. Analyze ongoing activities and recommend areas for further emphasis or expansion and activities that might be phased out to better meet project objectives in line with current Agency guidelines; and

5. Propose other areas of USAID involvement to promote investment and exports in line with Agency guidance, including cost estimates and possible implementation arrangements. Propose areas of assistance that should be curtailed or reduced.

D. Studies and Surveys

Are the studies already done and those planned useful and relevant? Are there other ways studies and surveys can enhance project efforts?

The assessment team should review studies done, in draft, and plans for additional studies. AID and contract personnel should be interviewed. Recommendations on further studies or surveys to be done should be included.

E. Industrial/Processing Sector

Are there activities that USAID/Nicaragua could undertake to support increased investment in industry or local processing of agricultural goods?

What are the constraints to local manufacture or processing of goods currently imported? What are the constraints to increased processing of goods for export? In light of legislative restrictions on investment promotion activities, could project assistance be useful in addressing these constraints?

The Assessment team will:

1. As in reviewing trade and investment support, interview representatives of the private sector including the President of COSEP and the Chambers of Commerce and Industry, representatives from the Ministry of Economy and Development, CARANA personnel, potential investors who have expressed interest in Nicaragua, companies considering exports, and USAID economists and private sector officers;

2. Review relevant studies on the potential for industrial development and processing of agricultural goods in Nicaragua; and

3. Recommend potential USAID/Nicaragua project activities that could address constraints to increased investment in manufacturing, other industry, and agricultural processing.

F. Regulation and Enforcement

How might USAID/Nicaragua project assistance address constraints to investment and export activities posed by the regulatory environment and enforcement mechanisms? What regulatory constraints to investment and export have been identified and what further analysis is required? What project activities could address regulatory issues?

The assessment team will:

1. Interview key business leaders (exporters) from Chambers and the business community. Also discuss problems with other donors working in the sector (UNDP, IDB, WB), as well as relevant GON officials (Customs, Finance, Ministry of Economy, etc.);

2. Review relevant studies prepared by INCAE, especially those written by Bell, De Franco, and Navarro; and

3. Suggest possible areas of project assistance to address regulatory constraints and enforcement issues.

G. Women in the Private Sector

How can USAID/Nicaragua project activities in support of the private sector promote the role of women? How are ongoing activities addressing

the needs of women in the private sector or promoting their active participation? What activities would promote the emergence of women entrepreneurs and increase numbers of active women in private sector organizations

The assessment team will:

1. Interview INCAE WID personnel, the Mission WID Officer and other donors on efforts to promote women's participation in private sector activities.

2. Review INCAE studies on women in management, as prepared (in draft) under the Technical Assistance and Training Project.

3. Recommended project activities that would promote the participation of women in the private sector.

H. Methods and Procedures

The following section briefly states the steps the team will take in performing its analyses and recommendations. Because of limited time and resources, it is not expected that the team will be able to do an in-depth study of the Nicaraguan private sector or resource potential. Instead, the team will need to rely on a review of available literature, interviews and discussions with a selection of representatives or important individuals, and to use their own judgement and experience in presenting a cohesive, logical and practical assessment of the private sector and the recommended areas for USAID assistance.

A. Review of Key Documents and Studies

Key documents useful for the assessment are those that describe the current private sector in Nicaragua, that provide some ideas or analyses of areas of opportunity for local economic growth, and that describe what has been done to date.

These headings would appear to be exhaustive, but are in fact rather limited. Appendix B includes a listing of documents identified for the team's use, all of which will be made available when team members have been identified.

Some key pieces include the following; USAID/N CDSS, Private Sector Support Project Papers, USAID Semi-Annual Reports, contractor/grantee quarterly reports, INCAE studies on the private sector, and Price Waterhouse studies on pensions, insurance, and the banking association.

B. Interviews and Discussions

It is essential that the team spend a significant amount of its time meeting with representative and influential people who are important to private sector growth. These people should be interviewed and/or

discussions held with them on their views of project progress, constraints to growth in the private sector, and potential areas where USAID can assist in strengthening and expanding the Nicaraguan economy through the private sector. Although it is probable that this list will be expanded considerably, the following individuals have been identified as important resources for the team's assessment. From this base, the team is encouraged to develop other contacts (especially amongst the business community). The following list and the contacts outlined above in the Statement of Work should be viewed only as a point of departure for developing a broader range of interviews beyond the normal AID circle of contacts. As appropriate, USAID staff may accompany team members in interviews and discussions.

