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TRADE AND COMMERCIAL LAW ASSESSMENT – NICARAGUA

FINAL REPORT



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Trade and Commercial Law Assessment Nicaragua

FINAL REPORT

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I. EXECUTIVE SUMMARY

The overwhelming need for judicial reform in Nicaragua surpasses all other governmental reform initiatives in its urgency. Questions regarding judicial independence, impartiality, and substantive and administrative capacities dominate Nicaragua's legal landscape and economic institutions. If the absence of political will and commitment to change in this area continues to negate the impact of reform efforts, lasting economic development will be threatened in the long run. Judicial reform must encompass not only current initiatives in human rights and criminal law but also whole-cloth improvements in the part that Nicaragua's courts play in addressing commercial law and institutional competencies.

Certain positive changes in recent years demonstrate that, when leadership and determination take root, systems in Nicaragua are far from intractable. In particular, improvements in trade facilitation are marked and impressive. The government has strengthened: its Customs Agency; engaged in development of open markets nationally, regionally, and internationally; improved relationships between the public and private sectors; and instituted more efficient trade-related visa and immigration processes.

The need for judicial independence in Nicaragua has never been greater, however, and reformers should move forward to meet the challenge. To begin with, a proactive and unified commitment from all willing entities—government representatives, donors, neighboring countries, the business community, the professions, civil society, the media, and others—is vital. Without a doubt, Nicaragua must make efforts to firmly entrench itself among the vast majority of nations in the Western Hemisphere that not only understand and honor the notion of judicial independence, but also recognize that their economies depend on judges who decide cases impartially, according to the law, and independent of external pressures and influences.

At the request of the United States Agency for International Development (USAID), Booz Allen Hamilton conducted an assessment in August 2004 to analyze strengths, weaknesses, and opportunities for change pertaining to two critical areas in Nicaragua: Commercial Legal and Institutional Reform (CLIR) and trade facilitation. The assessment was conducted by a team of legal and trade reform specialists as one part of a five-country Central American regional assessment. This report presents the team's findings and recommendations directly pertaining to Nicaragua. A report prepared for the region will address common issues in trade facilitation and CLIR, along with regional approaches to reform and development in these areas.

First, this report identifies certain overriding themes in Nicaragua's CLIR and trade environment that should be incorporated into reform programs on a cross-cutting basis. These issues include (a) the crisis in Nicaragua's judiciary, attributable to its entrenchment in politics and weak support systems for judges; (b) the crisis in the real property system, which remains mired in confusion born of past political chaos; (c) difficulties in establishment of and growth faced by small and medium-sized enterprises (SMEs), due particularly to the lack of access to capital; and (d) the need in Nicaragua for thoughtful and reform-oriented implementation of automated processes throughout government institutions. In addition, this section discusses the significance of Nicaragua's participation in the Millennium Challenge Account.

Second, this report examines 13 CLIR and trade-related areas designated for assessment by USAID: company law, contracts, real property, collateral law, commercial dispute resolution, bankruptcy, competition policy, international trade, flow of goods and services, flow of people, financial crimes, flow of money, and supporting infrastructure. Each topic is analyzed from a four-part perspective: Framework Laws, Implementing Institutions, Supporting Institutions, and Social Dynamics. The four-part analysis not only allows for a multidimensional understanding of specific CLIR and trade-related challenges but also creates the basis for certain general themes to emerge.

A. THE TRADE AND COMMERCIAL LAW ACTIVITY (TCLA) ASSESSMENT PROCESS FOR THE CENTRAL AMERICAN COUNTRIES OF THE CAFTA

The assessment process was carried out through much of 2004 in each of the CAFTA countries by a team of expatriate specialists. In order to gain the highest quality information possible, the CLIR portion of the TCLA also employed teams of local experts in each country, which included lawyers, judges, government officials and business leaders, to assist in the collection of data. The process began in March with a methodology seminar where local experts from the region were introduced to the CLIR methodology. Following this process, the local experts performed the base assessment for the CLIR portion of the analysis. With the completion of the base assessment, the expatriate team used this information as well as their own research to discern particular areas of focus prior to arrival in each country. The in-country Nicaragua assessment took place in August 2004. The expatriate team members and their areas of specialization are presented in the following table:

NAME	ORGANIZATION	SUBJECT AREA FOCUS*
Aimee Carter, Team Leader	Booz Allen, International Development Specialist	CLIR
Andrew Mayock, Co-team Leader, TradeStream™	Booz Allen, Legal Reform Specialist	Flows of People and Money, TradeStream™
James Newton, Assessment Coordinator	Booz Allen, Legal Reform Specialist	Commercial Dispute Resolution (CDR), Financial Crimes, other CLIR areas
John Corley	Booz Allen Hamilton, Engineer	Infrastructure
John Baker	Louisiana State University, Commercial Law Specialist	CDR, Financial Crimes, Competition
JoAnne Cornelison	Independent Customs Consultant	Flows of Goods and Services
Maria Coppola	Federal Trade Commission, Legal Reform Specialist	Competition
Dale Furnish, Boris Kozolchyk, Maria Alejandra Rodriguez, Mariana Silveira	National Law Center for Interamerican Free Trade, Legal Reform Specialists	International Trade, Bankruptcy, Collateral
Omar Garcia	BG Consulting, Legal Reform Specialist	Property, Contracts, Company Law
Irina Swift	Independent Customs Consultant	Flow of Goods and Services

* Given the extended nature of the assessment process, team members served as back-ups for each other as not all experts were able to participate in each country.

While in each country, the team interviewed numerous government officials, nongovernmental organizations, multilateral and bilateral donor agencies, judges, lawyers, notaries, investors, associations and chambers of numerous industries, trade and customs experts, and other domestic and international businesspeople to assess the trade and commercial legal environment of the each country.

1. Background of the Diagnostic Methodology Used

These assessments were the next in a series carried out since 1998 in a program that USAID created, and in which Booz Allen was retained to assist in the development of indicators and methodologies, for assessing the status of CLIR in a developing or transitioning country. In addition, more recently, the need for the development of a similar methodology was recognized with respect to trade matters, which Booz Allen completed (TradeStream™) and which is applied here for the first time. While the CLIR and TradeStream™ diagnostics can be considered as two separate parts, together they make up a more complete picture of a nation's overall situation with respect to domestic and international business.

Both the CLIR and TradeStream™ methodologies have been subjected to field testing and peer review on a regular basis. Moreover, they have been adapted to the exigencies and realities of the area of the world in which they are to be applied; in the case of the TCLA, the CLIR methodology was adopted to better fit the Central American legal context, as opposed to that of Eastern Europe, for example, where the methodology was originally applied.

In addition, new areas of law continue to be added to the methodology. Along with the first application of TradeStream™, TCLA saw the further development and application of the newest CLIR section, Financial Crimes, which focuses primarily on those issues surrounding terrorist financing and money laundering, and which have become more relevant in the wake of September 11, 2001.

2. Scope of the Methodology

The diagnostic assessment was designed to help USAID missions, the countries themselves, and other donors, achieve the following objectives:

- ♦ To provide a factual basis for characterizing the degree of development and the status of trade commercial law reforms in a country;
- ♦ To provide a methodologically consistent foundation for identifying and describing the root causes of the "implementation/enforcement" gap among the CAFTA countries; and
- ♦ To provide analytical and planning tools and metrics that will help USAID, the countries themselves, as well as other donors to design new approaches to sustainable, cost-effective interventions and reform programs.

While the subject matter areas have historically varied somewhat from country to country, for the purposes these assessments, "commercial law" and CLIR is defined to include the following substantive legal areas:

- ◆ **Bankruptcy.** Mechanisms intended to facilitate orderly market exit, liquidation of outstanding financial claims on assets, and rehabilitation of insolvent debtors.
- ◆ **Collateral.** Laws, procedures, and institutions designed to facilitate commerce by promoting transparency, predictability, and simplicity in creating, identifying, and extinguishing security interests in assets.
- ◆ **Commercial Dispute Resolution.** Laws, procedures, and institutions relating to the settlement of commercial disputes, whether through courts or alternative dispute resolution mechanisms, and the enforcement of judgments and decrees.
- ◆ **Company Law.** Legal regimes for market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals.
- ◆ **Competition.** Rules, policies, and supporting institutions intended to help promote and protect open, fair, and economically efficient competition in the market, and for the market.
- ◆ **Contract.** The legal regime and institutional framework for the creation, interpretation, and enforcement of commercial obligations between one or more parties.
- ◆ **Financial Crimes.** The legal regime, institutional infrastructure, and methods of international cooperation employed to prevent the financing of terrorist activities and laundering of criminal assets.
- ◆ **Real Property.** The laws, procedures, and institutions responsible for establishing, maintaining, and preserving rights in real property, including land, buildings, easements, liens, and other interests in real property.
- ◆ **International Trade.** The laws, procedures, and institutions governing cross-border sale of goods and services.

With respect to the TradeStream™ diagnostic, the areas of inquiry are as follows:

- ◆ **Flows of Goods and Services.** Analyzes a nation's ability to move goods and services smoothly through ports of entry and throughout the country.
- ◆ **Flows of Money and Flows of People.** Similar to Goods and Services, these two sections look at a nation's ability to facilitate the entry and exit of financing and short and long term business persons, respectively.
- ◆ **Supporting Infrastructure.** Assesses the capacities of a country's physical infrastructure relevant to trade, including sea- and airports, roads, railways, communications, and postal services.

B. ASSESSMENT METHODOLOGY: A 360° REVIEW

Within each of these substantive areas, four dimensions were examined which provided a conceptual framework for comparison both across areas and across countries. Taking data from a broad spectrum of stakeholders, the assessment builds a 360° picture of the challenge, drawn from the following areas:

- ♦ **Legal Framework.** The assessment first examines the laws and regulations that Nicaragua has in place that serve as the structural basis for its ability to achieve market-based development. Often discovered through this review are opportunities to make relatively small changes that may result in significant openings for business development and expansion.
- ♦ **Implementing Institutions.** Next the assessment examines the administrative bodies with primary responsibility for implementing and enforcing the legal framework and subsidiary laws, regulations, and policies governing one or more areas addressed in this report. For example, courts are usually a crucial institution in the examination of CLIR. Problems uncovered often relate to bureaucratic inefficiency, lack of resources and training, and of paramount concern, real or perceived corruption. With respect to the flow of goods, services, and people, Customs and Immigration authorities are the chief implementing institutions.
- ♦ **Supporting Institutions.** The assessment then considers the environment of organizations, individuals, or activities without which the legal framework or policy agenda cannot be fully developed, implemented, or enforced. Examples include notaries, banks, consumer groups, chambers of commerce, professional associations, and other similar ancillary service providers. Of particular interest with respect to supporting institutions is whether they have any meaningful involvement in *what the law says*. Where a “buy-in” from affected constituencies has occurred, a law is more likely to be understood, to be used properly, and to achieve its purpose.
- ♦ **Social Dynamics.** Finally, studying social dynamics entails asking whether the affected constituencies of a law or policy perceive a need for change and, if so, how they are demonstrating this need. Are they effectively lobbying those institutions that can make a change? Is the media seizing the issue as a topic of public concern? Are individuals speaking out? Or, have social dynamics taken a less positive approach—for example, is the “gray economy” growing as a response to over-burdensome conditions for market entry? Analysis of social dynamics may affect how an assistance project is ultimately designed. Where outside participation is strong and public understanding high, a reform program may simply involve a relatively small number of government officials who are capable of meeting the demands. In contrast, where mistrust and misunderstanding are abundant, an approach that involves significant engagement of “end users” will likely be necessary.

C. SUMMARY OF SUBJECT-SPECIFIC FINDINGS

Based on this multifaceted review process, reports for each area were completed and quantitative indicators scored. It should be noted that some repetition of material occurs in the various

sections so that each chapter reads as a complete whole. The general findings of the 13 subject matter areas addressed in this report are summarized as follows:

- ♦ **Company Law.** Nicaragua's legal framework for business needs to be brought into conformity with modern legal norms. In practice, similar to other Central American nations, it is overly formalistic. Publicly held companies do not exist, and protection for minority shareholders is weak. The legal framework has failed to keep pace with changes in business practices, leaving new firms and foreign investors to customize company by-laws to account for processes that are not included in the Commercial Code. Where conflicts arise, the terms of the by-laws must be recognized and enforced by a court. Given the poor state of the country's court system and the prevalence of corruption, investors cannot be certain that the terms of the by-laws will prevail in a conflict. In addition, registration of commercial entities is nominally easy, but the process is slow and tedious. Efforts are being made to reduce registration time by automating some processes. For example, a project in Managua to create a one-stop shop for investors has succeeded in reducing the cost and time associated with registration.

The majority of local businesses are micro, small, and medium enterprises, many of which are not registered. Excessive regulatory burdens, the cost of registration, and overly extreme, complex, and in some cases unfair taxes are mentioned as the main reasons for the prevalence of informal economic activity. Access to credit is scarce for all firms in Nicaragua, but particularly for SMEs. As a consequence, SMEs have difficulty expanding, and Nicaragua misses the opportunity to reap the benefits of its domestic entrepreneurial culture.

- ♦ **Contracts.** In many respects, the legal framework of Nicaragua allows for easy formation of contracts. It does not, however, cover some contracts that are common in modern business. Moreover, problems associated with the rule of law affect many areas of commercial activity. Because of problems within the judiciary, there is poor contract enforcement, which in turn deters investors. In such a climate, arbitration could provide means of resolution of contract disputes; however, Nicaragua lacks a culture that is conducive to arbitration as well as the needed arbitration centers to provide this alternative to traditional resolution mechanisms. In cases taken to *ad hoc* arbitration, enforcement of the arbitral award occurs through regular courts, making enforcement unpredictable.
- ♦ **Real Property.** The real property system of Nicaragua is in need of major reform. As a result of laws passed during the Sandinista Revolution (1979–1990), titles on many properties are uncertain. In some cases, two or even three parties claim title to the same property. During the revolution, many properties were expropriated, and a large percentage of the persons from whom the land was expropriated have not received promised compensation for their land. The unsettled status of compensation adds risk to property acquisition, as uncompensated parties may claim title to a prospective buyer's land in order to attempt to secure some claim to the land in the absence of compensation. To avoid such claims, prospective buyers must conduct relative extensive, time consuming, and costly research on property titles. There is little viable information to work with, however, because the Real Property Registry is inefficient and its information

is often outdated. Information from the Real Property Registry is not integrated with cadastre data, thus further adding to the confused state of affairs.

- ♦ ***Collateral Law (Secured Transactions).*** Nicaragua's current system of secured lending is inadequate to meet national and regional commercial credit needs—particularly those of micro and small businesses wishing to expand or improve their commercial activities. In Nicaragua, financing continues to rely predominantly on mortgage-based loans and satisfaction of formal and cumbersome requirements that are tailored to larger, more sophisticated companies. SMEs, which constitute the vast majority of the country's businesses, often find themselves paying interest rates in excess of 20 percent in borrowing from private lenders (microfinance corporations) that are willing to risk dealing with smaller companies and to offer simpler, non-real-estate based lending solutions. In a developing market and an ever-expanding globalized environment, where proven or newly created companies wish to remain competitive, higher interest rates are bound to significantly hinder the economic gains and growth that small companies or investors wish and need to achieve.
- ♦ ***Commercial Dispute Resolution.*** Although some progress has emerged in the area of criminal justice, the lack of transparency, consistency, and reliability in commercial law decisions, along with the general inability to enforce civil judgments, results in an economic environment that significantly impairs incentive or support for growth or investment. Alternative dispute resolution (ADR) is acknowledged as an important vehicle for improving the current conditions, and small steps toward the development of arbitration centers should continue to be supported. That said, renewed emphasis is needed on the vital link between political will, judicial reform, and economic development in Nicaragua. The entire commercial law community—government institutions, law schools, the business community, the legal profession, the media, and others—needs to be part of a comprehensive effort to engender meaningful change.
- ♦ ***Bankruptcy.*** No bankruptcy tradition or culture exists in Nicaragua, and the imperative for reform is much weaker in this area than in other areas of commercial law. More often than not, companies simply choose to close their operations and set up a new entity without going through a formal bankruptcy procedure, effectively leaving their creditors completely unprotected. For their part, creditors typically avoid a judicial procedure fraught with uncertainty and instead attempt to collect as much as they can directly from the debtor, or they simply give up on any potential claims they may have. Moreover, Nicaragua's rules on bankruptcy focus on the liquidation of business entities rather than on their reorganization. They do not provide for an equitable treatment of creditors, to the detriment of creditors located in foreign jurisdictions. Because of the problems in the country's judicial system, the notion of efficient and impartial resolution of bankruptcy procedures does not exist. This fosters a lack of transparency and a total absence of formal bankruptcy procedures. Historically, as a matter of practice, there are hardly any (if any) bankruptcy cases in Nicaragua.
- ♦ ***Competition Law and Policy.*** Recognizing the benefits of a competition law and policy, the government of Nicaragua has engaged in significant efforts to adopt a competition law. Since initial efforts began 10 years ago, however, no competition law has been enacted, including the most recent effort in 2000. In 1999, the *Ministerio de Fomento*,

Industria y Comercio (MIFIC) created the *Dirección General de Competencia y Transparencia de Mercado* (DGCTM), a technical advisory body within MIFIC. For competition issues, the DGCTM has the power to carry out market analyses and to undertake surveillance of markets. It lacks, however, both the proper specifications about the types of conduct that are to be regarded as “anticompetitive” and the enforcement authority to stop anticompetitive practices. Since its formation in 1999, the DGCTM has built a reputation for fairness and efficiency within the public and private sectors. This year, the DGCTM prepared a new draft competition law, prompted by preparations for the Central American Free Trade Agreement (CAFTA) as well as by frequent public complaints about inappropriate inflation of consumer prices or artificial limitations on demand for raw materials or intermediate goods (especially agricultural products) by large firms. As of December 2004, however, the law had not been enacted.