1. Ministry of Economy and Development
   - Minister, Pablo Pereira
   - Trade and Investment Chief, Amilcar Ibarra
   - National Investment Funds, Jorge Montealegre

2. Financial Sector
   - Superintendency of Banks - Superintendent, Angel Navarro
     - Consultant Juan Klingenberger
       - Consultant Juan Klingenberger
   - Private Bank Managers: BANPRO - Carlos Espinoza, BANCENTRO.
   - Eduaro Montealegre

3. Business Sector
   - COSEP - President, Ramiro Gurdian
   - Chamber of Commerce Director, Modesto Palacios
   - Chamber of Industry - President, Alberto Chamorro
   - INDE - President, Pedro Gutierrez
   - UPANIC - President, Gerardo Salinas
   - American Chamber of Commerce, Presient, Carlos Reynaldo Lacayo
   - APENN - President, Samuel Mansell

4. Center for Exports and Investments
   - Director, Bill Pfaeffle
   - Export and Investment Officers, Haroldo Lacayo, Norman Zavala, Joaquin Gonzalez, Manely Argenal, Maria Isabel Zuniga
   - CARANA Corp. - Chief of Party, Robert Hans and Deputy Edward Kelly

5. Privatization
   - CORNAP - President, Dayton Caldera
     - Privatization Director, Ivan Saballos
   - Price Waterhouse Consultants, Jorge Segura and Michael Apel
   - Rolando Rivas, TELCOR
   - Emilio Rappacioli, INE;
   - Minister Emilio Pereira, MIFIN

6. USAID Staff - Director, Janet C. Ballantyne
   Deputy Director, Mark Silverman
   Project Officer, Timm Harris
   Privatization Officer, Sally Everett
   Project Development, Leon Waskin
   Evaluation Officer, Todd Amani
   Mission Economists, Joe Ryan, Gary Linden

7. Embassy Staff - Econ Officers - Paul Trivelli and Kris Urs

8. Other Donors
   PAPIC Representative - Director, Dieter Hagenmiller
   World Bank Representative - Ulrich Laechler
   UNDP Representative Deputy Director - James Rawley
   IDB Representative - Joel Riley

9. WID - Leslie Hunter, INCAE, and Lawrence Odle, USAID WID Officer

C. Submission of Assessment

By the end of the first week, an outline of the assessment will be provided to appropriate USAID staff. Given the time frame for performance of this assessment (24 working days for primary team members), the assessment draft must be submitted by the end of the third week of the team's TDY. This draft will be reviewed by the Deputy Director, Private Sector Officer, Evaluation Officer, Project development Office, and the Privatization officer within two full working days. The assessment team will be required to submit a final report prior to their departure. Meetings concerning the format, contents and progress will be held at the beginning of the assignment and every Friday thereafter until the assessment is complete. Any additional meetings/discussions can be scheduled as necessary.

D. Timing and Logistics

The assessment team will be provided with all necessary reports at the time of arrival in Nicaragua for assignment. The team's arrival will ideally be in the beginning of February with completion of assignment within four weeks of starting (beginning of March 1993). The team will be responsible for obtaining office space and secretarial services as necessary, and must provide its own computer equipment, transport, and final document preparation and submittal.

<u>Composition of Team</u>

A. Contracting Mechanism

Through the use of an appropriate evaluation or private sector support assessment Indefinite Quantity Contract, an assessment team will be

selected. This will allow for timely execution with a firm which has a known expertise in performing such work in the Private Sector area. The contract will be negotiated and executed in A.I.D./W by MGMT/OP/OS.

B. Qualifications and Prior Experience

The assessment team will consist of three individuals who have the following qualifications:

- AID Project Design and/or Evaluation Experience - Team members should have experience in design of private sector activities, preferably in Latin America and/or experience in evaluating AID projects, especially private sector projects.

- Experience in providing technical assistance in Latin America in the following areas:

  -- Trade and Investment Specialist - Background and experience emphasizing investment and export promotion but also including skills in business development with small and medium-sized enterprises and the industrial processing sector. Services required for 24 working days.

  -- Financial Markets Specialist - background and experience emphasizing banking and securities markets but also including skills in regulatory framework for new business establishment and taxes. Services required for 24 working days.

  -- Privatization Specialist - Background and experience emphasizing infrastructure privatization, such as communications and energy. Services required for 12 working days.

- Educational background in business or economics at the Masters level or higher.

- Fluency in Spanish - Team members must be fluent in Spanish (FSI-3/3 minimum).

VII REPORTING REQUIREMENTS

A. Report Format

I. Conclusions and Recommendations

In general, the major task of the assessment team will be to identify strengths and weaknesses within the Mission's current Private Sector Support Project. In addition, the team is asked to identify new areas where the project could provide effective support. The recommendations will consist of specific courses of action the team feels the mission should take in support of the Nicaraguan private sector.

The team will prepare an assessment report providing findings, conclusions, and recommendations responsive to the questions in the Statement of Work above, based on analysis of information obtained. The analysis should be structured so that conclusions follow logically from findings and represent the team's interpretation of facts gathered during the evaluation.

ARTICLE IV - REPORTING REQUIREMENTS

The assessment report must be submitted in final, prior to the team's departure. It will be provided in draft at the end of the third week and in final the day before departure.

The report will provide findings, conclusions, and recommendations responsive to the questions in the Statement of Work above, based on the analysis for information obtained through tasks specified.

The written report will contain the following sections:

1. Executive Summary. Approximately three pages, single spaced.

2. Statement of Conclusions and Recommendations. Conclusions should be short and succinct, with the topic identified by a short sub-heading related to the questions posed in the Statement of Work. Recommendations should correspond to the conclusions. Whenever possible, the recommendations should specify who, or what agency, should take the recommended actions.

3. Body of the Report. The report is to include a description of the country context in which the project was developed and carried out, and provide the information (evidence and analysis) on which the conclusions and recommendations are based.

   The analysis should be structured so that conclusions follow logically from findings and represent the team's interpretation of facts gathered during the evaluation. Recommendations should follow from conclusions: Findings -> Conclusions -> Recommendations.

The body of the report should be no more than 30 pages in lengths; additional information details should be included in appendices.

4. Appendices. These are to include at a minimum the following:

- The evaluation Scope of Work;
- A description of the methodology used in the evaluation (e.g., the research approach or design, the types of indicators used to measure changes of the direction/trend of impacts, how external factors were treated in the analysis);
- A bibliography of documents consulted, list of persons interviewed, and site visits undertaken during the evaluation; and
- Full analysis of any topics which, due to space limitations in the body of the report, should be summarized there.

Other appendices may include more details on special topics, and a list of agencies consulted.

B. Report Submission

As mentioned earlier, the draft assessment should be submitted to the Deputy Director, Private Sector Officer, Project Development Officer, Evaluation Officer, and the Privatization Officer the end of the third week of the assignment. Within two working days, comments will be provided verbally or in writing on the draft.

The team will then have three or four working days for preparation for the assessment in final. Five copies of the final assessment must be submitted prior to departure. Submittal will be in the form of hard copies and a computer diskette in Word Perfect 5.1 format (and Lotus 1-2-3 format for any tables). Assuming that AID/W Contracts can execute an IQC during January, 1993 and that team members have been identified and agreed upon as part of that process, it is hoped that the team can initiate work by early February and complete the assessment by early March.

C. Debriefing

Meetings must be held weekly, including an initial briefing session early February and every Thursday/Friday thereafter, with the Mission liaison team. A final debriefing, just prior to departure, should be held for the Mission Director and Deputy Director, interested Office Chiefs, and the Program, Economics, and Private Sector Office.

APPENDIX B: DESCRIPTION OF METHODOLOGY

APPENDIX B: DESCRIPTION OF METHODOLOGY

A. Overview

The methodology and procedures employed by the team to conduct its analyses and recommendations of the PSS Project focused on extensive interviews and the comprehensive review of available literature. Given the limited time and resources, the broad experience of individual team members in international development projects was drawn upon during all stages of the project to expedite the outlined scope of work. A sample of the key documents that the team reviewed relating to the current situation of the private sector in Nicaragua was provided by USAID/Nicaragua and included USAID/N CDSS, Private Sector Support Project Papers, USAID Semi-Annual Reports, contractor grantee quarterly reports, INCAE studies on the private sector, and Price Waterhouse studies on pensions, insurance, and the banking association. A complete list of documents is provided in Appendix C.