- ♦ ***International Trade.*** Despite its regional and international commitments under several free trade agreements (FTA) and ongoing negotiations toward others, Nicaragua has significant ground to cover in international trade to improve its investment and business climate. The country’s free trade zones offer attractive opportunities to foreign investors, and government efforts to combat corruption have yielded positive results with respect to agencies that directly affect international trade operations (including the Customs Service). Political instability, an unpredictable judicial system, insufficient infrastructure, and a lack of access to credit at reasonable rates are only some problems that render the system less than appealing, both to foreign investors and to local companies wishing to expand their operations. Another problem is that, even though the country does not favor or promote monopolies, various situations continue to facilitate monopolistic or anticompetitive practices.
- ♦ ***Flow of Goods and Services.*** Recently, Nicaragua has made important strides in facilitating trade: (a) development of a stronger Customs Agency; (b) development of open markets nationally, regionally, and internationally; (c) improved relationships between the public and private sectors; (d) more efficient trade-related visa and immigration processes; and (e) achievement of adequate basic infrastructure for current trade volumes. However, the country’s trade-related institutions still encumber traders with unacceptable transaction costs through delays and administrative burdens. By eliminating the unwarranted and onerous constraints embodied in laws, regulations, and procedures, Nicaragua can capture greater savings and efficiencies. In fact, improving the trade facilitation environment can reduce trade costs by as much as 15 percent of the value of traded goods. Major areas in which improvement can lead to significant results include (a) further development of the overall capacity of the Customs Agency, especially through risk management, (b) better integration and simplification of processes among all trade-related agencies, and (c) improved logistics efficiency.
- ♦ ***Flow of People.*** Overall, Nicaraguan laws, public agencies, and private institutions support flows of trade-related people. Nicaragua could do more, however, to modernize its management of highly-skilled visitors seeking longer term stays. It also could do much more to address illegitimate people flows. Nicaragua’s borders with Honduras and Costa Rica are long and porous. Nicaragua’s little-developed eastern part of the country provides a frontier for narcotic traffickers to operate. Nicaragua serves as a key origin and transit country for illegal migration to the United States and Costa Rica.

- ♦ **Financial Crimes.** Integral to any discussion of financial crimes in Nicaragua is the problem of corruption in the political and judicial systems. On the one hand, Nicaragua has lower levels of ordinary crime, such as theft and robbery, than most of its neighbors. Financial crimes, on the other hand, seem to be more prevalent, although a few money-laundering prosecutions have occurred. The conviction in 2003 of former President Alemán for, among other things, siphoning millions of dollars into Panamanian and U.S. bank accounts, is highly significant. The exceptionality of the Alemán prosecution, however, highlights the general lack of financial crimes enforcement in Nicaragua. Given that the judiciary is widely regarded as corrupt, it should not be surprising that prevention, investigation, and prosecution of financial crimes in Nicaragua are reported to be weak.
- ♦ **Flow of Money.** Overall, Nicaragua's laws, public agencies, and private institutions support trade-related money flows. Cross-border goods and services transactions reflect a relatively small yet significant amount of monetary exchange that pays for those goods and services traded—approximately \$2.5 billion in goods and \$562 million in services traded annually in 2003. Of the goods flows, only \$605 million were exported, whereas almost \$1.9 billion were imported. Services were more evenly split: \$213 million exported and \$349 million imported. Remittances also represent a major trade-related financial flow.¹ In 2003, an estimated \$500-600 million (approximately 16 percent of the gross domestic product or GDP) poured into the country, sent by Nicaraguan workers and families abroad.² Nicaragua is challenged, moreover, by illegal money flows, as aptly demonstrated by the conviction of former President Alemán and his chief tax administrator, who were found guilty of laundering tens of millions of dollars in ill-gotten gains.
- ♦ **Supporting Infrastructure for Trade.** Overall, Nicaragua's trade infrastructure creates competitive disadvantages in the arena of international trade. The country suffers from incomplete systems, resulting in significant service gaps and high operating costs. In addition, broad differences exist in infrastructure quality, with regard to both installed capacity and overall administration. Because it lacks key infrastructure components, Nicaragua must rely heavily on the infrastructure and services of its neighboring nations in order to participate in international trade. This fact imposes uncompetitive costs on Nicaragua's system users, resulting in an overall lack of demand for some of the nation's existing infrastructure components. Nicaragua will require comprehensive strategic planning assistance to identify the appropriate direction for change, followed by technical expertise and funding assistance to implement a seamless trade infrastructure system that would be attractive for significant private sector investment in the nation.

¹ See <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=SV,NI>.

² Economic Intelligence Unit (EIU) Reports – Nicaragua Country Profile 2003-2004.

II. NICARAGUA'S TRADE AND COMMERCIAL LAW ASSESSMENT: CROSS-CUTTING THEMES

Along with the specific findings in 13 subject matter areas detailed in this report, certain cross-cutting themes emerged. While it would be prudent to address these themes within the context of any specific subject matter area reforms undertaken, addressing them as separate areas of focus could also benefit the overall trade and commercial law environment in the country.

A. URGENT NEED FOR JUDICIAL REFORM

In virtually every section of this report—contracts, collateral, real property, bankruptcy, flow of goods and services, and others—the inability of Nicaragua's judicial system to facilitate prompt resolution of commercial disputes and enforcement of its own judgments is identified as a fundamental problem.³ At the heart of the issue is the politicization of the judiciary by the other branches of government. Judges in Nicaragua are appointed according to their political affiliation and can be easily dismissed if they offend powerful political interests. They are also paid little and afforded few marks of respect, thus increasing the likelihood of corruption.

- ♦ ***Politicization of Judicial Appointment.*** National Assembly members, elected as part of an overall political party slate, appoint Supreme Court justices based on party affiliation as well. Supreme Court justices appoint the lower court judges using that same criterion: political affiliation.
- ♦ ***Politicization of Judicial Dismissal.*** In addition to holding the power to appoint judges, the Supreme Court can also remove judges at its discretion.
- ♦ ***Corruption.*** Corruption at all levels of the judiciary has been reported as a common occurrence. Recently there have been three well-publicized cases in which firms were issued unfair rulings by courts.

In addition to Nicaragua's weakness in judicial independence and impartiality, many other problems permeate the judiciary. Training of both judges and court staff is inadequate. Automation in most courts is virtually nonexistent. Legal education is weak, and competency standards for lawyers, such as a bar exam, are nonexistent. For example, some judges were appointed immediately after obtaining a law degree from schools that offered classes over weekends and shortened the required curriculum from 5 to 3 years.

As a consequence, lenders have little confidence that debts will be enforced, and so the use of collateral is highly restricted, thwarting plans for business development because of a lack of access to capital. Notwithstanding laws that permit pledges on movable property, entrepreneurs who do not own real property have little chance of obtaining a loan at the startup phase. Until the commercial community, in Nicaragua and outside, trusts that the courts are capable of affording remedies in the event of defaults on loans and breaches of contracts, there simply will be fewer loans and fewer contracts than the economy could otherwise support. In short, the significant

³ For a discussion of how other Latin American countries have addressed the issue of judicial independence, see Margaret Popkin, *Efforts to Enhance Judicial Independence in Latin America: A Comparative Perspective*, in USAID Office of Democracy and Governance, *Guidance for Promoting Judicial Independence and Impartiality* (Technical Publication Series, January 2002, Rev.Ed.) at 100.

risks involved with extending credit or engaging in an arms-length transaction will result in less economic activity and less growth. Even the development of alternative dispute resolution (ADR) mechanisms will not overcome the restraints that Nicaragua's under-functioning court system places on the economy. That is, there will be no confidence in ADR in the long run if the courts cannot be trusted to enforce ADR agreements and awards.

Thus, all future programs regarding the commercial legal environment should incorporate the judicial component of the issue. This would include leveraging the resources of existing court reform programs to emphasize the relationship between court reform and economic growth, and where gaps remain, formulating technical assistance efforts that accomplish the following:

- ◆ Build wide-scale consensus around both general electoral system reform and judicial selection and termination reform. Specifically, selection of judges should be undertaken by a separate and independent body rather than by the Supreme Court. Working groups consisting of the public sector, the private sector, and civil society should develop the basis upon which those changes are undertaken and build the necessary consensus to push reforms.
- ◆ Develop the commitment to professionalism, competence, and integrity among all judges in Nicaragua through support for professional organizations, continuing education in skills pertaining to judging, and other indications of judicial independence.
- ◆ Improve the commercial capacity of courts through administrative and automation processes that make the process of dispute resolution faster, more predictable, and more transparent.
- ◆ Train judges in areas pertaining to commercial activity, particularly with respect to modern types of commerce and newer laws, such as competition law, potential laws pertaining to modern contracts or electronic commerce, and laws concerning money laundering.
- ◆ Establish codes of conduct among judges and court staff, and where possible both in law and in practice, remove all indications of political influence on the actions of courts.
- ◆ Endeavor through training and statutory reform to address the overly formalistic, antigrowth aspects of the law and the judiciary.
- ◆ Through outreach and demonstrable results, persuade the public that the courts in Nicaragua are to be trusted to uphold their commercial agreements.

Efforts to reform the judiciary should be prominent, unequivocal in their support for judicial independence, and highly solicitous of public input.

B. NICARAGUA'S REAL PROPERTY CRISIS

Next to the crisis in the judicial system, the state of real property rights in Nicaragua is one of the most severe obstructions to growth in the country. As a result of laws passed during the Sandinista Revolution, titles on many properties remain uncertain. In some cases, two or three parties claim title to the same property. This report details the depths of the predicament—

including the absence of a cadastre map, the inadequacy of the Real Property Registry, the lack of a zoning law, the housing crisis, and more—which is compounded by the lack of an independent judiciary that is capable of moving the country toward resolution of disputes and compensation for those whose land has been taken without legally mandated compensation.

Economic reform efforts in emerging markets have been guided in recent years through the work of Hernando De Soto, who has shown that, if property cannot be bought and sold with the confidence that the authorities will uphold the transaction, the market itself will fail to generate growth. Indeed, this report finds that the absence of property rights is a central factor driving people out of formal markets and into the informal sector.

Since 2002, the World Bank has committed almost \$39 million toward reforming the property sector through, among other initiatives, its Land Administration Project (PRODEP). According to the World Bank, the goal of PRODEP—

...is to improve the security of land tenure and thereby boost investment in agriculture, contribute to social fairness, promote the sustainable use of natural resources, and increase revenue collection and facilitate planning at the municipal level. The project's medium-term objectives are to develop the legal, institutional, and technical framework for the administration of property rights, and to demonstrate the feasibility of a systematic land rights regularization program, initially in rural areas. There are six project components: 1) policy and legal reforms, including a land policy framework, legal and regulatory changes, and procedural and operational manuals; 2) institutional decentralization and strengthening, particularly support to the land policy directorate of the agriculture ministry (MAGFOR), strengthening of property rights administration, support to grassroots organizations and other actors, and capacity building on municipalities in land-related activities; 3) titling and regularization services, including alternative conflict resolution training; 4) demarcation and consolidation of protected areas; 5) demarcation of indigenous lands, including a focus on the regulatory land rights framework; and 6) an upgrade to an integrated information system, including a project financial and management information system and project impact monitoring and evaluation systems.⁴

Vigilant donor monitoring and support for these goals will contribute to their realization, although the process will be long and difficult. Any new reform programs pertaining to commercial law, to support for small and medium-sized enterprises (SMEs), or to rule of law and governance should be fully in step with property-related initiatives already in progress. New programs should leverage resources and recognize the importance of avoiding duplication or contradiction of effort. Moreover, the parties involved in real property reform efforts in Nicaragua should be mindful of the strides being taken in other Central American countries, particularly Honduras. By using best practices from its neighbors, as well as coordinating and harmonizing reform efforts, Nicaragua and the region arguably stand a better chance at economic growth and reducing poverty.

⁴ World Bank, Nicaragua Country Brief (<http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/LACEXT/NICARAGUAEXTN/0,,contentMDK:20214837~pagePK:141137~piPK:141127~theSitePK:258689,00.html>).

C. HELPING SMEs ACCESS CAPITAL: AN IMPERATIVE OF ECONOMIC GROWTH

Businesses in Nicaragua, in particular SMEs, face numerous obstacles within the legal, bureaucratic, and trade environments that inhibit their ability to become established formally under the law and to grow and expand. The fact that nearly 50 percent of businesses in Nicaragua operate in the informal sector—as compared to less than 17 percent in Organization for Economic Cooperation and Development (OECD) countries—reveals the difficulties that enterprises face.⁵ An entrepreneur seeking to establish a company in Nicaragua confronts procedural inefficiencies and corruption when trying to register; enormous restrictions in using collateral to secure debt; and grave threats to the very property on which the new company might operate. Moreover, companies that wish to expand their opportunities through international trade face costly inefficiencies within the agencies that are charged with regulating and facilitating their transactions, along with constant threats to the security of their goods.

The most recent government survey on SMEs is from 1998. According to the study, 50,000 micro, small, and medium enterprises existed in Nicaragua—90 percent of the country's businesses.

As reported herein, encumbrances specifically faced by SMEs in Nicaragua include the following:

- ◆ SMEs, especially informal ones, have significant difficulty obtaining credit because of the lack of lender confidence in the ability to collect on collateral. Financing continues to rely predominantly on mortgage-based loans and satisfaction of formal and cumbersome requirements that are tailored to larger, more sophisticated companies.
- ◆ SMEs often find themselves paying interest rates in excess of 20 percent in borrowing from private lenders (microfinance corporations) that are willing to risk dealing with smaller companies and to offer simpler, non-real-estate based lending solutions.
- ◆ Because of lenders' reliance on mortgages, SMEs are particularly harmed by the country's property crisis.
- ◆ SMEs disproportionately bear the costs of institutional inefficiency and politicization of institutions. Politicization, slowness, and corruption are constantly mentioned as the main problems businesses experience with the judicial system.

Certain initiatives promise to benefit SMEs in the long run. Under the auspices of the Inter-American Development Bank (IDB), a one-stop shop for investors, the *Ventanilla Única de Inversionistas* (VUI), was opened in 2003. Through an agreement among the Trade Ministry, the Commercial Registry, the Managua Mayor's office, and the National Revenue Office, the 72 steps associated with registering a business were to be brought into the VUI. By using the VUI, a business owner can reduce the incorporation process from 60 days to 15 days. VUI officers have not conducted any large-scale promotional campaigns, as they believe the new institution still

⁵ See World Bank, Snapshot of Business Environment—Nicaragua, at <http://rru.worldbank.org/DoingBusiness/ExploreEconomies/BusinessClimateSnapshot.aspx?economyid=141>.

lacks the capacity to handle a large inflow of registrants. Since inception, the institution has registered approximately 265 businesses and is currently receiving 40 new cases per month.

Throughout this report, similar opportunities for reform are identified and recommendations for change are suggested that would lessen the administrative burdens and unnecessary transaction costs forced on SMEs. The theme that emerges from these individual points is that even relatively small changes may result in significant improvements to the business environment. The costs and challenges of implementing all the recommended changes vary, but they should each be considered in the context of the overall environment for enterprise growth.

D. INVESTING IN TECHNOLOGY: AN IMPERATIVE FOR FUTURE REFORMS

Technology is underutilized and often misunderstood in Nicaragua. Although the Internet is widely used, public institutions are unable to keep pace with development in automation, as evidenced by the following:

- ♦ In the Commercial Registry, processes have not been automated, and registration information is handwritten into national record books. Few computers are available in the Registry of Managua, and those that do exist are often outdated.
- ♦ Nicaragua does not have a law on electronic contracts or electronic signature. This is a clear case of legislative “gap,” as the banking industry currently plans to issue financial products such as credit cards and online utilities payment that require electronic signature. Lack of legislation on these matters poses a problem if a dispute should arise and may create opportunity for illicit activity.
- ♦ Courts are not automated, and computers, when present, are only used for word processing and are often outdated. Inter-court communication is conducted by telephone. Court decisions are accessible to the public, but they are not published or accessible online. To access a decision, an interested party must visit the court in question and request the document.
- ♦ Neither Nicaragua’s substantive law nor its registry law is designed to accommodate modern, speedy, and voluminous commercial loans that are common and necessary for growing economies and increased foreign investment. A modern, electronic Collateral Registry should accommodate presentation in-person as well as presentation by the various forms of electronic transmittal, including mail, fax, modem, courier, and electronic data interchange (EDI). Ideally, registry reforms—and, overall, legal reforms to accommodate an electronic system—should be based on the guidelines established by the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Electronic Commerce, the UNCITRAL Model Law on Electronic Signatures and the Uniform Inter-American Rules on Electronic Documents and Signatures (IAREDS), which enable presentation by “any other method which is accessible for later consultation and which can be produced in a tangible form recognized by law or custom.” Also ideally, registry modernization should eventually lead to an integrated network of Central American registries.

- ◆ Customs lacks the appropriate hardware. Customs has a total of approximately 140 workstations to serve the entire country. In 1998, the IDB provided \$500,000 for these computers, but they are now obsolete and there is no funding to upgrade this equipment or provide for other needed equipment, such as a central server to maintain profiles. Currently, all “server-type” information remains on one workstation.
- ◆ The Customs information technology (IT) system lacks the appropriate software. The “Automated System for Customs Data” (ASYCUDA) has been in use since 1992, and the current system currently runs ASYCUDA ++ v.1.17. This version limits Customs’ ability to efficiently manage traded goods, and Customs would like to implement the new version, ASYCUDA World. ASYCUDA World is an Internet-based, open system, modular application that requires \$90,000 for trainers and technical personnel.
- ◆ Customs lacks the funding and training for IT staff. Currently, there is a staff of 17, including 4 programmers. There is no funding for additional training or courses, such as database management, which are much needed. And low salaries for the technology staff lead to high turnover rates.
- ◆ Customs is unable to fully conduct electronic clearance because of the poor network infrastructure. Declarations are transmitted through the Internet but do not receive electronic release notification. There is no electronic manifest transmission, although there are plans for implementation once all the areas are online and communication by satellite is available. The Atlantic coast is not automated. Communications failures with areas outside Managua are frequent because the microwave communication is disrupted during heavy rain. The free zones are not automated and are reluctant to automate. Recently, they were instructed to automate by the end of the year or Customs would remove onsite personnel.
- ◆ The import permit process is manual with no interface with the traders or Customs, and permits can only be issued by the headquarters office.

In the face of limited resources, Nicaragua may benefit from creating a National Automation Strategy, prepared in consultation with all branches of government, along with donors, neighboring countries, the private sector, civil society, and others. Planning for automation of government processes is a complex matter, and the opportunity for waste and abuse is immense. Nicaragua would clearly benefit from a long-term, “big picture” understanding of what it needs to bring its antiquated procedures into the 21st century. This is an area in which donor guidance and support are crucial.

E. MILLENNIUM CHALLENGE CORPORATION

Along with Honduras, Nicaragua is one of two Central American Free Trade Agreement (CAFTA) member states selected as eligible for support from the Millennium Challenge Corporation (MCC) for both fiscal year (FY) 2004 and FY 2005.⁶ With this eligibility, Nicaragua has been invited to submit proposals for how it will utilize MCC funding to improve economic growth and reduce poverty. As of December 2004, Nicaragua had submitted draft

⁶ The other CAFTA countries, as well as the Dominican Republic, exceeded the per capita income threshold and therefore were not candidate countries under the Millennium Challenge Account (MCA) process.

proposals and was among only four countries with which the MCC was entering into specific negotiations that could result in an award of MCC funding.

The value of the MCC's activities in Nicaragua, in addition to the obvious benefits of increased resources, is that it reiterates more emphatically the position enunciated in this and other studies: that economic growth and poverty reduction can come only from a broad range of interventions in the areas of governance, investment in health and education, and the creation of an enabling environment for private sector activity. Certainly, the process of regional integration and trade liberalization brought by CAFTA will yield significant benefits, but the agreement alone, without complementary reforms, will not achieve the high expectations for poverty reduction and economic growth that have been raised, and that are truly the *raison d'être* of trade agreements.