The team, accompanied by USAID officials where appropriate, conducted extensive interviews with key representatives of the private sector. The team met with high-level government officials in MEDE, key players in the financial and business sectors, mangers and project officers of CEI, persons crucial to the success of privatization efforts such as the president of CORNAP, the Minister of Finance, and USAID contractors and officials, representatives of other donors such as the IDB, World Bank, and PAPIC, and women in development experts. Appendix D lists the interviews conducted by team members during the project.

B. Financial Services

As part of the financial services component of the PSS Project, the team undertook several tasks to assess important issues raised in the SOW regarding the financial sector of Nicaragua. Among other tasks, the team reviewed the financial sector study written by J.L. Daly, Inc., the contractual arrangements under the project, the feasibility studies on private insurance and pension plans, and the proposed assistance to a new stock market in order to assess the ongoing assistance provided by USAID/Nicaragua and to make recommendations for its improvement.

The team undertook extensive interviews with the Superintendent of Banks, the IMCC contractor working with the Superintendency, representative private bankers, potential business clients referred by COSEP, USAID economists, private sector staff, and other donors such as the IDB. Information gathered in these interviews allowed the team to

assess whether the contracted services through IMCC meet the needs of the Superintendency and whether changes are needed to the institutional arrangements that would help improve the effectiveness of IMCC assistance. The interviews also revealed the relevancy of the inputs, outputs, and indicators in the logical framework of the Project Paper, and the appropriateness of other planned activities such as bankers' training. Information gathered by the team also pointed to ways in which USAID can improve the effectiveness of the private banks in offering financial services to a broad range of clients.

In analyzing the current activities in the financial sector, the team addressed the strategic objectives of USAID/Nicaragua in promoting increased investment and participation, competitiveness, and diversification in the economy. The team determined whether the lack of commercial credit is a constraint to investment in Nicaragua, and the disadvantages and advantages of the ways in which USAID could help mobilize savings and expand the availability of non-subsidized credit to sectors of the economy that lack access to such credit. Likewise, the team recommended USAID's promotion of certain financial services that would encourage a broader ownership of productive assets and the advantages and disadvantages of strategies that USAID could undertake to achieve this goal.

C. Privatization

As part of the privatization component of the PSS Project, the team focused its analyses on the ongoing and planned future assistance provided by USAID/ Nicaragua, Price Waterhouse, and donor agencies in order to determine whether these efforts have met, and are planned to meet, project objectives, and to make recommendations for improvement in USAID support of this component of the project.

In order to analyze progress made to date, current USAID support, and possible future requirements, the team conducted extensive interviews with key CORNAP personnel, representatives of the IDB, World Bank, Price Waterhouse, USAID economists and private sector staff, and representatives of the major institutions being considered for future privatization. The team gave particular attention to determining whether the current support provided to CORNAP under the Price Waterhouse Buy-In through the Privatization an Development Project is addressing the needs of CORNAP, whether adjustments are required in the logframe to meet project objectives, to defining a strategy of assistance from various donor agencies, and to mapping out a time frame in which to complete the CORNAP portfolio of privatization. Additionally, the team analyzed the range in cost of companies undergoing the entire privatization process, and assessed cost implications of privatizing an entire sector of the economy. The team supplemented information gathered through these

interviews by an assessment of existing reports prepared by Price Waterhouse, USAID, and other donor agencies.

The team also assessed the technical assistance needs including cost estimates, a plan of implementation, and other support required by the GON in order to undertake privatization efforts aimed at state-owned enterprises such as TELECOR and INE. As part of this analysis, the team made recommendations regarding the potential involvement of USAID in these efforts, and how such efforts could complement those undertaken by other donor agencies.

D. Trade and Investment Support

The aim of the trade and investment support component of the PSS Project is to determine ways in which USAID activities can help promote trade and investment in Nicaragua in a manner that is consistent with recent US legislation, given restrictions on USAID involvement in certain areas of this sector of the economy. As part of this effort, the team undertook extensive interviews with representatives of the Nicaragua private sector including the President of COSEP and the Chambers of Commerce and Industry, representatives from MEDE, Carana personnel, potential investors, companies considering exports, and USAID economists and private sector officers. The team also reviewed INCAE studies and analyzed mechanisms to improve the private sector capability to identify investment opportunities and to design and implement strategies to undertake investment projects.

The information gathered from the interviews and through the examination of the studies allowed the team to determine the continuation, adjustment, or curtailment of certain current activities aimed at the expansion of trade and investment, and to recommend areas for further emphasis. As part of this analysis, the team determined whether contractors and grantees have been able to deliver the services expected of them, given the restrictions on USAID involvement, whether the current mechanisms for assistance available to chambers and associations are appropriate, and whether the institutional and working arrangements are conducive to meeting project objectives. In making recommendations for further USAID participation, the team took into account cost objectives and implementation arrangements with regard to USAID guidelines.

E. Studies and Surveys

The team undertook an extensive review process of studies and surveys previously prepared that pertain to the PSS Project and those that are planned in the future by first gathering studies prepared by USAID, contract personnel, INCAE, and donor agencies. Next, the team reviewed the documents summarized areas that need to be expanded. The team then conducted interviews with USAID and contract personnel to discuss the relevancy of the studies and surveys to the PSS Project.

Through extensive discussions and review of the relevant documents, the team recommended further areas of study and methodologies to use in order to enhance project efforts.

F. Industrial/Processing Sector

As part of the Industrial/Processing sector part of the PSS Project, the team reviewed relevant studies concerning the potential for industrial development and processing of agricultural goods in Nicaragua. The team also undertook numerous interviews with representatives of the private sector, including the President of COSEP and the Chambers of Commerce and Industry, representatives from MEDE, Carana personnel, potential investors, companies considering exports, and USAID economists and private sector officers.

From the information gathered from discussions and the review of relevant studies, the team analyzed the constraints to the local manufacture and processing of goods currently imported and the constraints to increased processing of goods for exports. The team determined the activities that USAID/Nicaragua could undertake to support increased investment in industry or local processing of agricultural goods within US legislative guidelines and made recommendations for the strategy and implementation of these proposed activities.

G. Regulation and Enforcement

The team addressed regulatory constraints and enforcement issues after conducting interviews and reviewing studies that pertain to regulation and enforcement. Specifically, the team met with key business leaders who are active in promoting Nicaraguan exports, members of Chambers of Commerce and Industry, and representatives from donor agencies such as the UNDP, IDB and World Bank, as well as relevant GON officials in Customs, Finance and the Ministry of Economy. The team reviewed studies prepared by INCAE, and focused on work prepared by Bello, De Franco, and Navarro. The team recommended

areas of further analysis and determined further project activities that could address regulatory issues.

H. Women in Private Sector

As part of promoting women in development (WID), the team analyzed ongoing activities aimed at addressing the needs of women in the private sector and the promotion of the participation in this sector of the economy by conducting interviews with INCAE WID personnel, the USAID officer in charge of women's issues, and representatives of other donors. Based on these interviews, and a comprehensive review of INCAE studies on women in management, as prepared under the Technical Assistance and Training Project, the team recommended USAID project activities that would promote the participation of women in the private sector with the aim of increasing the number of women entrepreneurs and women participants in the private sector.

APPENDIX C: BIBLIOGRAPHY

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APPENDIX D: INTERVIEWS AND DISCUSSIONS

APPENDIX D: INTERVIEWS AND DISCUSSIONS

I. INTERVIEWS IN FINANCIAL SERVICES COMPONENT

USAID

Mark Silverman	Deputy Director
Timm A. Harris	Chief, Private Sector Development
Sally Everett	Private Sector Office
Leon S. Waskin	Project Development Officer
Brian D. Rudert	Chief, Agricultural and Rural Development
Joseph S. Ryan Jr.	Economist
Gary Linden	Economist
Todd Amani	Program Officer

Superintendency of Banks

Angel Navarro Deshon	Superintendent
Juan Klingenberger	Senior Advisor to the Superintendency

Central Bank of Nicaragua

Mario J. Flores L.	General Manager

Ministry of Finance

Marco Antonio Narvaez B.	General Treasurer of the Republic

Advisor to the President

Julio Cardenas	Advisor to the President

BANEXPO

Silvio Conrado	Executive Director
Gilberto Wong	General Manager

BANPRO

Chale Espinosa	General Manager

BANCENTRO

Eduardo Montealegre	Gerente General

INTERBANK

Leonel Arguello	President
Jaime Valdivia	Genral Manager
Odette Rubinfeld Arguello	Advisor to the General Manager