Assuming a successful negotiation for MCC funding, the programmatic outcome of the negotiations is likely to highlight the complex interrelationships between social and economic policies and the benefits to be achieved through a wide participatory process. Through the demonstration effect, the experience and lessons of MCC countries can have a salutary impact on the region's development aspirations as a whole.

III. COMPANY LAW

A. INTRODUCTION

Nicaragua's legal framework for business is in need of updating to account for changes in business practices, leaving new firms and foreign investors obliged to customize by-laws to account for processes that are not included in the Commercial Code. If a conflict were to arise, the terms of the by-laws would have to be recognized and enforced by a court. Given the poor state of the country's court system and the prevalence of corruption, investors cannot be certain that the terms of the by-laws would prevail in such a conflict.

Registration of commercial entities is nominally easy, but the process is slow and tedious. Efforts are being made to reduce registration time by automating some processes. A project in Managua to create a one-stop shop for investors has succeeded in reducing the cost and time associated with registration.

Publicly held companies do not exist, and protection for minority shareholders is weak. Lack of protection for minority shareholders discourages investment by small investors and consequently affects the capacity of the country to enhance the stock market and its economic growth.

The majority of local businesses are micro, small, and medium enterprises, many of which are not registered. Excessive regulatory burdens, the cost of registration, and excessive, complex, and sometimes unfair taxes are mentioned as the main reasons for the prevalence of informal economic activity.

Access to credit is scarce for all firms in Nicaragua, but particularly for SMEs. As a consequence, SMEs have difficulty expanding, and the country misses the opportunity to reap the benefits of its domestic entrepreneurial culture.

B. LEGAL FRAMEWORK

The Commercial Code is the primary legal code governing company law. The Commercial Code was originally passed in 1914 and has not been modernized sufficiently to govern current businesses. Many modern business practices, such as electronic contracting, remain uncovered by the Code.

The *Sociedad Anónima*, a limited liability corporation, can be created under the Commercial Code. The Code allows for other types of business structures, such as the *Sociedad en Nombre Colectivo*, a general partnership. However, the *Sociedad Anónima* remains the most popular and the most regulated form of business.

A company's articles of incorporation must be notarized, and a capital contribution must be paid before registration can be completed. Interviews during the assessment revealed that a firm must have paid at least 10 percent of the stated capitalization if the contribution is to be made in cash and 100 percent if it is to be made in kind. This required payment differs from regional requirements in that there is no minimum limit on the amount that can be contributed to the company's capital.

Creditors of an unregistered company can sue and seize property of both the company and its shareholders. Under those circumstances, both company and shareholder assets for unregistered companies can be subject to seizure by creditors.⁷

With regard to publicly-held companies, the assessment team was told that no public companies exist. There is, however, a rarely used procedure for startups to raise capital publicly: a public subscription of capital. However, because of the lack of a developed stock market, the stock market's lack of a legal regulatory code, and the absence of knowledge regarding the public subscription process, companies do not trade shares publicly. In a rare exception 5 years ago during the privatization of a local bank, company shares were offered to the public through advertisements in newspapers. Interested parties were supposed to acquire shares at branch locations at a fixed price rather than through a market mechanism.

Changes to by-laws for *Sociedades Anónimas* must be approved by a judge before the changes can be registered at the Commercial Registry. An increase in the equity capital of a *Sociedad Anónima* is considered a change in the by-laws.⁸ Thus, increases in the equity capital are deterred by the transaction costs associated with registering changes. Hence, increases are often left unreported.

Internal corporate control is very lax. *Vigilantes* (auditors) are called to be appointed to supervise administrators. *Vigilantes* are allowed to be shareholders of the company, and they usually are. Only shareholders of a company can be administrators. As a result, as was described during assessment interviews, it is possible for the same person to be shareholder, administrator, and *vigilante*. This overlapping of monitoring and administrative roles allows and probably encourages monitoring to be biased. U.S. companies conducting business in Nicaragua, and Nicaraguan companies conducting business in the United States that subject themselves to this standard of internal control, would be in jeopardy of violating the Sarbanes-Oxley Act.

Administrators of *Sociedades Anónimas* are not liable to third parties for wrongdoings committed by the firms they control. However, administrators are personally liable to shareholders and third parties for noncompliance of duties as expressed in the by-laws and the relevant statutory bodies. In cases of fraud or other misdeeds, persons knowledgeable in this area of law stated that it is not possible to lift the corporate veil or disregard the legal personality of a subsidiary's parent company. This is due to the lack of legislative provisions or the precedent regarding these practices.

According to the Nicaraguan Commercial Code, annual publication of financial statements is mandatory for all companies.⁹ However, only financial institutions publish financial statements in national newspapers. Financial institutions are also the only business type that publish independently audited financial statements from certified public accountants (CPAs). CPAs in Nicaragua tend to follow international accounting standards but not the International Accounting Norms (IAN). The use of IAN was made mandatory by the Association of CPAs in July 2004; however, the standards have been said to be too complex for most Nicaraguan firms, and there seems to be a general lack of training in IAN.

⁷ Article 126, Nicaraguan Commercial Code.

⁸ Article 213, Nicaraguan Commercial Code.

⁹ Article 248, Nicaraguan Commercial Code.

Bearer shares can be issued but are uncommon. Concerns were expressed about the possibility of such shares being used to evade responsibility, launder money, or engage in other illicit activities. Because of concerns regarding the use of bearer shares, the Superintendency of Banks recently passed a resolution requiring banks to divulge the origin of funds received in any kind of transaction.

A company must have at least three shareholders at all times. If a company has fewer than three shareholders for more than 6 months, that company will be considered to have dissolved, and shareholders will be jointly and unlimitedly liable to creditors.¹⁰

Protection for minority shareholders is weak. In cases in which minority shareholders cannot reach accord with administrators, minority shareholders can leave the firm and their shares will be bought back at market value once an assessment of the company's assets is completed.¹¹

In cases of conflict among shareholders, a little known provision of the Commercial Code states that third-party arbitration should be used to resolve the conflict. It was learned during the assessment that all arbitration is *ad hoc* because there are no arbitration centers in Nicaragua. Thus, the provision for arbitration is not widely used.

Companies are taxed heavily in Nicaragua. One company stated that for every dollar it received in revenue, it paid 31 cents in taxes before income taxes were levied. Many kinds of taxes are levied on corporate revenues. An enterprise asset tax is levied on the value of companies' assets even in cases in which the firm has incurred annual losses. Additional taxes reported include a 15 percent value-added tax, a 9 percent consumption tax, a 1 percent municipal tax, and a 15 percent sales tax.

C. IMPLEMENTING INSTITUTIONS

Registration is mandatory for all companies. If a company is not registered, it does not exist for the purposes of third parties. The Commercial Registry is part of the Real Property Registry and a subpart of the Supreme Court. The Registry is governed by the Public Registry Law of 1904. There are 17 registries in the country, but the Managua Registry handles the majority of the country's registrations.

The Commercial Registry is in need of modernization. Processes are not automated, and registration information is handwritten into national record books. Few computers are available in the Managua Registry, and those that exist are often outdated and/or not used. In fact, it was reported that some rural registries have no computers at all. Some facilities are in such poor repair that information contained in the books is at risk of being lost to water damage because facilities leak and documents are not adequately protected. In other registries, electricity restrictions make computer use difficult.

The Managua Commercial Registry is producing an electronic database for the information it processes and archives. However, only half of the Managua Registry's information has been included in the database as yet.

¹⁰ Article 270, Nicaraguan Commercial Code.

¹¹ Article 262, Nicaraguan Commercial Code.

Costs of registering a *Sociedad Anónima*, including associated legal fees, range from \$1,000 to \$3,500. This cost is considered high and is mentioned as a deterrent to business formalization. Company registration is a time-consuming process that involves many entities and processes. It typically takes about 60 days to complete the process. A foreign investor underlined the frustration and cost associated with registration by noting that he could incorporate a business in the United States by mail in 2 days at a relatively low cost, whereas in Nicaragua it would take months to process the request and cost significantly more.

According to persons knowledgeable of the situation, revenues from the registration process do not remain at the Registry, instead going to the central government. The government allocates approximately 4 percent of its annual budget to the Supreme Court, which then allocates a portion of that amount to the country's registries.

The Managua Registry has a staff of approximately 100 persons and receives 200 applications daily. Personnel are not trained in modern registration issues and are not paid well. These factors seem to affect performance, as productivity and motivation are low within the Registry. Internal factors such as lack of automation and external factors such as limited financial resources have contributed to the Commercial Registry's inability to perform its duty of promptly registering commercial entities and commercial transactions.

Under the auspices of the IDB, a one-stop shop for investors, the *Ventanilla Única de Inversionistas*, or VUI, was opened 1 year ago. Through an agreement among the Trade Ministry, the Commercial Registry, the Mayor's office, and the National Revenue Office, the 72 steps associated with registering a business were to be brought into the VUI. By using the VUI, a business owner can reduce the incorporation process from 60 days to 15 days. The VUI, however, is available only in Managua. VUI officers have not conducted any large-scale promotional campaigns because the new institution still lacks the capacity to handle a large inflow of registrants. Since its inception, the institution has registered approximately 265 businesses and currently receives 40 new cases per month.

Commercial disputes are handled by local courts, which are often subject to outside, unethical influences. . Politicization, slowness, and corruption are constantly mentioned as significant problems with the judicial system. Adding to businesses' frustration regarding the lack of swift and just means of resolving conflicts, no arbitration centers exist to provide an alternative to the judicial system. Moreover, courts are not automated and have very low budgets. Judges and lawyers lack knowledge of modern international business law. As a result, foreign investors have canceled investment plans after hearing of the insufficient state of the judicial system. Thus, an inefficient Commercial Registry and the poor court system can be cited for damaging the business climate and discouraging investments.

D. SUPPORTING INSTITUTIONS

All Nicaraguan lawyers are notaries. The Supreme Court grants the authorization to practice law and to be a notary. These authorities are granted simultaneously without any required competency exam. As of 2000, there were roughly 13,000 lawyers in Nicaragua and 12 law schools. During the Sandinista Revolution, there was a surge in new schools, some offering law degrees in 3 years rather than the 5-year program of other schools.

There is no Bar Association, but voluntary associations of lawyers do exist. Disciplinary authority over lawyers is allocated to the Supreme Court, which has been reported to use disciplinary tactics arbitrarily. Some lawyers reported that because of the high volume of nonqualified lawyers, a mandatory Bar Association with disciplinary authority should be created to enhance and maintain professional standards and expunge lawyers lacking these standards.

Because companies' articles of incorporation must be notarized before being registered, lawyers are necessarily involved in starting a business. Notary fees are considered high. Often notarized documents are returned from the Commercial Registry because of mistakes made by the drafting lawyer. An excess of lawyers and the absence of an effective disciplinary mechanism make controlling the conduct of notaries difficult. In the absence of a monitoring agency, some notaries reportedly conspire in fraudulent activities.

There is an association of accountants to which all CPAs must belong. The association follows international accounting principles and has recently imposed higher accounting standards for audits based on IAN. However, some accountants feel that IAN is not appropriate for the majority of Nicaraguan firms.

A stock exchange market has been in place for 10 years. Most securities offered are bonds and other debt instruments. Only one public issuance of equity securities has occurred. Ninety percent of transactions in the exchange are related to governmental issuance. Reportedly, \$800 million were traded in the stock market last year. Purchases can be made electronically, and the stock market is generally modern. Most investments are made by banks as direct investors, and only a small quantity of investments are made by individual investors. Lack of a sound regulatory body for the stock market discourages potential investors. For example, TACA airlines tried to issue bonds in the Central America stock markets, but differences in regulatory standards and incompatible procedures forced the company to cancel the effort.

E. SOCIAL DYNAMICS

Chambers of commerce and individual lawyers demand reform of the Commercial Code. Some have mentioned that due to the pace with which business practices are changing, specialized laws such as a law on commercial instruments, a law on trusts, and a stock market law may provide more complete and adaptable regulations. A draft law on the stock market is pending approval in the National Assembly.

Generally, corporate governance principles are not widely known by Nicaraguans. The auditing principles of the Sarbanes-Oxley Act, which apply to Nicaraguan companies conducting business in and with the United States, are also not widely known. Some civil society groups have expressed the need for more stringent laws on corporate governance. These concerns have been voiced especially with respect to the banking sector. No government initiatives are pending in the area of corporate governance.

Likewise, increased protection for minority shareholders through legal reform is needed. Again, no plans for reform have been announced in this area.

An overhaul of the Registry system has been a consistent request from foreign investors. A new law on the Public Registry is pending approval at the National Assembly. A World Bank project

directed toward legal, institutional, and technical reforms for the entire Public Registry has been approved. Likewise, the IDB is financing a project to create a one-stop shop for investors. The project, to be completed by 2006, includes passing a law on the simplification of the administrative components for startups. The law intends to reduce the registration process in Managua to 3 days and automate the system. The World Bank is planning to finance similar initiatives in the municipalities.

Changes in the judicial system are of paramount importance to the business community. All businessmen interviewed expressed deep concern regarding the status of the judiciary. Because judges are appointed by the Supreme Court, often based on political affiliation, and lawyers are often unqualified, many have argued that there is a need for a law on judicial careers. In response to this, a bill on that issue was passed in the fall of 2004. However, given that it did not officially go into effect until early 2005, its effectiveness is still unknown.¹² Likewise, lawyers expressed the need to allow some written procedures to be conducted orally to expedite judicial activity.

There is no law on SMEs. The most recent government survey on SMEs dates from 1998. According to the study, there were 150,000 micro, small, and medium enterprises in Nicaragua, and 90 percent of the country's business were SMEs. Many SMEs are informal. In fact, reportedly half the economy operates outside the formal commercial sector. Some micro businesses have explained their failure to formalize by citing an excessive tax burden and a lack of benefits associated with incorporating. Formal SMEs have difficulty obtaining credit, and informal SMEs cannot legally obtain credit. Micro financiers exist, but the 30 percent interest rates (19 points higher than rates at commercial banks) charged by these institutions deter many businesses. Commercial banks require stable guarantees (usually a mortgage) to grant credit to SMEs, and many SMEs lack this guarantee. Thus, there is a strong demand for customized SMEs credit mechanisms.

F. RECOMMENDATIONS

- ♦ The Commercial Code must be updated. A detailed assessment should be conducted to determine the areas in which reform is needed. The approval of specialized laws for different areas such as the stock market, trusts, the startup process, corporate governance principles, protection of minority shareholders, and cases in which the legal personality of a company can be disregarded may provide a simpler means for reform. The private and public sectors should be incorporated into reform discussions, and consensus around reforms should be built.
- ♦ The legal profession must be reformed. Many problems associated with the poor judicial system are due to the lack of ethical and professional standards for legal professionals. Admissibility requirements such as competency exams should be imposed for lawyers and notaries. Continuing legal education should be mandatory for lawyers.

¹² The *Ley de la Carrera Judicial*, No. 501 was approved on November 30, 2004, after Congress rejected the President's partial veto (the full text of the law is available at http://www.presidencia.gob.ni/buscador_gaceta/BD/LEYES/2005/LEY%20No.%20501%20CARRERA%20JUDICIAL.pdf).

- ◆ Legal education must be modernized. International business transactions and international and comparative law should be included as part of the curricula for legal education. Judges should be trained in these areas, with additional training on substance over form and tools such as economic analysis of law. Teaching methods should be modernized to utilize the Socratic and the case methods.
- ◆ The Commercial Registry must be modernized. The Public Registry bill should be updated, and supervision responsibilities for the Registry should not be given to the Supreme Court as the current bill states. The World Bank project on the Registry's modernization should be monitored and complemented when necessary. Collaboration on registration process automation and improving equipment and facilities is needed. Similar collaboration and monitoring should be given to the IDB one-stop shop for investors project.
- ◆ A status assessment of SMEs and the size of the informal sector should be conducted. The assessment should identify obstacles that hinder SME growth and provide a strategy for the removal of these barriers. Consideration should be given to issuance of special status to SMEs, similar to the 8(a) certificates issued by the Small Business Administration (SBA) in the United States, to provide SMEs preferential treatment on matters such as taxes, government contracts, or credit access. Likewise, special programs for SME financing should be devised that allow for alternative forms of guarantees and provide loans with interest rates closer to commercial rates. A regional donors' conference to generate capital for the establishment of financing institutions specializing in assisting SMEs may address some of the credit issues faced by small businesses. Once the bank is set up with the seed capital granted by donors, extra funds could be raised through venture and risk capital. Tax incentives should be offered to banks specializing in small loans and to risk capital funds that invest in microfinance institutions or SMEs.
- ◆ An assessment of the tax system should be conducted to identify methods of simplifying and reducing the tax burden on firms in Nicaragua.
- ◆ Integration of the Central American stock market is crucial. Regulatory and procedural standards for the stock markets of Central American countries should be harmonized, and a strategic plan for full integration should be devised.

IV. CONTRACTS

A. INTRODUCTION

In many respects the legal framework of Nicaragua allows for easy formation of contracts. However, the legal framework does not cover some contracts that are common in modern business.

Problems associated with the rule of law affect many areas of commercial activity. The judiciary is inefficient, poorly trained, ill-equipped, and subject to political influence. Such shortcomings lead to poor contract enforcement, which can deter investors.

In the climate of a poor judiciary, arbitration can provide a means of resolution of contract disputes, but Nicaragua lacks the arbitration culture and arbitration centers to provide this alternative to traditional resolution mechanisms. In cases taken to ad hoc arbitration, enforcement of the arbitral award occurs through regular courts, making enforcement unpredictable.

B. LEGAL FRAMEWORK

According to the Civil Code, individuals and companies can, in principle, create a contract for any agreement that is not contrary to a law or the public order.¹³ In this sense, a contract is law among the signing parties. In the absence of specific contractual provisions, the Civil Code applies. If the contract relates to a commercial matter or a businessperson or company is involved, then the Civil Code is complemented by the Commercial Code. If the contract involves a government entity, the Civil Code applies jointly with the Law on State Contracting.

Contracts generally are written, but oral contracts can be recognized if they are verified by at least four witnesses and no written evidence contradicts the existence of the contract. Oral contracts are particularly common for agreements on labor.

The Civil Code was originally passed in 1904. Many problems with legal framework for contracts in Nicaragua are associated with the Civil Code's failure to include modern practices. Specifically, the Civil Code does not account for practices such as leasing, factoring, and electronic contracts.

Based on the principle of freedom to contract, parties have devised arrangements that provide for situations that are usually protected under leasing legislations. However, there is the potential that these contractual arrangements be annulled for being contrary to public order or existing law.

The Internet is widely used and purchases are often made electronically; however, no law exists on electronic contracting or electronic signature. This is a clear example of the legislative gap, as the banking industry currently has plans to issue financial products such as credit cards and online utilities payment that require electronic signature. Lack of legislation on these matters poses a problem if a dispute should arise.