Stock Exchange (Bolsa de Valores)

Carolina de Barrios	General Manger

Inter-American Development Bank

Joel A. Riley	Representative
Jose V. Chibbaro	Sectorial Specialist

World Bank

Ulrich Laechler	Resident Representative

Carana Corporation

Robert S. Hans	Chief of Party (PSS)
Carlos Torres	Partner
Ned Kelly	Administrator

II. INTERVIEWS IN PRIVATIZATION COMPONENT

CORNAP

Ivan Saballos	Director General de Privatizacion

Eduardo Belli	Deputy Director-Presidente
Alfredo Barcenas	Sub-Director General
Ricardo Vega	Privatization Manager
Marvin Escobar	Privatization Manager

Price Waterhouse

Charles Waddell	Partner
Jorge Segura	Project Manager
Michael Apel	Project Assistant

INCAE

John Ickis	Dean, Managua Campus
Antonio Colindras	Manager, IADB/INCAE project

ENABAS

Alfredo Guzman	Executive Director

Ministry of the Presidency

Ricardo Barrios	Director of Privatization

III. INTERVIEWS IN TRADE AND INVESTMENT, STUDIES AND SURVEYS, AND WOMEN IN THE PRIVATE SECTOR COMPONENTS

Center for Exports and Investments (CEI)

Bill Pfaeffle	Executive Director

Export and Investment Officers:

Haroldo Lacayo	Deputy-Director of Investments
Norman Zavala	Trade and Investment Executive
Joaquin Gonzalez	Director of Investments
Maria Isabel Zuniga	Director of Capacity, Administration and Finance

Others:

Ana Cecilia Penalba	Administrator

CARANA:

Carlos Torres	President
Robert Hans	Director
Edward (Ned) Kelly	Deputy Director

B. BUSINESS SECTOR

Consejo Superior de la Empresa Privada (COSEP)

Ramiro Gurdian	President

Instituto Nicaraguense de Desarrollo (INDE):

Pedro Gutierrez	President
Armando Urbina	President of FUNDE
Mario Amador	Executive Director

Asociacion Nicaraguense de Productores y Exportadores de Productos No Tradicionales (APENN) -

Samuel Mansell	President

Nicaraguan Chamber of Commerce

Gilberto Serrano Gutierrez	Co-Director
Modesto Palacios Reyes	Co-Director
Mario Hernandez Rueda	Deputy-Treasurer

American Chamber of Commerce

Arturo Cruz
Flor de Cana

Mario Jose Jarquin Garcia	International Operations Director

IBW Communications

Susan Bursey-Wyss	President
John Wyss	Vice-President

TANIC (Tabacalera Nicaraguense, S.A.)

Hugh Tweed	General Manager

MINISTRY OF ECONOMY AND DEVELOPMENT

Pablo Pereira	Minister
Amilcar Ibarra	Trade and Investment Chief

CENTER FOR INFORMATION ON COMMERCE (CIC)

Luz Marina Arana	Director
All support personnel	

USAID

Mark Siverman	Deputy Director,
Timm Harris	Project Officer
Sally Everett	Privatization Officer
Leon Waskin	Project Development Officer
Todd Armani	Evaluation Officer
Lawrence Odle	WID Officer
Brian Rudert	Agricultural Project Officer

OTHER DONORS AGENCIES

IDB

Joel Riley	Representative
Jose Chibbaro	Sector Specialist

IBRD

Ulrich Laechler	Representative

OTHERS

Julio Cardenas	Office of the Presidency, Special Advisor to economic affairs.
Juan Klingenberger	IMCC consultant

APPENDIX E: CAPITAL MARKETS

APPENDIX E: CAPITAL MARKETS

Development of capital markets in developing countries has been a long standing USAID objective to facilitate and stimulate economic development.

Capital markets are usually divided into two categories: 1) money markets consisting of cash (fed. funds) and short term instruments for both government and private sector for a period of up to 2 years which are liquid and readily negotiable; 2) longer terms instruments which are from 5-30 years for use in countries where they are accepted for investment.