¹³ Article 1832, Nicaraguan Civil Code (*Código Civil*).

In contrast to other countries in Central America where distribution and agency contracts are disproportionately regulated in favor of the local distributor or agent, Nicaraguan legislation on distribution and agency contracts is equitable.

Nicaragua is not a signatory of the Inter-American Convention on Legal Regime of Powers to Be Used Abroad. Failure to participate in this accord denies the possibility of using powers of attorney granted by another country that is signatory to that convention. Powers of attorney must be legalized through the consulate of Nicaragua in the country where the power of attorney was granted and through the Ministry of Foreign Affairs. Powers of attorney must then be notarized in Nicaragua. Costs associated with the process of having powers of attorney granted abroad create further disincentives to regional investors.

C. IMPLEMENTING INSTITUTIONS

In principle, contracts in Nicaragua are valid without being notarized. However, some contracts must be notarized to make them valid vis-à-vis third parties, including contracts related to real estate, real property leases lasting more than 4 years, and pledges of commercial property. For notarization, the contract must be certified by a notary who is a lawyer authorized by the Supreme Court to certify the veracity of contracts and the other submitted documents. There are around 13,000 lawyers in Nicaragua. (See further discussion in III. Company Law, section C.)

The court system is the only mechanism available to parties to enforce contracts. The judicial system, however, is very political, which affects the manner in which contracts are enforced. Nicaraguans elect members of the National Assembly by selecting candidates from lists presented by political parties. In turn, Assembly members appoint Supreme Court justices based on party affiliation. Supreme Court justices appoint the lower court judges using that criterion: political affiliation.

In addition to holding the power to appoint judges, the Supreme Court can remove judges at its discretion. Some judges were appointed immediately after obtaining a law degree from schools that offered classes on weekends and shortened the required curriculum from 5 to 3 years. Many judges are therefore not well trained. Many lack knowledge regarding international business transactions and the international laws to which Nicaragua is party. Judges salaries are low and often are supplemented by other employment.

Judicial personnel are poorly trained as well, and court administration functions typical of a modern court system are lacking. Courts are not automated, and computers, when present, are used only for word processing and are often outdated. Inter-court communication is conducted by phone. Court decisions are accessible to the public but they are not published or accessible online. To access a decision, an interested party must visit the court in question and request the document.

The number of cases managed by courts is high. Roughly 2,000 cases are managed annually in each court. Notifications and procedural orders take up most of the time that the court devotes to a case.

Corruption at all levels of the judiciary has been reported to be a common occurrence. Recently there have been well-publicized cases in which firms were issued unfair rulings by courts.

In one case, a person linked to the Sandinista party sued a bank that among its debtors included the Parmalat dairy company. Parmalat's debt was not yet due; however, as part of the preventive measures asked by the plaintiff, the court appointed the plaintiff as chief administrator to the firm. In another case, a previously bankrupt bank, BECA, was reinstated by order of the Supreme Court. BECA ceased operations for a period long enough to allow for the statute of limitations to run out for many of its debts. Once the BECA was reinstated, it was clear of those debts.

The USAID Country Strategy for Nicaragua describes the poor state of contract law stating, "The inability to enforce contracts and the lack of transparency and reliability in judicial decisions are the most serious obstacles to invest in Nicaragua. The justice system in general is inefficient and politicized and additional reforms are needed to establish the legal framework required for transparent government."¹⁴

In cases in which the courts fail to provide a foreign investor with a fair trial, certain foreign investors can initiate international arbitration against Nicaragua before the International Center for Settlement of Investment Disputes (ICSID) according to the terms of the ICSID Convention to which Nicaragua is a signatory and the relevant Bilateral Investment Treaty (BIT) between Nicaragua and the country of the investor in question. Nicaragua has signed 14 BITs with different countries, including the United States, the United Kingdom, France, and Germany, but 11 of these treaties have not been ratified by either party and so this option is available only for investors from Taiwan, Spain, and Denmark. Thus, only a small percentage of foreign investors have the recourse of international arbitration against Nicaragua.

Exhibit 1, prepared by the World Bank, compares the procedural complexity involved in enforcing commercial contracts in Nicaragua with the regional and OECD averages.

Exhibit 1. Procedural Complexity Index

Enforcing Contracts (2003)			
The ease or difficulty of enforcing commercial contracts in Nicaragua is measured below, using three indicators: the number of procedures counted from the moment the plaintiff files a lawsuit until actual payment, the associated time, and the cost (in court and attorney fees). An overall index of the procedural complexity of contract enforcement is calculated by averaging four subindices related to dispute resolution. The index varies from 0 to 100, with higher values indicating more complexity in enforcing a contract. The Procedural Complexity Index for Nicaragua is 79, compared with the regional average of 70 and the OECD average of 49.			
Indicator	Nicaragua	Regional Average	OECD Average
Number of procedures	17	33	18
Duration (days)	125	363	213
Cost (% gross national income (GNI) per capita)	17.7	38.0	7.1
Procedural Complexity Index	79	70	49

Source: World Bank

¹⁴ See <http://www.usaid.org/ni/pdf/countryplanpublic.pdf>

In summary, the judicial system, instead of providing the means to resolve conflict and instill confidence of consistent and just resolution for businesses, creates an environment of uncertainty. The absence of a dependable or just judicial system deters investment and formalization of business and thus contributes negatively to economic growth.

D. SUPPORTING INSTITUTIONS

Nicaragua currently has no arbitration centers, although the Nicaragua Chamber of Commerce is in the process of creating such a center. However, to create an alternative means for justice, the legal framework must be reformed to formally incorporate and define the role of such an institution. Currently, there is a draft bill on ADR mechanisms under discussion. Ad hoc arbitrations are possible but not widely used. There is a general lack of knowledge regarding the availability and advantages to arbitration. Some lawyers refer contracts to arbitration centers abroad; however, the manner in which foreign awards will be enforced by local courts is yet to be seen.

The national Chamber of Commerce plays an important role in shaping opinion on issues affecting the business community. The Chamber has been very critical of the current state of the judicial system and has advocated for increased transparency, reliability of justices, and reform to the appointment process. The Chamber has also voiced concerns about legal instability, complaining that laws are often changed without consultation with civil or commercial society.

Several bi-national chambers of commerce exist, including a Nicaraguan-American Chamber of Commerce. These groups are good sources of information about the business climate and seem willing to provide foreign investors with pre-investment and post-investment support. Bi-national chambers have also criticized the chaos of the judicial system and have stated that under current circumstances foreign investments look elsewhere.

There are at least two voluntary associations of lawyers in Nicaragua: the Bar of Lawyers and the Association of Democratic Jurists of Nicaragua. Not all lawyers are members of these associations. Their missions relate to educating the public regarding legal issues, lobbying for legal changes, and alerting the public about violations of the Constitution or laws. The associations do not have disciplinary authority and lack the resources to be key players in legal change.

E. SOCIAL DYNAMICS

It is well known that Nicaragua has experienced political and social turmoil, and at times unrest has degenerated into violence. In 1979, the Sandinista revolution overthrew a dictator and ruled the country for more than 10 years. A counter-revolutionary movement fought the revolution until a democratic transition commenced in 1990. However, political and social division persists, and the judicial system is often seen as a tool in the larger fight for political supremacy.

Interviews conducted during the assessment process revealed that a large portion of the business community seeks transformation of the judicial system. Society-at-large demands radical transformations of the judicial system. A law on judicial career is pending approval by the National Assembly. Under the new law, judges would be selected according to merit rather than the political and often arbitrary manner in which the Supreme Court currently makes selections.

The law, however, fails to address the system's failures completely, as the Supreme Court, an institution noted to be highly political, maintains its role in selecting judges.¹⁵

Lawyers and the business community also seek changes in the procedural system. Specifically, parties have expressed an interest in the use of oral proceedings rather than proceeding only in writing to expedite routine procedures. There are no initiatives in place in that area.

Arbitration centers are needed. A law on ADR is necessary to place the centers in the appropriate judicial context and ensure the acceptance of arbitration rulings. There is currently a dialogue between private and public sectors on the subject of arbitration, but the likelihood of the law being approved by the National Assembly is uncertain. Promotion of the advantages of ADR is constantly mentioned by the business community as a critical component of the overall reform of the judicial system.

Weak regulation of lawyers has been mentioned as a cause of disturbance for many business transactions. Stronger regulations, admissibility requirements, supervision, and a specialized disciplinary body for lawyers were requested by the private sector as possibilities for addressing issues of lawyers' behavior.

F. RECOMMENDATIONS

- ◆ A weak rule of law is one of the most critical problems faced by Nicaragua. Selection of judges should be undertaken by a separate and independent body rather than the Supreme Court. Private and public sector working groups should develop the basis upon which those changes are undertaken and build the necessary consensus to push reforms. As the USAID Country Strategy for Nicaragua stated, "Political will is the key element in promoting good governance widely just as political will has been the catalyst for the extraordinary advances in fighting corruption." Political will can emerge if consensus is built throughout all parties.
- ◆ The legal profession needs reform. Stronger admissibility requirements for lawyers and notaries should be established. Consideration should be given to international practices such as a required admission or bar exam and the requirement for continuing legal education for lawyers.
- ◆ Legal education should be reformed and modernized. Law schools should promote student specialization during the final portion of programs through the provision of elective courses. Existing lawyers and judges should be trained in the importance of the rule of law, basic legal principles, international law, international business law, foreign jurisprudence, and doctrines such as "substance over form" and economic analysis of law. Courses on European law offered in Nicaragua by the Universidad de Valladolid from Spain are beneficial in broadening legal interpretations, but a similar program is

¹⁵ The *Ley de la Carrera Judicial*, No. 501, Article 3. The law was approved on November 30, 2004, after Congress rejected the President's partial veto (the full text of the law is available at http://www.presidencia.gob.ni/buscador_gaceta/BD/LEYES/2005/LEY%20No.%20501%20CARRERA%20JUDICIAL.pdf). Given the recent nature of the law (including the fact that it will come into force sixty days following its publication), at this stage it is premature to determine whether its implementation will, in fact, contribute to the much needed reform of the judicial system.

needed for U.S. law in preparation for the CAFTA. Legal education reform should include training of basic legal principles to lay persons for the purpose of providing civil society the means for monitoring the rule of law and for shaping the greater legal climate.

- ◆ A law on ADR should be made a legislative priority and passed. Arbitration and mediation centers should be created. Likewise, a promotional campaign on the use of alternative dispute mechanisms could increase the usage of these valuable alternatives to traditional means for legal settlement.
- ◆ A change in the civil procedure code should be promoted. Allowance for oral procedures to expedite routine procedures would decrease the length of judicial hearings. Consensus should be built between the public and private sectors through working groups and workshops about the need to change the written procedures into oral ones. A promotional campaign explaining the reform and underlining the advantages of changing from one system into the other should be undertaken.
- ◆ Bills should be drafted on leasing, factoring, electronic contracts, and electronic signatures. Consensus between the private and public sectors regarding these laws should be built based on the advantages that approving the bills will provide both sectors.
- ◆ A working group with public and private sector members should be appointed to consider the possibility of Nicaragua signing the Inter-American Convention on Legal Regime of Powers to Be Used Abroad.

V. REAL PROPERTY

A. INTRODUCTION

The real property system of Nicaragua is in disrepair. As a result of laws passed during the Sandinista Revolution, titles on many properties are uncertain.

During the revolution, many properties were expropriated. A large percentage of the expropriated persons have not received the compensation promised for their land. The unsettled status of compensation adds risk to property acquisition, as uncompensated parties may claim title to a prospective buyer's land in an attempt to secure their interests in the land in the absence of actual compensation. To avoid such claims, prospective buyers must conduct research on property titles, which discourages purchases and adds to the cost of land. Coastland can be occupied but not owned. Many foreign investors have been defrauded by sellers offering land that cannot legally be owned. Land settlers face the risk of invasions, which are usually politically motivated.

Zoning is chaotic, and there is no national law on territory order. The lack of a reliable judicial system creates uncertainty. Slow judicial procedures discourage investment in real estate and make execution of real estate guarantees difficult.

For most loans, the only guarantee accepted by creditors is mortgages. Due to the uncertainty of land tenure and ownership, even mortgages are often rejected as guarantees. When guarantees are accepted, interest rates are high due in significant part to the risk created by questionable securitizations and the questions surrounding the rule of law. Thus, access to credit is low and its cost, when available, is high.

Securitization of land or land titles does not occur. There is no law on financial trusts. The Real Property Registry is inefficient, and its information is often outdated. Information from the Real Registry is not integrated with cadastre data.

Overall, the current state of the Nicaraguan real property system discourages both foreign investment and local business growth.

B. LEGAL FRAMEWORK

There are two separate property rights systems in Nicaragua. The first governs communal indigenous land and protected areas, which respectively account for 12 percent and 17 percent of total land. The remaining portion of the national territory is under the legal body of the second system for property rights, which pertains to private property. This second system is divided into the agrarian reform sector and the non-reform sector.

The Nicaraguan Constitution gives locals and foreigners the right to own real estate. The Civil Code of 1904 provides the specific procedures for acquiring real estate or imposing liens on real estate.

During the Sandinista Revolution, many real estate properties were confiscated and allocated to party affiliates. In 1990, after the Sandinistas were defeated in a presidential election, but before

the new administration took control, three laws (popularly called the “*Piñatas* laws”) were passed whereby title was granted to those who occupied confiscated property. Immediately after the Chamorro administration gained control, those laws were not recognized and many settlers were left in a legal vacuum.

Before the Chamorro administration, some of the titles granted by those laws were registered, but many titles were left unregistered, leaving a gap in Registry information. After the revolution, some of the evicted landowners demanded compensation for expropriated properties and others demanded the return of their land. As a consequence of the chaos associated with land ownership created by successive regime changes, special offices were created to assess the situation, regularize land tenure, and properly compensate title holders.

There are roughly 11,000 pending cases for which compensation for expropriated land is demanded. There are also many displaced persons who have not yet filed claims. Victims of expropriation have created their own association and are threatening a suit against the government if they do not receive compensation.

Interviews during the assessment revealed a great deal regarding the current status of dealing with expropriations, including that compensation for expropriated properties has been slow and when it is paid, undervalued. For example, often it is paid below the seized property’s market value and in the form of bonds, which are usually traded in a secondary market at as low as 30 percent of par value. However, it has been reported that those bonds can yield interest of up to 12 percent, and although they are paid in local currency, they have a currency stability clause. Similarly, properties affected by the *Piñatas* laws sell at lower prices than comparable property due to ambiguity of ownership.

There is abundance of supplementing titles. A court can grant a supplementing title to an individual who has possessed a property for which the owner is unknown for longer than 1 year, can prove good faith, and has improved upon and maintained the property. This legally grants title after the court document is recorded with the Real Property Registry.¹⁶

In 1917, a law was passed prohibiting individuals from owning coastland.¹⁷ Coastlands belong to the central government but are managed by municipalities that rent the land to individuals. Persons knowledgeable of the situation stated that in some cases, coastlands are rented for up to 99 years. Rent is paid annually and is calculated at 0.5 percent of the property’s value, which is calculated annually by the municipality. Municipalities can revoke rent agreements at their discretion. It is unclear whether a person who had held a land title on a coastland since before 1917 can sell that property. However, it would be up to a local court and presumably to the Supreme Court to solve that issue.

There is no national zoning law. The Law on Municipalities states that local governments should have a development plan produced by their internal zoning departments. Issuance of the plan is to be announced in advance to provide civil society the opportunity to participate in the development of the plan. Interviewees stated that permits are required to build and are to be granted according to divisions that the municipality has set forth in the development plan.

¹⁶ Article 888 Nicaraguan Civil Code.

¹⁷ Article 2, Agrarian Law, (*Ley Agraria*).

However, the Chamber of Real Estate Brokers complained that the municipality of Managua is not well organized and lacks local zoning and municipal planning.

There is a 4 percent tax on transfers of real property based on the property's value. There is also an annual municipal tax on land use calculated at 0.5 percent of land value. It has been reported that the value-added tax of 15 percent has occasionally been imposed to real property transfers.

Non-liquid rights on real property, such as portfolios of mortgage credits, cannot be secured and converted into tradable instruments. There is no law on securitization, nor is there a law on trusts. In addition, the stock market is not well developed. Thus, securitization of real property rights and issuance of bonds secured with mortgage portfolios do not seem feasible in the near term.

In summary, simultaneously allowing for different types of claims, such as ownership and possession, on a single property creates ambiguity concerning ownership. This ambiguity is a source of conflict and decreases the value of property, investments in real estate, and land development in general. As a consequence, the construction industry is depressed, foreign investments are discouraged, and jobs related to real estate are not created.

C. IMPLEMENTING INSTITUTIONS

The Real Property Registry is a dependency of the Public Registry. It is regulated by the Public Registry Law of 1904 and is under the supervision of the Supreme Court. There is a Real Property Registry in each of the 17 provincial departments of the country. Real property transactions such as real property transfers, mortgages, and powers of attorney must be recorded in this Registry to be considered valid.

The Real Property Registry of Nicaragua is not automated, and information is handwritten into record books. In some provincial registries, records have been damaged by water and in some cases the information has been lost.

Once the information has been officially recorded, a certificate is issued to the interested party. It can take 2 to 3 months to receive a final certificate of registration for a property. Mortgage registration can be completed in 15 business days.

Banks have entered into agreements with the Supreme Court whereby banks can hire a Registry employee to work exclusively on their real property cases. In such cases, banks pay the specialized employee's salary and are able to expedite the registration process.

Registration fees were set by a governmental order in 1990 and are considered fair. Currently, registration fees range from \$3 to \$350.

An electronic index of all registered real properties in Managua is under construction. Eighty percent of that index is now finished.

The cadastre system has a number of deficiencies as well that will need to be rectified to complete the update of the Real Property Registry. First, there is no national cadastre map. In fact, there is updated cadastral information for only 20 percent of the land. Lack of proper land

boundary demarcation due to the poor cadastre can be remedied through a due diligence of land. That process, however, is usually time consuming and expensive. Second, some municipalities have their own cadastre, which is used for tax purposes, and these offices are not linked. Because no national cadastre exists, updated information from the municipal cadastral offices should be aggregated, and missing information should be obtained when necessary. Discrepancies between the Real Property Registry and the cadastre could be corrected through a court procedure. Lastly, there is no cadastre law.