In Nicaragua, plans are underway to establish a Stock Exchange (Bolsa de Valores), private insurance companies and a private pension fund system. These entities are considered here in the context of the creation of a capital market. The Central Bank is making plans for the establishment of an open market system to control liquidity through the purchase or sale of Treasury bills to the banks and other organizations which is where the Fed. Funds market is important.

The interbank funds market (Fed. Funds) usually consists of funds traded which represent a bank's excess of the reserves required by law in the Central Bank or a deficit in reserves which requires a bank to purchase funds to maintain its reserve requirement. At present, Nicaragua requires that a reserve contains 10% of funds in cordobas and 25% in US dollars, for the total amount which the banks have on deposit. In addition to providing liquidity to the banks that need it for reserves and as a means to sell excess reserves, the interbank market in the US (known as the Fed. Funds market) serves another important function. It enables the Federal Reserve Bank of New York to use the Fed. Funds rates as a reference rate for the pricing of its Treasury bill issues for normal financing and as a bench mark in accepting bids for Treasury issues in its "Open Market operations."

The Open Market Operations control the amount of liquidity in the financial system in the United States. It is important in the creation of a real money market in Nicaragua to establish a real interbank funds market through the trading of funds directly by banks as well as through "Fed Funds" brokers specialized in this operation. This activity should be monitored by the Central Bank by a telescreen in the BCN connected to the banks and the brokers which would be watched throughout the day at the BCN. The rates would be published daily. The interbank average trading rate can be used by the BCN in pricing its short term Treasury bills and developing a "yield curve" to encompass longer term issues of government debt.

Treasury bills can be sold to the banks as "primary dealers" and resold on the Bolsa de Valores creating a secondary market for liquidity of these issues in Nicaragua. These bills would be the short term LEMS (Letras de Estabilzación Monetaria) to be issued by the Central Bank later this year in its capacity as an agent of the Treasury. Other issues which could be traded on the Exchange are the Bonos Fiscales to be issued by the Treasury (Ministry of Finance) with maturities from 3 months to 1 year to finance temporary (monthly or seasonal) deficits in tax collections, for example, and would be similar to US Tax Anticipation Certificates issued by the US Treasury. Other instruments to be traded on the Bolsa could be the "CBTs" (Certificados de Bonos Tributarios) with 24 month maturities issued to exporters. None of the above mentioned instruments would appear to be ready to be issued until June of this year at the earliest. When there is sufficient confidence, longer term Bonos de Pago por Indemnizacion issued to pay for confiscated property may be traded. Some $500 million Cordobas of these have been authorized for issuance and are beginning to be awarded. They carry a 20 year term with interest at 3% P/A to be capitalized.

Other instruments tradable on the Exchange are bank C/Ds (when issued), bankers' acceptances, and commercial paper of first class firms and banks. Commercial paper has to be rated however, as do private sector bond issues and a rating agency would have to be established perhaps under the Bolsa's auspices, to act as a Standard and Poors or Moody's does in the United States. Insurance companies and pension funds would be the short and long term investors in the Exchange's instruments.

The Central Bank is particularly interested in integrating the financial markets in Nicaragua with the rest of Central America and sees the Stock Exchange as a link with the other Exchanges in Central America.

The Central Bank and the commercial banks in Nicaragua do not seem to be familiar with the operations of money markets in large financial centers, it is recommended that USAID arrange a visit by heads of the commercial banks and one or two senior managers of the BCN (English speaking) to New York for 3 or 4 days to visit the New York Fed money market operations as well as those of some large commercial and investment bank trading operations in money market instruments. This would help accelerate the formation of a money market system in Nicaragua.

APPENDIX F: PSS PROJECT CONTRACTUAL WORK

PSS PROJECT $5.5 million through 3/94

Privatization

PW Buy-in

T&I

CARANA Contract

MEDE Proj. Grant

COSEP Coop Agreement

CEI

Financial

PW Buy-in

- Assist Super Adviser-Farjardo
- Banking Assoc.
- Insurance
- Pension

studies

($70,000 avail)
short term-71 days left

IMCC subcontract

- Juan-Sr. Advisor
- 93 days left - short term $60 K avail.

Add'l $ Avail. Now to Amend

Available

160 PW/IMCC work days avail. w/o amending

APPENDIX G: GUIDE FOR THE SMALL ENTERPRISE

APOYO DISPONIBLE

PROGRAMAS VIGENTES DE APOYO AL SUBSECTOR

EL PAPIC: Programa de Apoyo a la Pequeña y Mediana Industria de Centroamérica.