Real property disputes are managed by the court system. A general lack of trust of the judicial system leaves many people hesitant to try to settle disputes through official means. The Heritage Foundation gave Nicaragua's real property system a score of four out of five, five being the worst possible score. In addition, the U.S. Trade Representative reports that "[p]oorly enforced property rights and the resulting proliferation of property disputes are among the most serious barriers to investment in Nicaragua." According to the Economist Intelligence Unit, "The selection of magistrates and judges has always been political and judicial independence from executive and legislative pressures is slight. There is no judicial career (merit) system, the training of judges is highly deficient, and public confidence in the fairness of judicial processes is very low. Corruption and influence-peddling in the judicial branch put foreign investors at a sharp disadvantage in any litigation or dispute."¹⁸

ADR mechanisms are not available to settle property claims. The Supreme Court has instituted a mediation section for property disputes arising out of the *Piñatas* laws called the Division of Conflicts Alternative Dispute Resolution. However, that section has not resolved any property dispute through mediation and instead has delayed the regular resolution process.

In conclusion, the institutions that pertain to real property contribute to the confusion related to land ownership. Problems with the Real Property Registry and cadastre increase transaction costs and encourage informal transfers of land, all of which dramatically affect security in land tenure and investments in real estate.

D. SUPPORTING INSTITUTIONS

Real estate transactions must be public; i.e., documents pertaining to real property acquisitions, mortgage, and powers of attorney must be certified by a notary who confirms the truth of the documents' content and the identification of the signing parties.

In Nicaragua all lawyers are notaries after being authorized to practice by the Supreme Court. Because of only minimal control and supervision of notaries, some notaries lack accurate understanding of the law (there is no qualification exam for notaries or continuing legal education requirement in the legal profession) and have reportedly conspired in land fraud cases. According to one interviewee, notaries in rural areas may falsify documents to make someone appear to be a good faith settler with a granting-right public document.

There is a real estate brokers' chamber of commerce. Currently it has 20 members and has lobbied for a law on real estate brokers, which would provide the framework in which licenses

¹⁸ Heritage Foundation, Economic Freedom Index for 2004,
<http://www.heritage.org/research/features/index/countries.html>.

would be granted to real estate brokers after passing an exam. The real estate brokers' chamber of commerce has expressed that poorly trained and unsupervised brokers have been the source of fraudulent cases. Foreign investors, mainly retirees from the United States, often come to Nicaragua in search of affordable beachfront property, which is purported as available by fraudulent brokers. Such activities damage the country's image and discourage foreign investments.

Title guaranty services are available through private companies. These firms provide escrow and title guaranty services devoted to protecting the potential buyer and indemnify for losses.

E. SOCIAL DYNAMICS

Regularization of land tenure is demanded by society at large. Double titles and sudden claims supported on rights not disclosed at the time of purchase are major problems. The World Bank has conducted a study that identifies the main obstacles for a sound real property regime and made recommendations for their removal. Most of the changes will require political will to achieve real legal and institutional change. Until Nicaragua regularizes the land tenure situation, real estate guarantees will be in jeopardy. Chambers of commerce and international donors constantly mention real property regularization as a national priority, second only to reform of the judicial system. However, the politicization of the country has not allowed the chaos in the real property system to be seriously addressed.

As part of real property reform, the Registry needs to be modernized and integrated with the cadastre. It has been said that an updated national cadastre could cost \$100 million and could take up to 15 years to complete. There are currently no plans, however, to update the system. In absence of a proper cadastre, insecure titles will remain and buyers will hesitate to purchase land.

The World Bank has initiated a project to modernize the Registry. The project intends to draft a new Registry law and cadastre law and to automate the Registry. Automation is expected to be finished by 2006. The project ends in 2007. The two laws have been drafted and are pending approval of the National Assembly.

City residents request urban planning to regulate growth in urban areas. There have been discretionary attempts by municipalities to provide better information about zoning and construction restrictions. The results of these attempts have been unsatisfactory, especially in Managua where a discotheque can be built next to a hospital.

There is a constant demand from both the legal community and the general population for the imposition of higher standards on lawyers and notaries. Currently there are no quality standards for lawyers or notaries or any serious supervision of the profession. There is a growing concern about the conduct of these professionals caused in part by the propensity of some of them to commit fraud. Lawyer and notary fees were mentioned to be very high.

The loudest and most consistent calls for reform regard the judiciary. Recent approval of the judicial career law is important in improving public confidence in the judiciary. Even this law,

the authority for appointing judges lies with the Supreme Court.¹⁹ A new code on civil and commercial procedures, which provides for use of oral procedures, has been demanded by chambers of commerce. There are currently no plans for such reform.

There is bill on the stock market pending approval of the National Assembly. It will remove the obstacles that currently make real property asset securitization difficult.

F. RECOMMENDATIONS

- ◆ Private property must be regularized. Parties whose property was expropriated without compensation should be paid in accordance with guidelines based on prioritized geographic areas and economic sectors. The administrative steps to regularize property should be reduced.
- ◆ Reforms on the Real Property Registry should be monitored and when necessary complemented. Approval of the Public Registry law is essential to ensuring accurate information and building the structure of a sound system of ownership. Efforts to automate are crucial, and collaboration on these efforts would be useful.
- ◆ An updated national cadastre is needed. A project to create a national cadastre map that integrates information with that of the Real Property Registry should be made a priority. The first step to this project is ensuring that the cadastre law is passed. Subsequently, integration of existing municipal cadastre data into a national multipurpose cadastre should be sponsored. That could pave the way for a national cadastre integrated with the Property Registry.
- ◆ Standards for lawyers and notaries must be increased. Admissibility requirements for the professions should be strengthened and enforced. Certification exams should be developed professionally, transparently, and independently to ensure the competency of legal professionals. Likewise, supervision and disciplinary authority for lawyers and notaries should rest on an independent body. Continuing legal education requirements should be imposed on lawyers and notaries to ensure that practicing lawyers are familiar with modern legal concepts and remain abreast of legal reforms.
- ◆ Zoning regulation is chaotic. A law on territory order should be drafted, and the proper institutions should be empowered to enforce the law. Strategic planning techniques should be introduced to the public officers relevant to the territory plan and zoning. Civil society's involvement in the zoning process is crucial.
- ◆ The housing deficit should be addressed. A survey to diagnose the extent and nature of the deficit should be conducted. Subsequently, a specialized legal framework should be implemented whereby incentives are offered to encourage the development of low-income housing.

¹⁹ The *Ley de la Carrera Judicial*, No. 501, Article 3. November 30, 2004 (the full text of the law is available at http://www.presidencia.gob.ni/buscador_gaceta/BD/LEYES/2005/LEY%20No.%20501%20CARRERA%20JUDICIAL.pdf).

VI. COLLATERAL

A. INTRODUCTION

An effective system of secured lending is the product of (a) an up-to-date substantive law; (b) a fully transparent, accurate, and easily accessible registry of debtors and of individually valuable collateral that can be identified by serial number or other means of individual identification; (c) an enforcement of security interests by means of extra-judicial self-help and by speedy and reliable judicial processes of execution of the various security interests; and (d) a sound central banking or regulatory policy that carefully monitors the lending risks and rewards to prudent lenders with access to liquidity and better interest rates.²⁰ When regarding these factors, the issue that becomes most noticeable and prevalent in Nicaragua as compared to other countries in the region is the weakness in the rule of law and a reliable judicial system: courts appear to base some decisions on political considerations rather than on merit. Clearly, in its current state, this is not a climate that promotes foreign investment or business growth.

Aside from the judicial problem, Nicaragua's current system of secured lending is inadequate to meet national and regional commercial credit needs—particularly those of micro and small businesses wishing to expand and improve their commercial activities with a view to taking advantage of the benefits of CAFTA. In Nicaragua, financing continues to rely predominantly on mortgage-based loans and satisfaction of formal and cumbersome requirements that are tailored to larger, more sophisticated companies. Micro, small, and sometimes even medium-sized Nicaraguan businesses—which constitute the vast majority of businesses in Nicaragua—often pay interest rates over 20 percent in borrowing from private lenders (microfinance corporations) that are willing to risk dealing with smaller companies and to offer simpler and non-real-estate based lending solutions. In a developing market and an ever-expanding globalized environment, where proven or newly created companies wish to remain competitive, higher interest rates are bound to significantly hinder economic gains and growth that small companies or investors wish and need to achieve.

Unless Nicaraguan SMEs can borrow at reasonable rates, the country will experience limited growth and perhaps even a loss of micro, small, and medium-sized businesses. Nicaragua will also become a less attractive market to prospective foreign investors and commercial and other enterprises, and will continue to rely heavily on remittances from abroad, as well as on financial aid from international donors.

First and foremost, Nicaragua must reform its judicial system. The government has implemented an initiative to reduce corruption, but much remains to be accomplished. Even the best laws are totally ineffective where no reliable implementing institutions exist. Legal uncertainty increases the cost of conducting business, and therefore constitutes a disincentive and trade barrier, in essence, to both foreign and local investments.

Second, Nicaragua must modernize its secured lending law and unify it with that of its Central American neighbors. With the help of legal modernization and harmonization with its regional

²⁰ Introduction to National Law Center for Inter-American Free Trade, *8 Financial Scenarios of Secured Lending in the NAFTA countries*, (NLCIFT, 1999); see also Boris Kozolchyk and John Wilson, *The OAS Model Law of Secured Financing*, Uniform Law Review.

counterparts, Nicaraguan financial institutions would qualify for assistance and cooperation by some of the largest secured lending institutions in the United States and Europe.

B. LEGAL FRAMEWORK

Nicaragua does not have a stand-alone law to regulate collateral; this generates uncertainty and confusion for both local companies and foreign investors wishing to become familiar with the system. Matters pertaining to collateral are regulated under the Civil Code (1867, as amended), the Commercial Code (1914, as amended), the Law on Agrarian or Industrial Pledges (1937), and the Law on Commercial Pledges (Law No. 146, 1992).

Mortgages over immovable property are the most common type of collateral used in Nicaragua.²¹ According to interviewees knowledgeable in this area, the second most common type of collateral includes agrarian and industrial pledges. These pledges cover movable assets such as machinery, equipment, crops, and cattle.²² In theory, these pledges should benefit small and medium-sized producers. However, the Law on Agrarian or Industrial Pledges requires that the document constituting the collateral be formally documented in a public deed, before a notary public; alternatively, the agreement may be documented privately by the parties, but their signatures also must be certified by a notary public.²³ In addition, even though the law seems to allow for general descriptions of goods, as a practical matter the Public Registry requires that goods be clearly identified and those descriptions be as detailed as possible. These additional formalistic requirements, which increase the transaction's cost and complexity, must be satisfied for the pledge to be accepted and registered by the Public Registry of the province (department) where the property is located.

1. Role of Banks

Even though no formal statistics exist regarding the number of pledges that are recorded at public registries throughout the country, persons experienced in this area made it clear that mortgages continue to be the preferred mechanism used by lenders. Banks do resort to pledges, particularly agrarian and industrial pledges.²⁴ According to one interviewee, banks are the main registrants of such pledges; typically, private parties (individuals and merchants) do not record pledges.²⁵ However, bank loans are not readily accessible to micro and small businesses—these

²¹ However, even in the areas of mortgages and real estate, most interviewees identified considerable obstacles and limitations, a significant number of which stem from the uncertainty that plagues real property in Nicaragua and that considerably limits the value assigned by lenders to this type of property (*see further*, Chapter V. Real Property).

²² Law on Agrarian or Industrial Pledges, Art. 2.

²³ *See* Law 146, Art. 7; Law on Agrarian or Industrial Pledges, Art. 5. If the documents are to be registered, they must be documented by means of a public deed or "other authentic document." (Civil Code, Art. 3941).

²⁴ This fact may be construed as an indicator that banks do provide loans to agricultural and industrial businesses, at least to some extent. Although this may be true in the case of larger companies, most pledges that banks register under the category of "agrarian or industrial pledges" correspond to car loans (rates for these loans average 9 to 11 percent). As a practical matter, most bank loans correspond to mortgage or car loans. Because no legal framework is in place to register cars other than the Law on Agrarian or Industrial Pledges, one interviewee stated that banks have resorted to that general framework to record pledges over cars and other vehicles.

²⁵ As a practical matter, this does not mean that private parties do not resort to this mechanism. Rather, parties resort to a variety of pledge mechanisms that are not recorded at the Public Registry.

constitute the bulk of potential secured debtors in the country. Legal practitioners interviewed as part of this assessment noted that banks require a long list of conditions in order to extend credit, including clearly identified collateral, registered by-laws, and up-to-date accounting books and financial statements. This becomes a serious constraint for numerous micro and small businesses that (a) are not formally organized and (b) only have access to certain types of collateral (including accounts receivable and inventory) that do not necessarily fall under the legal descriptions. At best, existing mechanisms benefit larger companies and a limited number of medium-sized companies in the country.²⁶ Bankers interviewed acknowledged that, typically, bank loans are based on a risk assessment and the loan amount. Smaller companies' lack of collateral that can be easily recorded is compounded by the additional administrative costs that banks must face to manage a number of smaller loans.

Banks are also careful when deciding who receives a loan. As one banker explained, the political climate in the 1980s generated a nonpayment culture that then became exacerbated by the situation in the judiciary and challenges faced with respect to the rule of law. This banker also mentioned that the existing legal framework does not provide incentives to lending and is not creative in designing ways to take advantage of various forms of collateral. In addition, various interviewees noted that the Public Registry is severely deficient. Overall, the system does not promote the trust that is required to facilitate business transactions. The problem is not liquidity; money is readily available. However, because of the strict requirements mentioned previously, money does not find its way into the hands of potential beneficiaries and, in particular, of micro and small companies.

Representatives from micro and small businesses noted that it would be helpful for the country to create a development bank—some remarked that the creation of such a bank is mandated under Article 99 of the Nicaraguan Constitution. Given the country's current political instability, as well as the previous experience with a development bank (Banades), which was one of the victims of the bank failures in the 1990s (see VIII. Bankruptcy), an initiative of this nature will likely require considerable more analysis and deliberation.²⁷

2. Microfinancieras

From a practical standpoint, larger companies that meet the formal requirements set forth by banks have access to lower interest rates (average rates range from 10 to 14 percent), yet micro and small businesses or merchants must resort to alternative sources of financing that normally charge higher rates (approximately 20 percent and more). These alternative sources include microfinance corporations (*microfinancieras*). According to several interviewees, although some *microfinancieras* operate within reasonable parameters, others charge usurious interest rates, taking advantage of the debtor's inability to access alternative sources. This seems more prevalent in areas of the country where fewer *microfinancieras* exist and there is little or no

²⁶ Larger companies that have the option of obtaining credit in other jurisdictions, where interest rates tend to be much lower, typically choose to do so. Others have opted to place equity in foreign markets—such is the case, for instance, with the Nicaraguan subsidiary of Pepsi-Cola International.

²⁷ Central Bank authorities noted that the concept of a development bank has worked well in other regions of the world (e.g., Asia and Europe). However, similar experiences have failed in Latin America, including the case of Banades in Nicaragua.

competition.²⁸ Rates vary according to the nature of the loan. The Nicaraguan Association of Microfinance Companies (*Asociación de Microfinancieras* or ASOMIF) reported that loans for agricultural activities range from 12 to 20 percent; for industrial activities, rates vary from 14 to 24 percent; for commercial activities, rates range from 24 to 40 percent; and rates for micro credits average 36 to 48 percent.

It is noteworthy that a government agency (INPYME)²⁹ was created in 1994 to promote the development of micro, small, and medium-sized companies. INPYME has a plan to facilitate access to credit to these types of companies for export operations. Sectors that currently benefit from this plan include textiles, food, wood and furniture, and metals. Credit is not given directly to the companies. Instead, INPYME receives funds from various international sources and lends these funds to microfinance corporations at an average interest rate of 6 percent. In turn, the *microfinancieras* extend credit to micro, small, and medium businesses at rates that average 9 to 11 percent. Given that *microfinancieras* must repay this money to the government and that they are not authorized to charge higher interest rates, in practice the outcome has been that only those companies that can provide sufficient collateral to guarantee their loans have had access to these funds. Consequently, only a limited number of companies may truly benefit from this program, while others remain in the same situation that they face with respect to banks. Overall, interviewees support efforts by INPYME but believe that more must be done to expand the universe of companies that can benefit from this plan.

It is not surprising that the lack of financing at reasonable rates was identified by small and micro entrepreneurs interviewed as part of this assessment as one of the major obstacles they face in Nicaragua. In their own words, they feel they are “working for the lenders.” Interest rates are high; loan applicants are required to provide collateral in excess of twice the amount of the requested loans (yet the collateral they offer is often priced at half its value); and loans are typically extended only on a short-term basis. The aggregate of these factors is a situation in which a majority of businesses in Nicaragua lack sufficient access to credit. In turn, without adequate access to credit, companies cannot grow and produce the volume and quality of products that their foreign clients demand; they cannot invest in technological innovations to improve and streamline their production; and they cannot pay additional employees to guarantee on-time delivery.

3. Commercial and Mercantile Pledges

In addition to agrarian and industrial pledges, the other types of pledges recognized under Nicaraguan legislation are the commercial and the mercantile pledges. The commercial pledge is used when the credit was granted to finance the debtor’s acquisition of the movable asset

²⁸ As reported by one interviewee, the National Assembly is considering a proposal that will regulate the activities of *microfinancieras*. Under this proposal, the Superintendency would be in charge of supervising the activities of those *microfinancieras* that choose to be governed by the new system. Even though submission to this supervisory system will not be mandatory, those *microfinancieras* that opt to be supervised will benefit from access to second-tier banks such as the Nicaraguan Financial Investment Institution (Financiera Nicaragüense de Inversiones or FNI), as well as to foreign financial institutions.

²⁹ INPYME stands for *Instituto Nicaragüense de apoyo a la Pequeña y Mediana Empresa* (Nicaraguan Institute to Support Small and Medium-Sized Businesses). See further at <http://www.inpy.me.gob.ni>.

encumbered.³⁰ The relevant agreement must include, among other things, a detailed identification of the movable property given as collateral.³¹ The mercantile pledge, regulated by the Commercial Code, is the most traditional type of collateral regulated in Nicaragua, and it entails delivery of the pledged assets to the creditor,³² effectively preventing the debtor from using the collateral until the debt has been fully paid. In the case of the mercantile pledge, because the creditor is in possession of the goods, it is not necessary to record the agreement at the Public Registry. In the case of the commercial pledge, registration is also not required.³³

4. Practical Solutions and Their Shortcomings

From a practical standpoint, legal practitioners have noted that some of their clients—mostly larger companies that conduct distribution businesses—enter into pledge agreements involving inventory and accounts receivable. However, these types of transactions are not comparable to the ones that take place in modern secured lending systems and that facilitate the creation of a security interest over a fluctuating pool of assets—a security interest that is furthermore perfected by filing a simplified document in the Public Registry.

These transactions were described by a Nicaraguan legal practitioner as follows: the parties enter into an agreement that is certified by a notary public. This commercial pledge contract is not recorded at the Public Registry but, by virtue of the law, it constitutes a title that, at least in theory, enables the parties to have access to an expedited procedure for judicial enforcement (*acción ejecutiva prendaria*).³⁴ Given prevailing conditions in the judicial system, it is unlikely that these procedures afford any benefits to potential litigators. As part of the pledge agreement, the debtor must provide to the creditor a description of the accounts receivable, including the total amount. Because of the nature of the collateral, which is in constant flux, the debtor must update that description and provide a new list to the creditor every two weeks. Clearly, this is an extremely cumbersome and labor-intensive arrangement that can work efficiently only in a limited number of cases and for certain activities. The legal practitioner interviewed mentioned a case in which a car dealership had granted a security interest on all its accounts receivables.

Another flaw associated with this practice is that, because of the absence of a Registry filing, it becomes difficult for a secured debtor to obtain an additional line of credit based on the same collateral. For instance, in the previous example, the car dealership that obtained a loan from creditor A would need to go back and secure creditor A's authorization to use those accounts receivable as collateral for a loan granted by creditor B. This not only makes it difficult for the company or investor to obtain additional lines of credit, it also supports fraudulent activities by unscrupulous debtors who choose not to give notice to subsequent debtors of the security interest that already exists vis-à-vis creditor A. By virtue of the principle of *prior tempore, potior iure* (first in time, first in right), which is recognized in Nicaragua, creditor A would have preference over any other subsequent creditors with a security interest over the same collateral. However, even that is uncertain given the current judicial system. Consequently, it is not surprising that banks or other financial institutions are reluctant to provide credit to smaller companies under

³⁰ Art. 1, Law 146.

³¹ *Id.*, Art. 9.

³² Commercial Code, Art. 510.

³³ *See, generally*, Law 146.

³⁴ Law 146, Arts. 11 *et seq.*

these circumstances. In contrast, if these transactions could be recorded in a centralized and reliable Registry, many companies could obtain credit based on their accounts receivable and, because the inherent risk would be much lower, interest rates would decrease.

Inventory financing in Nicaragua is carried out in a manner that resembles the one described above for accounts receivable. A legal practitioner related a case in which a pharmaceutical company created a security interest over its inventory. The transaction was also documented in an agreement certified by a notary public and, as in the previous example, the secured debtor had to provide a description of the relevant inventory. This transaction is also not subject to registration, which in turn raises the same criticisms noted in the previous case. In addition, this type of mechanism does not allow for modern types of inventory financing, including, for example, the purchase money security interest (PMSI). The main objective of the PMSI is to provide freedom to the debtor to borrow funds from various creditors. The PMSI allows a PMSI creditor to obtain priority over previous creditors with respect to goods specifically acquired by the debtor with the proceeds of the PMSI credit. In turn, this allows a debtor more flexibility to obtain additional financing for new goods by allowing the PMSI creditor a preferential right. Simply put, a PMSI allows a party second-in-time to become first-in-right with respect to the acquired property.³⁵ Clearly, the mechanisms used in Nicaragua do not allow this type of flexibility and hence limit access to credit.

Another mechanism used in Nicaragua relies on storing collateral at authorized warehouses (*almacenes generales de depósito*). Generally speaking, this mechanism effectively limits the debtor's access to and use of the relevant goods. As a practical matter, the creditor may agree to allow the debtor to withdraw a certain number of goods to conduct his or her business—the specific number or percentage will be based on the parties' agreement. Many companies find this mechanism burdensome because it hinders their access to the goods and implies additional costs—warehouse rental, surveillance services (if needed), special permits, etc.

Parties also resort to atypical and innovative—albeit cumbersome—legal arrangements that provide for the management or administration of certain assets. The mechanism of the guaranty trust, which is commonly used in other Central and Latin American countries, is not regulated under Nicaraguan law. Some lawyers advise their clients to set up guaranty trusts abroad (e.g., in Costa Rica), but this is not a common practice in the country, and it assumes that the relevant transaction involves a significant amount.

With regard to enforcement procedures, the Nicaraguan legal system relies exclusively on the enforcement of security interests by means of judicial mechanisms. Not only are non-judicial enforcement mechanisms not provided for, they are prohibited. Article 3759 of the Civil Code establishes that any clause authorizing the creditor to repossess the collateral will be void. A similar principle is established under Article 515 of the Commercial Code. However, both articles provide that the parties may resort to the sale of the property in a public auction, without the need for a judicial process. Legal practitioners interviewed noted that, from a practical standpoint, this procedure is not used; parties may resort to a public auction, but such auction is typically the result of a judicial process. Once again, given the judicial system's shortcomings,

³⁵ See generally, Kozolchyk and Wilson, *The OAS Model Law of Secured Financing*, *supra* note 20.

the existing system affords no protection to local companies or foreign investors that are unwilling or unable to play under the “rules” of such a system.

Overall, the concept of pledge in Nicaragua remains restrictive and does not respond to the needs of a modern credit market.

C. IMPLEMENTING INSTITUTIONS

1. Real Property and Mercantile Registry

Property registration in Nicaragua originated in the Mortgage Registry set up by the Spanish in the late 18th century. After Nicaragua’s independence, the first Civil Code was passed in 1867 and included provisions on a *Registro Conservador*. In 1904, the new Nicaraguan Civil Code came into effect and replaced the *Registro Conservador* with the Real Property and Mercantile Registry (*Registro de la Propiedad Inmueble y Mercantil* or RPIM). The Registry encompasses transactions pertaining to real estate (immovable property), pledges (movable property), and companies (Mercantile Registry). The basis for RPIM’s authority is Title XXV of the Civil Code and the applicable regulations (*Reglamento del Registro Público*).³⁶

The RPIM is administered by the Supreme Court, which is also responsible for appointing and removing the registrars in each RPIM office (17 in total). The Court administers the RPIM’s budget, issues relevant regulations, and polices and monitors the RPIM’s daily operations.³⁷ Revenues generated by the Registry also go to the Supreme Court and are then transferred to the Treasury.³⁸

Despite some modernization projects and reform efforts during the 1990s (including pilot projects in Masaya and León), the Registry continues to be in serious need of reform. Books are kept manually, and the public has access to the books—a practice that generates opportunities for fraud and contributes to the deterioration of the records.³⁹ The process is slow, and recording a document may take weeks or months. Registry resources are insufficient: The government assigns 4 percent of its budget to the Supreme Court, and part of that goes to the Registry. Registry information is not centralized, and the offices have not been interconnected.⁴⁰ Another problem plaguing the Registry system is physical infrastructure. RPIM office buildings are in general disrepair,⁴¹ and users report that various registries throughout the country have encountered serious operating difficulties because of lack of electricity and building leaks that have contributed to the deterioration of the books. Authorities are looking for new facilities for some of these registries throughout the country.

³⁶ See further, *The Reform of Property Registration Systems in Nicaragua: A Status Report*, Brian Trackman, William Fisher, and Luis Salas (INCAE, June 11, 1999), at 2.

³⁷ *Id.*, at 2-3.

³⁸ Registry fees are set forth by the *Arancel de los Registros*, which is set by the national legislature. *Id.*, at 5.

³⁹ The current registrar in Managua, who has been in office for 3 years, noted that during his tenure he has not been aware of any fraudulent activities or removal of records. It should be noted that signs on the wall warn the public not to make notes on registry books.

⁴⁰ See *INCAE Status Report*, *supra* note 36, at 4. A centralized registry is important because it allows interested third parties, including potential lenders, to determine whether a debtor has any liens of record in a particular department or region, or in the entire country, by consulting one single, centralized registry.

⁴¹ *Id.*

Current modernization efforts undertaken in conjunction with the World Bank include a proposed Public Registry law. Under the new system, the Registry would continue under the Supreme Court of Justice, but it will have functional, administrative, and budgetary autonomy (i.e., in the future, part of the government's budget will be assigned directly to the Registry rather than to the Supreme Court). All three registries (immovable property, pledges, and companies) will continue to operate together, although there is a separate proposal for a law for the Mercantile Registry.

Modernization efforts are focusing on the scanning and digitalization of books and information and on the automation of indexes. This process is expected to be completed in 2006. Additional reforms will require the adoption of a legal framework to enable the use of electronic and digital signatures.

Complaints regarding the Registry include the insufficient training of Registry employees. However, the main complaint pertains to delays in the registration process; registering a property or pledge may take 2 to 3 months. Such delays may be risky because a document may be already accepted but not yet processed; consequently, an interested party conducting a search on the relevant property may not detect the existence of a prior security interest. In addition, when a party is applying for a loan, it is not uncommon for the lender to wait to disburse the totality of the loan until the relevant document has been duly registered. When a business transaction is relying on the payment of such a loan, 2 to 3 months can effectively become a barrier to business. As a result, it is not surprising that reports of "grease payments" being used to expedite the registration process have become a common practice.

Overall, registration of movable property is significantly limited, and it refers exclusively to pledges granted under the Law of Agrarian or Industrial Pledges—as noted before, most of these involve car loans.

Under its current structure, the RPIM is not equipped to file contemporary secured transactions in an expeditious, economical, and reliable manner. Nicaraguan legislation has not envisioned the existence of a centralized Registry for collateral, or a Debtor Registry. A modern system for secured lending requires this type of debtor indexing, which allows interested parties to search the Registry to determine the existence of liens on a particular debtor's property by using the debtor's name. Several important features of a secured financing system cannot function properly if the Registry index is based on real property rules requiring collateral descriptions instead of debtor names. Security interests such as future goods, inventory, and accounts only function within a system that allows for general collateral descriptions, not for detailed identification of goods. Consequently, a modern Registry system cannot function based on a collateral criterion, but can only function when debtor names are used as the registration search criterion.⁴²

Finally, neither Nicaragua's substantive law nor its Registry law is designed to accommodate modern, speedy, and voluminous commercial loans that are common and necessary for growing economies and increased foreign investment. A modern electronic Registry should accommodate presentations in-person as well as presentations by the various forms of electronic transmittal,

⁴² See further, Kozolchik and Wilson, *The OAS Model Law of Secured Financing*, *supra* note 20, at 48-49.

including mail, fax, modem, courier, EDI, etc. Ideally, Registry reforms—and legal reforms to accommodate an electronic system—should be based on the guidelines established by the UNCITRAL Model Law on Electronic Commerce, the UNCITRAL Model Law on Electronic Signatures, and the Inter-American Rules on Electronic Documents and Signatures, which enable presentation by “any other method which is accessible for later consultation and which can be produced in a tangible form recognized by law or custom.” Also ideally, Registry modernization should eventually lead to an integrated network of Central American registries.⁴³

2. The Commercial Registry

There is no registration of collateral in the Commercial Registry (*Registro Mercantil*), which is located in the same building as the Property Registry.

As noted before, efforts to modernize the Commercial Registry are under way.

3. Courts

Aside from the inadequacies of the substantive and procedural law of pledges and the shortcomings affecting Registry procedures, it will be very difficult to build an effective system of secured lending in Nicaragua without a major reform of the current judiciary system which currently fails to meet modern norms for predictability and transparency.⁴⁴ This presents a major risk for investors and the business community as a whole.

Efforts to reform the Law of the Judicial Career (*Ley de la Carrera Judicial*) so that judicial appointments could be based on merit and judicial conduct and sanctions for misconduct could be clearly defined gave rise to lengthy debates and political arguments. The *Ley de la Carrera Judicial*, No. 501 was ultimately approved on November 30, 2004, after Congress rejected the President’s partial veto. Given the recent nature of the law (including the fact that it will come

⁴³ The concept of an integrated network of Central American registries is not a novel concept and has, in fact, been envisioned by registry representatives from all Central American countries, as reported by one of the experts working on the World Bank Registry Modernization Project in Nicaragua.

⁴⁴ The Parmalat case has generated a public outcry in the midst of an already ignited political confrontation between the Sandinista Party (the *Frente Sandinista de Liberación Nacional* or FSLN) and the Liberal Party (*Partido Liberal Constitucionalista* or PLC). On August 11, 2004, the former banker Haroldo Montealegre was appointed intervenor of the Nicaraguan subsidiary of Parmalat, an Italian multinational. (See *La Prensa*, August 12, 2004, at <http://www-ni.laprensa.com.ni/archivo/2004/agosto/12/>, *Montealegre se Posesiona de Parmalat* (Montealegre Takes Over Parmalat)). The appointment came as a result of the fact that the Banco de Crédito Centroamericano (Bancentro) owes US\$6.2 million to Mr. Montealegre, allegedly resulting from the purchase of some shares of Banco Mercantil (Bamer), a bank that was liquidated in the late 1990s. In turn, Parmalat has a debt of US\$5.8 million with Bancentro. As a result of the decision of the District Court judge, Bancentro’s rights were effectively transferred over to Mr. Montealegre who, as the new intervenor for Parmalat, has the right to manage the company and get paid on his debt over a period of 5 years. It is worthwhile noticing that Parmalat was not a party to the trial involving Montealegre and Bancentro; furthermore, Parmalat was not required to appear in that trial. Finally, Parmalat is not bankrupt nor has it defaulted on its payments. Clearly, this does not present a favorable outlook to investors who may be considering opening a business in Nicaragua and who could, based on this and other well-known judicial cases, harbor significant doubts as to the protection of their rights and investments and, more generally, to the application of the rule of law

into force sixty days following its publication), at this stage it is premature to determine whether its implementation will, in fact, contribute to the much needed reform of the judicial system.⁴⁵

Even if the pervasive nature of political considerations were not an issue, legal practitioners have noted the excessive formalism in judicial procedures. Technical considerations take precedence over substance and generate unreasonable delays. In the experience of one lawyer interviewed, courts may take years to process an appeal, just to issue a decision that states that the appeal was submitted after the relevant term had expired. Generally speaking, judges are not familiar with commercial matters. Even though training is available and it is frequent to hear that judges are attending seminars or conferences, such seminars mostly address issues pertaining to civil, procedural, labor, and criminal law. There is a serious need for increased training in commercial matters. A legal practitioner related a case in which a judge decreed a lien over goods that were pledged and deposited at an authorized warehouse, under the framework of the Law of General Warehouses (*Ley de Almacenes Generales de Depósito*), totally disregarding that Article 192 of that law prohibits such liens.

Some have seen the development of ADR methods, including conciliation, mediation, and arbitration, as a positive occurrence to provide a more transparent and efficient tool for the resolution of disputes. These efforts have been supported by the Nicaraguan Chamber of Commerce (CACONIC) and USAID, among others, and include the enactment of a law on conciliation, mediation, and arbitration (based on the Model UNCITRAL Law), which is being considered by the National Assembly.⁴⁶

D. SUPPORTING INSTITUTIONS

1. Notaries and Professional Associations

As in other Central and Latin American countries, notaries have the power to certify and authorize acts and contracts in which their participation is required by law or by the parties. Notarial services pertaining to contracts and deeds to be registered in the Public Registry—and particularly those relating to real estate—are generally in the mid- to high-price range.

All lawyers may become notaries, following an administrative procedure that does not entail any additional tests. As in El Salvador, there is no limit to the number of lawyers who may become notaries. As for the quality of the legal education, interviewees had mixed opinions. Some believe that public universities continue to be the most prestigious and are the only ones that provide a good education. Others spoke favorably of private universities. Some believe that neither public nor private universities are providing high-quality education.

Notary supervision is carried out by the Supreme Court of Justice. In theory, notaries are under the obligation to submit monthly reports of all documents they authorize. However, this requirement is rarely met or actively monitored. From a practical standpoint, complaints are commonly heard about contracts—particularly those that deal with real estate—where rights are

⁴⁵ The full text of the law is available at http://www.presidencia.gob.ni/buscador_gaceta/BD/LEYES/2005/LEY%20No.%20501%20CARRERA%20JUDICIAL.pdf.

⁴⁶ See further, Commercial Dispute Resolution Report.

transferred by persons who are known to be out of the country or who have long been dead. Irregularities in this area are due to a combination of unscrupulous notaries and deeds that are granted by non-notaries. In theory, the Public Registry should have a way to detect such irregularities, but as a matter of practice, the Registry does not keep a roster of authorized notaries public. This practice only exacerbates the uncertainty that underlies property titles and rights in general in Nicaragua.

2. Professional and Business Associations

No official bar association exists in Nicaragua. Some lawyers noted that there are various common-interest associations. However, no business, industrial, and professional associations focus specifically on the significance of providing commercial credit at reasonable rates of interest to Nicaraguan and Central American micro, small, and medium-sized businesses. Various interviewees acknowledged the seriousness and urgency of the problem and the need for a modernized system.

Overall, supporting institutions are playing a limited role in promoting economic and investment potential vis-à-vis the development and implementation of a modern and effective system of secured lending. Instead, they seem to have adopted a position of “spectators” and are waiting for the government to take the initiative.

E. SOCIAL DYNAMICS

The legal framework for collateral, including registration, has not witnessed a major push for reform. There are high-ranking government authorities who are aware of the need to modernize the legal framework for secured transactions; and the need for reform has been raised in the past. Legal practitioners interviewed note that this is not a high-priority item in the government’s agenda, but a small group of legal experts and associations have pointed out the need to modernize both the legal framework for secured lending and the Registry. Studies undertaken in the late 1990s already identified the concern about insufficient access to credit by farmers, rural businesses, and other small companies.⁴⁷ However, not much has happened since then. An expert who has been working on the World Bank’s Registry modernization project noted that 5 years ago there were discussions regarding a proposed secured transactions framework, and a draft law was submitted for consideration. Legal experts and authors had identified changes that would need to be introduced to both the civil and the commercial codes, and that generated some opposition. Some noted that to carry out such a reform, it would be necessary to reach a consensus with both the judiciary and the legislature, and no further steps have been taken to achieve such consensus. As a matter of fact, many legal practitioners interviewed (and even lawyers at the Superintendency of Banks) expressed that they were not familiar with any proposed laws on secured transactions for Nicaragua.

The private sector is fully aware of the need for change, but as one lawyer put it, they have not been instrumental in bringing about that change. He described it not as a lack of interest but as a general state of disenchantment with the overall public sector approach that has not given

⁴⁷ *Nicaragua: How Problems in the Framework for Secured Transactions Limit Access to Credit—1997*, Center for the Economic Analysis of Law, available at [http://www.ceal.org/ceal-org/papers/Nicaversion26\(cealp039\)CovPage&ExecSum,v2.htm](http://www.ceal.org/ceal-org/papers/Nicaversion26(cealp039)CovPage&ExecSum,v2.htm).

priority to these issues. International donors also have long been aware of the need to modernize the country's legal framework, starting, on a general level, with the legal framework for commercial transactions. As reported by the USAID mission in Managua, there is a proposal for a uniform commercial code for all Central American countries, which would be based on best practices and experiences gained from other countries in the Americas, including Chile and El Salvador. Interviewees noted that this would be a good initiative, because commercial law principles currently in force in Nicaragua are frequently inconsistent with commercial practices embodied in modern free trade agreements, including CAFTA.