Donde: Banco Centroamericano de Integración Económica (BCIE)

Contacto: Ingeniero Dieter Haggenmiller

Dirección: Edificio Málaga, Plaza España, Managua.

Crédito:
- Pequeña Industria hasta US$ 25,000.00
- Mediana Industria hasta US$100,000.00

Se otorgan cuatro años de plazo para la inversión fija y un año para capital de trabajo (materia prima, insumos, etc. No contempla pago de salarios, construcción, compra de vehículo.)

Tasas de Interés: Corto plazo (1 año) 18%
Largo plazo (4 años) 14%

Trámites Necesarios:

1) *Elegibilidad:* Incluye el monto solicitado en (US$), requisitos del préstamo, detalle de los requerimientos solicitados, costo y precio FOB y/o CIF de los productos, plan de exportación si serán exportados en (US$) y/o ventas locales de los productos (el mercado interno y externo, demanda, oferta y competencia), el plan industrial (layout), estado de pérdidas y ganancias en (US$), balance general.
2) Solicitud de financiamiento en el Banco Comercial de su preferencia. La solicitud debe incluir: Carta de Solicitud del Crédito adjunto a documentación del proyecto - Formalización del crédito por medio de escrituración, firma de pagaré y entrega de cheque.

EL FYME. Programas de Apoyo a la Pequeña y Mediana Empresa (Industrial)

Donde: El Banco Comercial de su preferencia

Contactos: Gerente de Crédito

Líneas de Crédito:
- Pequeña Industria hasta US$ 40,000.00
- Mediana Industria hasta US$100,000.00

Se otorgan cuatro años de plazo para la inversión fija y un año de plazo para capital de trabajo.

Trámites Necesarios:

1) *Elegibilidad:* Las empresas que tienen un año de establecido. Incluye monto solicitado (en córdobas), requisitos del préstamo, detalle de los requerimientos solicitados, costo y precio FOB y/o CIF de los productos, plan de exportación en dólares si los productos serán exportados, ventas locales (mercado interno y externo: demanda, oferta y competencia), plan industrial (layout), estado de pérdidas y ganancias en córdobas, balance general.
2) *Solicitud de Financiamiento al Banco:* Incluye Carta de Solicitud del Crédito adjunto a documentación del proyecto - aprobado el Crédito se formaliza por medio de escrituración, firma de pagarés y entrega de cheque.

EL FAIM, Fondo de Apoyo a las Importaciones para la Industria Manufacturera

Donde: El Banco Comercial de su preferencia.

Lineas de Crédito:
- Pequeña Industria hasta US$ 50,000.00 con tasa de interés de 13% anual.
- Mediana Industria hasta US$500.000.00 con tasa de interés de 18% anual.

El financiamiento está dirigido a empresas que producen bienes intermedios para las empresas exportadoras o empresas manufactureras de bienes que sustituyen importaciones de consumo básico.

Trámites Necesarios:

1) *Elegibilidad:* Incluye monto solicitado en (US$), requisitos del préstamo, detalle de los requerimientos solicitados, costo y precio FOB y/o CIF de los productos, plan de exportación si los productos serán exportados y/o ventas locales en dólares, el mercado interno y externo (demanda, oferta y competencia), plan industrial (layout), estado de pérdidas y ganancias (en US$), balance general.
2) *Solicitud de Financiamiento:* Incluye Carta de Solicitud de Crédito adjunto a documentación del Proyecto. Después de aprobado el crédito se formaliza por medio de escrituración, firmando pagarés y entrega de cheque.

EL PAMIC. Programa Nacional de Apoyo a la Microempresa

Crédito:	• Un máximo de US$1,000.00 para el sector productivo • Un máximo de US$600.00 para el sector comercial
Interés:	18% anual para el sector productivo 30% anual para el sector comercial
Término:	A seis (6) meses
Elegibilidad:	Las empresas que tienen de 1-5 empleados, 1 año de establecido y C$35,000 de activos (incluye mercadería, herramientas, etc.)
Nota:	El PAMIC se contacto por medio de Organismos No Gubernamentales y se gestiona a través del Banco Popular.