F. RECOMMENDATIONS

The shortcomings of Nicaraguan substantive or procedural laws have not been remedied by Nicaraguan Registry and case law; on the contrary, they have been exacerbated by the deficiencies in both the Registry and judicial systems. The situation calls for numerous reforms—including legal reform, Registry reform, and training all participants in the system. However, these reforms can only be effective if they are based on an overall reform of the judicial system. This, in and of itself, will not be an easy task. It will require political will and consensus building—in the government, the private sector, and among the general public—that changes in the judiciary are absolutely essential. Nicaragua's potential benefit from CAFTA or any other multilateral or bilateral trading arrangements will be threatened if its judicial system does not afford any level of protection or predictability to foreign investors or local businesses.

- ◆ Modernization has to be conducted in a way that reflects international standards and best practices. New legislation is needed in Nicaragua to address, *inter alia*, secured transactions, electronic commerce, and bankruptcy. A uniform commercial code that incorporates generally accepted principles and best practices for the region would be a useful tool to guide reform in Nicaragua. In addition, a quick and inexpensive realization of Nicaraguan security interests will remain an unattained goal until a program of substantive, procedural, and Registry law modernization is undertaken not only in Nicaragua but also throughout the region.
- ◆ Although to a lesser extent than in other countries in the region, some members of the Nicaraguan public and private sectors realize that secured lending laws must be modernized in Nicaragua and Central America in the nearest possible future. The Nicaraguan public and private sectors and stakeholders should coordinate their efforts with their neighboring countries to adopt and implement the Organization of American States' (OAS) Model Law on Secured Transactions for the region. To this effect, efforts leading to the adoption of a new law and regulation(s) should include a comparison between current Nicaraguan laws and developments in other countries of the region and throughout the Americas, including the principles embodied in the OAS Model Law. The proposal should include the development of a regional electronic Commercial Registry and establish a work plan for the operation of individual in-country registries. It would also entail the modernization of the legal framework for electronic commerce and electronic signatures in compliance with international standards.
- ◆ In conjunction with legal and judicial reform efforts, some interviewees recommended creating a Nicaraguan development bank to better serve the needs of micro, small, and

medium-sized companies. As indicated in this report, given previous experiences in the country, this recommendation will likely require additional consideration.

- ♦ Training on the scope and operation of the new legal system should be provided to judicial and administrative officials to facilitate implementation of modernized laws and systems. Such training should include information pertaining to the new collateral structure; interconnection between the new secured transactions framework and other areas of the law; financing options available to local companies and foreign investors; and Registry operations.

VII. COMMERCIAL DISPUTE RESOLUTION

A. INTRODUCTION

Without major reforms in the judiciary, the only safe—yet still inadequate—option for resolving commercial disputes is arbitration. Steps are being taken, however, such as a new “judicial career law,” to implement changes. However beneficial this law may prove to be, it does not address the inadequate training in commercial law of the judges, nor other sources of the inefficiency in the judicial system.⁴⁸

B. LEGAL FRAMEWORK

The Constitution provides the following jurisdictional bodies: (a) the Supreme Court of Justice, (b) the Courts of Appeals, (c) the district courts, and (d) the local courts. There are also military courts that hear cases exclusively related to military offenses and crimes, without prejudice of the actions and remedies before the Supreme Court of Justice.

Nicaragua has no specific courts for resolving business-related issues. Commercial issues must be submitted to and resolved by a civil district court. Civil courts also hear cases related to administrative litigation, with the Court of Appeals on Administrative Litigation of the Supreme Court of Justice being the highest level.

A commercial code and a bankruptcy law exist, but both are outdated and need revision. Creditors have first claim in bankruptcy cases after preferred stockholders. Monetary judgments usually are rendered in Nicaraguan currency, though they may be given in U.S. dollars as well.

There is no specific law on arbitration. However, the procedural code, in Article 894, addresses arbitration. The law provides enforcement by courts. It also allows arbitration to be set up by courts—at the request of the parties. Each party chooses an arbitrator. If they cannot agree on a third selection, the judge makes the choice.

Proposed new legislation on arbitration is pending in the National Assembly. It would leave arbitration more in the control of the private parties. The courts would be involved at the enforcement stage. Supporters are optimistic about prospects for passage in the near future.

The Nicaraguan government accepts binding international arbitration of investment disputes between foreign investors and the state. Nicaragua is a party to the Inter-American Convention on Arbitration and a member of the International Center for the Settlement of Investment Disputes. The government of Nicaragua signed the 1958 New York Convention on the recognition and enforcement of foreign arbitration awards and submitted it to the National Assembly in early 2003. The National Assembly approved it on June 24, 2003. It is recommended that arbitration clauses be included in business contracts as a means of avoiding dependence on the Nicaraguan judicial system.

⁴⁸ The *Ley de la Carrera Judicial*, No. 501, November 30, 2004 (the full text of the law is available at http://www.presidencia.gob.ni/buscador_gaceta/BD/LEYES/2005/LEY%20No.%20501%20CARRERA%20JUDICIAL.pdf).

C. IMPLEMENTING INSTITUTIONS

Difficulty in resolving commercial disputes, particularly the enforcement of contracts, remains one of the most serious obstacles to investment in Nicaragua. As part of its mission to foster a more attractive business environment, the recently established investment promotion agency ProNicaragua tries to facilitate resolution of investment disputes and to act as a channel for investors to bring their concerns to the attention of the government.

Length of proceedings remain a concern. For example, in one civil district court, the average period to decide on a case at first instance was reportedly near one year; when in theory it should take three to four months. Courts lack an automated system. An overwhelming portion of the court clerks have only a typewriter as a working tool. Most typewriters are in poor condition and improperly maintained. The archives are not computerized, thus reducing the physical space in the courts due to the huge number of court files that the clerks handle.

The significant majority of judges lack experience and knowledge on trade and commercial matters. Many judges acknowledge this limitation. They say that the Supreme Court has tried to repair this gap through seminars, workshops, or training, but that much remains to be accomplished. The lawyers who practice commercial law reported frequent obstacles as a result of a judge's lack of knowledge of special procedures that apply in commercial matters.

Nicaragua, through its Law of Organization Statutory Law of the Judiciary, has institutionalized "enforcement judges," with a responsibility to enforce the judgments once they are final, i.e., when there is no legal remedy of pending proceedings that may affect the results of said judicial decision. At the time a judgment passes to an enforcement judge—who is an important assistant of the jurisdictional bodies—it cannot be appealed in any way. So the judge supposedly must limit himself or herself to enforcing the order provided in the judicial resolution. Enforcement judges are appointed to their positions generally in the same manner as the ordinary judges.

The enforcement process is in theory free of charge because these officials are paid by the government. However, it is their common practice to charge for the execution of attachment or eviction orders. According to persons interviewed for the assessment, the Supreme Court has made various official statements forbidding said charges, but they still occur.

The newly created assistants of justice have significantly lightened the parties' burden by speeding up the process. They carry out every service of the process in all cases heard before each jurisdictional body. Prior to the existence of this office, the court clerk of proceedings was responsible for said service, and lawsuits moved at a much slower pace. At present, this service is free of charge, and remuneration of the service officials is paid by the government.

D. SUPPORTING INSTITUTIONS

Nicaragua has about 11,000 attorneys. There are several bar associations, but membership is not required. The bar associations have no weight or influence in the society or in the National Assembly. The attorneys, however, seem motivated to pursue judicial reform because many have been sanctioned in ways that lack due process.

The majority of Nicaraguan lawyers practice in the fields of civil, criminal, and labor matters. Few engage in corporate or business practice. Now, however, academic curricula strongly emphasize commercial areas so that all law professionals graduating from these universities may have a much broader scope.

Overall, the legal system is weak and cumbersome. Members of the judiciary, including those at high levels, are believed to be corrupt or subject to outside political pressures. Enforcement of court orders is uncertain and frequently subject to non-judicial considerations. Foreign investors are not specifically targeted but are often at a disadvantage in disputes against nationals with political connections. Misuse of the criminal justice system sometimes results in individuals being charged with crimes arising out of civil disputes, often in order to pressure those targeted into accepting a civil settlement.

The passage in 2001 of a new Criminal Procedures Code and its partial implementation starting in December 2002 may help reduce arbitrary exercise of criminal charges. Final implementation of the Criminal Procedures Code is scheduled for December 2004, and passage of a complementary Criminal Code is anticipated. The Alemán administration that preceded the current Bolaños government was regularly accused of interfering in the court system. The Bolaños government is attempting to change the judiciary through legislation.

The business community has been gradually developing alternative methods of dispute resolution outside the ordinary courtrooms to achieve more just and prompt discussions for its claims. It has therefore set up centers of arbitration and mediation, to which the parties can easily submit their disagreements for consideration and from which they can expect appropriate results, fundamentally in compliance with justice impartiality and the laws.

The private sector is continually promoting draft bills to resolve judicial problems. The private sector is currently promoting with strong enthusiasm and determination a Law of Arbitration and other alternative means of conflict resolution, which would facilitate development by bringing peace of mind to the business community regarding resolution of their conflicts. Most of the private sector is convinced that this law will mean greater judicial integrity in the country. Many private stakeholders think that if there were conflict in the judicial system, they may be subjected to pressure or coercion from the dominating political faction to obtain some benefit in return for a favorable result in a legal action proceeding.

Dispute resolution can be especially complex in the Northern and Southern Atlantic Autonomous Regions, where most of the country's fisheries, timber, and mineral resources are located. In these large districts, which make up more than one third of the national territory, the division of authority between the central and regional autonomous governments is murky, and local judges often act without effective oversight. Furthermore, the traditional indigenous peoples of the Atlantic coast have interpreted very broadly a regulation stating that their communities have ownership of "traditional" areas. This has led to many challenges, legal and physical, to purchases of property by foreign investors, even those with legal titles. Many titles, predominantly on the Atlantic coast, have been registered improperly or fraudulently. The national government tried in 2001 to reassert ownership of some coastal property, even though the lands may have been in private hands before the enactment of a law declaring such areas sovereign territory. Legislation passed in December 2002 but pending implementation as of

August 2003 expands the autonomy of the Atlantic regional governments. The effect of the legislation on foreign investment has yet to be determined, though the Southern Atlantic Autonomous Regional government has cited it in an attempt to block or benefit from offshore oil exploration concessions that the central government plans to grant to U.S. companies.⁴⁹

E. SOCIAL DYNAMICS

Various individuals and groups within Nicaragua seek to address the challenges associated with dispute resolution in the country. Some steps have been taken, such as the passage of the Judicial Career Law, but more is needed. Many of these challenges will be difficult to overcome, however, as the judiciary has been described as a playing piece in a larger struggle between political parties in the country.

F. RECOMMENDATIONS

- ◆ Steps must be taken to depoliticize the judiciary. Although the political situation makes this an extremely difficult proposition, without such reforms international businesses will have further disincentive to operate in Nicaragua, and domestic businesses will continue to operate informally, which will hamper growth in the country. An important step in this process is to improve judicial selection will be the full implementation of the recently passed judicial career law and a willingness to review and reform this law should it not prove effective.
- ◆ The Legislative Assembly should adopt the pending bill, which will reform arbitration and mediation by putting those procedures under the direction of private parties and organizations.
- ◆ Before and after adoption of such a bill, business and other private organizations should educate members of the business sector on the advantages of arbitration and mediation, especially in the context of Nicaragua's dysfunctional judiciary.
- ◆ Legal education must be improved for judges at all levels and lawyers.

⁴⁹ U.S. Embassy, Ch. 7, "Nicaragua Investment Climate Statement," <http://usembassy.state.gov/managua/wwwhe14.html>

VIII. BANKRUPTCY

A. INTRODUCTION

Insolvency systems are an important element of financial stability. An effective insolvency system facilitates the rehabilitation of enterprises and provides an efficient mechanism for liquidating those enterprises that cannot be rehabilitated. Increasingly, the reform of the legal framework for insolvency has become an important component of international donors' economic programs in many countries because of the impact such reform can have on that country's economic and financial system.

In the absence of adequate insolvency laws, individual creditors may compete to be the first to seize collateral or to obtain a judgment against a failing debtor. It is in the collective interest of creditors that the reorganization or liquidation of a debtor be carried out in an orderly manner.⁵⁰ In April 2001, the World Bank issued a report, "Principles and Guidelines for Effective Insolvency and Creditor Rights Systems."⁵¹ Even though the insolvency principles focus primarily on corporate insolvency, some of the concepts identified are also helpful when developing principles and rules for the insolvency of non-corporate and "mixed" capital debtors such as banks and decentralized entities.

The World Bank report establishes that a modern economy requires predictable, transparent, and affordable enforcement of both secured and unsecured credit claims by efficient mechanisms within and outside the insolvency system. These systems must be designed to work in harmony.⁵² The World Bank report includes an in-depth analysis of a number of principles, some of which are summarized here. In general terms, an effective insolvency system should (a) be integrated with the country's broader legal and commercial systems (insolvency reform is often ineffective without parallel reform of other commercial laws);⁵³ (b) maximize the value of the company's assets by enabling it to reorganize; (c) strike a careful balance between liquidation and reorganization; (d) provide for equitable treatment of similarly situated creditors, including both foreign and domestic creditors; (e) provide for timely, efficient, and impartial resolution of insolvency proceedings; (f) prevent the premature dismemberment of the debtor's assets by individual creditors; (g) provide a transparent procedure that contains incentives for gathering and dispensing information; (h) recognize existing creditor rights and respect the priority of claims with a predictable and established process; and (i) establish a framework for cross-border insolvencies, including the recognition of foreign proceedings and judgments, as well as cooperation and assistance among courts in different jurisdictions.⁵⁴

⁵⁰ See further, Group of 22: Report of the Working Group on International Financial Crises, October 1998, at 15 (the "G-22 Report"). Available at <http://www.imf.org/external/np/g22/ifcrep.pdf>.

⁵¹ The World Bank: Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, April 2001 (the "World Bank Report"), available at <http://www.worldbank.org/gild>.

⁵² *Id.*, at 3.

⁵³ G-22 Report, *supra* note 50, at 15. In this regard, international donors have also long been aware of the need to modernize the country's overall commercial legal framework. The USAID mission in Managua reported on a proposal for a uniform commercial code for all Central American countries, which would be based on best practices and experiences gained from other countries in the Americas, including Chile and El Salvador.

⁵⁴ World Bank Report, *supra* note 52, at 4, and G-22 Report, *supra* note 51, at 16 and 44 (Annex A). To the extent that there is a lack of communication and coordination among courts and administrators from concerned

The legal framework for bankruptcy in Nicaragua does not comply with any of these principles. The country's commercial system, in particular as it pertains to the regulation of collateral and real estate, does not provide a system that facilitates efficient, transparent, and reliable methods for recovering debt, including seizure and sale of immovable and movable assets. An efficient system for enforcing debt claims is crucial to a functioning credit system, for both secured and unsecured credit. A creditor's ability to take possession of a debtor's property and to sell it to satisfy the debt is far more effective than the threat of an insolvency proceeding. Non-judicial enforcement does not currently exist in Nicaragua, and judicial enforcement procedures lack legal certainty and predictability.

Nicaragua's rules on bankruptcy focus on the liquidation of business entities rather than on their reorganization. They do not provide for an equitable treatment of creditors, to the detriment of creditors located in a foreign jurisdiction. In effect, there is no framework for cross-border insolvencies. Because of serious shortcomings in the country's judicial system,⁵⁵ the notion of efficient and impartial resolution of bankruptcy procedures effectively does not exist. This, in turn, fosters a lack of transparency and the absence of formal bankruptcy procedures. As a matter of practice, there are hardly any (if any) bankruptcy cases in Nicaragua. Legal practitioners interviewed remembered a few cases within the last two to three decades, and maybe only one or two procedures that were actually completed. Typically, companies simply choose to close their operations and set up a new entity without going through a formal bankruptcy procedure, effectively leaving their creditors completely unprotected. In contrast, there were a few bank liquidations in the 1990s, and in the beginning of this decade that culminated in the salvage or absorption of failing banks by healthy banks, with the Nicaraguan government covering the deficiencies.⁵⁶

B. LEGAL FRAMEWORK

1. Bankruptcy Legislation

Current Nicaraguan legislation governing insolvency and bankruptcy is generally found in the Civil Code (*Código Civil de la República de Nicaragua*), the Code of Civil Procedure (*Código de Procedimiento Civil de la República de Nicaragua*), and the Commercial Code (*Código de Comercio*). The liquidation of financial entities is regulated under the General Law of Banks, Non-Banking Financial Institutions and Financial Groups (*Ley General de Bancos, Instituciones Financieras no Bancarias y Grupos Financieros*, 1999).

Under Nicaraguan bankruptcy rules, a creditor wishing to initiate bankruptcy proceedings against a debtor must file a claim before a civil court (there are no specialized bankruptcy courts, or even

jurisdictions, it becomes increasingly likely that assets will be concealed or disposed of disregarding the interests of all affected creditors. The G-22 Report also encourages the widespread use of the UNCITRAL Model Law on Cross-Border Insolvency or similar mechanisms to facilitate the efficient resolution of cross-border insolvencies

⁵⁵ See Collateral Report.

⁵⁶ In April 2002, a couple of months into the Bolaños administration, the President stated that the internal debt amounted to approximately \$1.6 billion. Of that amount, \$750 million accounted for the payment of real property indemnity bonds (*see* Real Property Law Report) and approximately \$347 million originated from "bank rescues" following a number of bank failures in the 1990s and the beginning of this decade. Source: <http://www.laprensa.com.ni/> - 02/05/2003.

commercial courts). The claim has to evidence the debtor's insolvency, including, for example, an order of attachment of assets that has not been complied with because of insufficient assets (Commercial Code, Article 1065). A debtor who has ceased to make payments may also appear before a court and voluntarily request a declaration of bankruptcy; if the debtor fails to appear voluntarily, the bankruptcy may be declared to be of a negligent nature, which may make the debtor liable to criminal sanctions (Commercial Code, Articles 1067, 1089, and 1096).⁵⁷ To appear before the court, the debtor must also be a merchant, duly registered before the Commercial Registry.⁵⁸

The issuance of a bankruptcy decree by a court has adverse effects on the debtor, who is effectively removed from the administration and management of his or her assets.⁵⁹ Nicaragua does not provide for reorganization procedures such as those found in Chapter 11 of the U.S. Bankruptcy Code. Like other countries in the region, Nicaragua treats bankruptcy as a foreclosure/collection action brought against a debtor, without incorporating a preventive or reorganization element into the process. Theoretically corporate reorganization is possible under Nicaraguan law (through the procedure of the *suspensión de pagos*), but in practice this mechanism has not been used.⁶⁰ Legal practitioners interviewed noted that this stemmed from a combination of a lack of knowledge of the availability of these methods and the cumbersome nature of the procedures. In contrast, an effective reorganization procedure should afford debtors a chance to save a business in temporary trouble, while protecting creditors by means of adequate judicial supervision of the debtor's activities—thus promoting a more certain and predictable business and investment environment.

From a practical standpoint, neither insolvency nor bankruptcy procedures have been extensively used in Nicaragua. This report does not go into much detail regarding the specific rules governing bankruptcy procedures (those have already been addressed in the country report submitted by the Nicaraguan experts). This report focuses on some distinctive or noteworthy aspects of the Nicaraguan legal framework and practices as they pertain to bankruptcy.

Insolvency and bankruptcy proceedings encompass all claims pending against the debtor and stay all foreclosure/collection efforts against such debtor, except for those proceedings involving mortgage debts and secured interests, which may proceed separately.⁶¹ This exception intends to protect the rights of secured creditors. However, labor creditors may be paid prior to certain categories of secured and other creditors—this solution stems from social policy considerations in Nicaragua and other countries (e.g., Mexico) that have strong policies in favor of protecting employment. This policy may considerably undermine a creditor's (including local companies and foreign investors) ability to enforce a security interest. This is one area in which it is

⁵⁷ A bankruptcy may be declared to be fortuitous, negligent, or fraudulent (Commercial Code, Art. 1087 *et seq.*). This classification establishes the potential criminal responsibility of those involved in the bankruptcy, and it also determines the way in which the court will handle the relevant case.

⁵⁸ Clearly, this requirement leaves out a significant number of micro and small businesses that operate in the informal market. If the legal framework on bankruptcy made it easier for companies to reorganize and continue their business operations, this in turn could act as an incentive for companies to regularize their legal status. It is essential that reforms to the bankruptcy legal framework be conducted in conjunction with increased efforts to further facilitate procedures for the creation and registration of companies (*see further*, Company Law Report).

⁵⁹ Commercial Code, Art. 1071.

⁶⁰ Commercial Code, Suspension of Payments, Art. 1047 *et seq.*

⁶¹ Commercial Code, Art. 1077; Civil Code, Art. 2297.

important to coordinate rules pertaining to bankruptcy and rules applying to collateral. Indeed, the effectiveness of a security interest should be predictable at the time it is created; the validity and priority of such an interest should not be subject to, or undermined by, bankruptcy laws. A company, for example, may grant a security interest to a creditor for purposes of financing the purchase of machinery; however, in the event of bankruptcy, such security interest will be subordinate to labor credits that may not have existed when the security interest was created.⁶²

Nicaraguan debtors resort to alternative mechanisms rather than declare themselves (or risk being declared) bankrupt. In some instances, they attempt to reach an agreement with their creditors, and assets are surrendered by way of payment (*dación en pago*). There are honest businesspersons who are genuinely interested in repaying their creditors and continuing their business. However, they would rather not endure the stigma that is associated with a declaration of bankruptcy. A businessman interviewed as part of this assessment related some of his experiences and emphasized that, because he is well known in the community, he would not have wanted to be labeled “bankrupt.” Instead, he closed his business and repaid all his debts over several years. To this day, he continues to be a well-known entrepreneur, and he believes that, by avoiding the bankruptcy process, he “saved” his reputation.

The stigma related to bankruptcy is such that, recently, some lawyers have started using the threat of bankruptcy as a mechanism to force debtors to pay. When a debtor does not have (or claims not to have) sufficient assets, he or she is asked to appear in court and state that fact under oath. Because this is, in fact, an acknowledgement of insolvency, lawyers then threaten to file a claim to obtain a declaration of bankruptcy against such debtor. Rather than be faced with a bankruptcy process, debtors many times end up admitting they do have assets and paying their debts.

Because formal bankruptcy procedures are not used, there is a significant risk that in many instances one or more creditors might be left out, to the benefit of others (the ones who have sufficient power to negotiate or to file claims such as those described in the preceding paragraph). Furthermore, it is not uncommon to hear about a business that closes and disappears, maybe to reopen its doors a few days later under a new name. Legal doctrines such a “piercing the corporate veil,” which may protect creditors against such practices, are not used in Nicaragua. Similarly, actions tending to challenge illegal or fraudulent transactions (*acciones paulianas*) exist only in the text of the law but have not been effectively used as a mechanism to

⁶² The provisions governing the classification and ranking of debts can be found under Arts. 1113 *et seq.* of the Commercial Code. *See also* The Americas Restructuring and Insolvency Guide 2004/2005—Nicaragua, at 239. Under these sections, labor creditors have preference over secured creditors whose collateral comprises movable property; a different solution applies in the case of real estate, where secured creditors would, in fact, have priority over labor credits (Art. 1114). Even though a legal practitioner interviewed interprets that these rules have been superseded by the 1937 Law on Agrarian and Industrial Pledges, which grants a special privilege to secured creditors governed by such law, neither the relevant legal provisions nor doctrinal opinions have specifically clarified this issue. Given the uncertainty and unpredictability that permeate the judicial system in Nicaragua, as well as the fact that only certain limited categories of collateral are governed by the Law on Agrarian and Industrial Pledges (*see* Collateral Report), it is not unreasonable to assume that the rights of many secured creditors—and particularly, the priority of such rights when facing a bankruptcy procedure—continue to be unclear, at best. This further emphasizes the need for coordination between the collateral (secured transactions) and bankruptcy legal frameworks.

prevent these transactions. These practices do not promote a healthy and reliable investment climate.

As in other Central American countries (e.g., Costa Rica and El Salvador), there is a discrimination against creditors located abroad under Nicaraguan law in a bankruptcy proceeding. Article 2334 of the Civil Code provides that creditors residing in Nicaragua can foreclose on or repossess assets of a debtor subject to a foreign bankruptcy procedure. If there are any assets left after local creditors have been satisfied, those shall be allocated to the foreign bankruptcy or insolvency proceeding. These provisions contradict the international standard whereby equitable treatment must be afforded to similarly situated foreign or domestic creditors. In an increasingly globalized investment environment, effective insolvency systems need to maintain the confidence of both domestic and foreign investors, which is not the case under the referenced legal provisions.

2. Financial Entities

As is customary throughout the financial world, financial entities such as banks are subject under Nicaraguan law to their own bankruptcy provisions. The liquidation of financial entities is currently governed by the General Law of Banks, Non-Banking Financial Institutions and Financial Groups (*Ley General de Bancos, Instituciones Financieras no Bancarias y Grupos Financieros*, No. 314, October 1999).

Chapter VII of Law 314 regulates matters pertaining to the oversight, stabilization plans, intervention, and liquidation of financial institutions. It authorizes the Superintendency of Banks to conduct the supervision of banks, to adopt preventive measures, and to impose sanctions in the case of irregularities.⁶³ Preventive measures include the bank's obligation to submit a stabilization plan (*plan de normalización*) when required by the Superintendency. If the plan is approved, the Superintendent may subsequently modify it or cease its application when it is no longer required.⁶⁴ If the bank does not comply with the stabilization plan and applicable laws, fails to meet certain minimum capital requirements, or becomes a risk to depositors and creditors, then the Superintendency may decree its intervention.⁶⁵ The intervenor(s) appointed may or may not be Superintendency employees.⁶⁶ The intervenor(s) assume the administration of the entity and, as such, are entitled to conduct "all businesses of the bank, to the exclusion of the relevant authorities or bank directors." The Superintendency may also choose not to designate any intervenors, in which case it will be directly responsible for the bank's administration.⁶⁷

The Superintendency will decree the liquidation of the failing bank in the case of manifest insolvency, clear inability to reinstate normal activities, or evidence that the bank may not be recovered by virtue of its acquisition or merger with another bank, among other considerations.⁶⁸ This declaration needs to be followed by a judicial declaration of the liquidation and by the

⁶³ General Law of Banks, Non-Banking Financial Institutions and Financial Groups, Art. 80 *et seq.*

⁶⁴ *Id.*, Art. 83.

⁶⁵ *Id.*, Art. 84.

⁶⁶ *Id.*, Art. 85.

⁶⁷ *Id.*, Art. 86.

⁶⁸ *Id.*, Art. 88.

appointment of a liquidator or a board of liquidators, who will also be subject to the supervision of the Superintendency.^{69]}

There is no legal or doctrinal reference to the rights of creditors derived from letters of credit. However, legal practitioners note that letters of credit are widely used—indeed, letters of credit are commonly used in international trade to facilitate the buying and selling of commercial goods. As a matter of fact, an effective trading environment demands that obligations relying on letters of credit be expediently satisfied. In the case of insolvent banks in Nicaragua all of them were absorbed ultimately by other banks, and obligations were paid. Interviewees specified that this included letters of credit. A different situation may have arisen had those banks not been absorbed, but this is speculation. In this regard, it should be noted that the General Law of Banks does specify certain debts that need to be paid first, which include debts to employees, deposits, debts to the Nicaraguan Central Bank, and taxes (Articles 100 and 101).⁷⁰

Interviewees in the banking industry remarked that, as a matter of fact, the financial system had disappeared in Nicaragua during the revolution, and it only reappeared in 1991. The Superintendency was also created at that time as the entity in charge of supervising financial institutions. To attract investment, initially capital requirements to set up a bank were relatively low. Allegedly, supervision mechanisms during the early 1990s were not as strict as they should have been, and several banks were involved in fraudulent activities. This process culminated with the intervention and liquidation of several banks in the late 1990s and in the years 2000 and 2001.

One bank affected by these failures was the *Banco Europeo Centro Americano* (BECA). The case of BECA has recently resurfaced and, together with the Parmalat case,⁷¹ has become one of the most controversial judicial decisions of 2004. BECA went bankrupt in 1996 based on allegations of fraudulent disbursements of funds and inadequate management of the credit portfolio. Following an audit, the Superintendency of Banks recommended that the bank be liquidated. BECA was sold for \$25 million to the *Banco de Crédito Centroamericano* (Bancentro), and as in similar cases involving bank liquidations, the debts were absorbed by the Nicaraguan government.⁷²

⁶⁹ *Id.*, Art. 89 *et seq.*

⁷⁰ Even though legal provisions do not make specific reference to letters of credit, the Civil Code provides for a right of vindication (*reivindicación*) with respect to certain commercial documents (including bills of exchange, promissory notes, and other endorsable documents sent to the bankrupt entity so as to be invested on certain payments (Art. 2339); in turn, the Commercial Code provides a right to vindicate any goods where title has not been legally and irrevocably transferred to the bankrupt entity (Art. 1109).

⁷¹ *See* Collateral Report.

⁷² In chronological order, the banks affected by failures have been Banco Nacional de Desarrollo (Banades), Banco Europeo Centroamericano (Beca), Banco del Sur (Banco Sur), Banco de Crédito Popular (BCP), Banco Intercontinental (Interbank), Banco del Café (Bancafé), Banco Mercantil (Bamer), and Banco Nicaragüense de Industria y Comercio (Banic). The deposits of both BECA and Banco del Sur were absorbed by Bancentro. Banades and BCP deposits were backed 100 percent by the Nicaraguan government. All these banks ceased operating in the mid to late 1990s. The years 2000 and 2001 marked the bankruptcies of Interbank, Bancafé, Bamer, and Banic. The most complex situation was the one affecting Interbank, which at the time was the largest bank in the system. The government authorized a line of credit to support Interbank's liquidity needs and announced that it would guarantee all deposits. The Central Bank then proceeded to call on other banks to submit bids to purchase Interbank and offered government bonds to cover the gap between assets and liabilities.

Eight years later, in July 2004, the Supreme Court of Justice reopened the BECA case,⁷³ lifted the declaration of bankruptcy, and declared void all actions taken by the Superintendency of Banks following the date of the intervention, alleging that the procedures had not taken into account due process considerations with respect to the bank's owner, Mr. Alvaro Robelo. The Supreme Court decision generated heated reactions. According to some legal practitioners, the issues to analyze were whether the bankruptcy could be appealed and whether Robelo had in fact had a chance to submit his defense. Instead, the Supreme Court looked at the substance and lifted the bankruptcy declaration without specifying whether the bank was insolvent or whether it had any assets. That issue remains to be established. Although some economists and the Superintendency of Banks maintain that the bank was clearly bankrupt because its liabilities exceeded its assets, Mr. Robelo insists that the bank had the best customer base in the country, which was ultimately "stolen" from him.⁷⁴ Unfortunately, the question often comes down to a political debate that features the judiciary in a leading role.

At present, there is a proposal to reform the General Law of Banks, Non-Banking Financial Institutions and Financial Groups. Reforms will address the role of intervenors and the administration of the liquidation process. Under the proposed law, the Superintendency will play a less significant role; it will continue to oversee stabilization plans, and it will also decree the intervention of the relevant financial entity. Subsequent to that, the supervision and management of the entity will be conducted by the Deposits Guarantee Fund (*Fondo de Garantías de Depósitos* or FOGADE). However, an exchange of information will continue between the Superintendency and FOGADE.⁷⁵

The draft proposal has been submitted to the consideration of the Association of Banks. It is anticipated that the consultation process at the Association will be completed by the end of 2004, and at that time the draft will be sent to the executive government. Some bankers consider that, given current political instability, this may not be the appropriate moment to consider a proposal of this nature. From a substantive standpoint, others disagree with the new role that would be entrusted to FOGADE, as they believe that FOGADE may not have the technical capability to conduct these activities.

Many interviewees criticized the government approach vis-à-vis the banks that were liquidated in the 1990s and in the beginning of this decade, and particularly that the Nicaraguan government

Similar auction procedures and issuances of government bonds also took place in the case of the other insolvent banks. As a result, Banpro acquired Interbank and Banic, Bancentro acquired Bamer, and BDF acquired Bancafé. Following these consolidations, the total number of banks in the country was reduced from 14 to 6—the ones that currently continue to operate. *See further*, Banco Central de Nicaragua—Financial Bulletin No. 8, 2003, at <http://www.bcn.gob.ni/publicaciones/boletin/financiero/BFmar03.pdf>.

⁷³ There is no statute of limitations for the Supreme Court to reopen a case.

⁷⁴ *See* Confidencial—Weekly newspaper (August 8 – August 14, 2000), at <http://www.confidencial.com.ni/2004-400/economia1-400.htm>. *See also*, *Corte Regresa Al Beca* (Court Returns BECA), at <http://www-ni.laprensa.com.ni/archivo/2004/julio/21/>.

⁷⁵ Allegedly, the draft law also includes a proposal to render the Superintendent immune from prosecution. As a result of the series of bankruptcies in the 1990s, 2000, and 2001, several accusations were made against the acting superintendent, Mr. Noel Sacasa (mostly by some of the bankers affected by the interventions and politicians who were associated with these bankers). The accusations and threats of criminal prosecution became so severe that eventually the superintendent had to leave the country, and a new superintendent was appointed.

covered those deficiencies through the issuance of government bonds, a practice that significantly increased the country's internal debt. Experts interviewed consider this to be bad macroeconomic management and an undue exposure. The government, however, alleges that this was the only way to guarantee financial stability and avoid increased losses of deposits and investors. A banker interviewed emphasized that the system is now "cleaned up," and he believes that the six remaining banks, together with existing insurance companies, financial entities, and bonded warehouses (*almacenes generales de depósitos*), make up a strong and solid financial system, particularly when compared to other Central American countries. Not all interviewees share this view with respect to all existing financial institutions, but most agree that overall the financial system is considerably stable.

C. IMPLEMENTING INSTITUTIONS

1. Courts

Ordinary courts dealing with civil matters have the primary responsibility for implementing the bankruptcy legislation for non-financial entities and individuals and for declaring the judicial liquidation of financial entities. There are no specialized bankruptcy courts in Nicaragua, likely as a result of the lack of demand for such courts. In fact, there are also no specialized commercial courts—a serious shortcoming if the country wishes to modernize and further integrate its commercial legal system. However, as noted elsewhere in this report, modernization of the underlying legal framework and creation of specialized courts will not be effective unless preceded by judicial sector reform.

Most of those interviewed noted that before the Parmalat and BECA decisions became public, the public's general perception was that "things were getting better" in the judiciary. That perception has been shattered. Clearly, the courts are not contributing to the certainty and stability of the system. In the case of the financial system, and by reopening old cases, they are hampering the credibility and authority of the Superintendency of Banks.

2. Administrative Entities

The Superintendency of Banks is the entity in charge of the supervision and control of banks, credit institutions, financial institutions, insurance companies, and other institutions designated by law. The Superintendency also supervises operations at the stock exchange.⁷⁶ All processes pertaining to the formulation and implementation of a stabilization plan must be carried before the Superintendency. In addition, the Superintendency has the functions described previously under B. Legal Framework, 2. Financial Entities.

In general, interviewees consider that the Superintendency has played an adequate role in the system, although in some cases it may have been guilty of omissions or of not deciding on the intervention of a bank in an expeditious manner. Some legal practitioners interviewed consider that, initially, the Superintendency lacked sufficient power, and some banks benefited from an extended "grace" period before an intervention was decreed. Some interviewees noted cases in

⁷⁶ The Superintendency comprises four units that cover the following areas: (a) banks and other financial institutions, (b) securities, (c) insurance, and (d) deposit warehouses (Law of the Superintendency of Banks and Other Financial Institutions (No. 316 / October 1999).

which the liquidation of banks had not been conducted in an entirely transparent fashion, although such cases seem to be an exception rather than the rule.

Overall, banks are satisfied with the role of the Superintendency and acknowledge good dialogue with the relevant officials (particularly through the Association of Banks), although there is still room for improvement.

D. SUPPORTING INSTITUTIONS

Trustees (*síndicos*) are not specifically regulated under Nicaraguan rules. Instead, the role that is typically assigned to trustees is exercised in Nicaragua by receivers (*procuradores*).

1. Receivers

The receiver is the most important participant in the bankruptcy scheme under Nicaraguan legislation. The judge appoints a provisional receiver in the order that declares the bankruptcy. The provisional receiver is responsible for drawing up an inventory of the debtor's assets and a list of creditors, as well as for requiring the appraisal of the assets. The receiver must be confirmed in his or her position by the Creditors Committee.⁷⁷ There are no detailed provisions regarding the qualifications and activities of receivers. The requirements listed by Article 2275 of the Civil Code include that the receiver must be an attorney or, in those areas of the country where there are no attorneys, a notary public, or other persons "educated in the law" may be appointed as receivers.

All assets will be managed by the receiver. He or she is functionally independent but requires the consent by the Creditors Committee in cases involving sales of real estate, settlement of judicial actions, acceptance of third-party claims over the bankruptcy assets, and submission of claims to void contracts or transactions entered into by the bankrupt party (Civil Code, Article 2290). The receiver represents the creditors both in court and out of court (Civil Code, Article 2279).

The absence of actual bankruptcy cases precludes a detailed analysis of the receiver's role and its practical relevance.

2. Intervenors and Liquidators

Under the General Law of Banks, the intervenor(s) appointed may or may not be Superintendency employees. The Superintendency may also choose not to designate any intervenors, in which case it will be directly responsible for the bank's administration. If a liquidation is decreed, then the Superintendency will appoint a liquidator or a board of liquidators; both intervenors and liquidators are subject to the supervision of the Superintendency.

The board of liquidators may not comprise more than three members, and at least one of these must be a lawyer with 10 or more years of professional experience.

⁷⁷ Civil Code, Art. 2274.

Recent complaints pertaining to bank failures in the 1990s and early 2000s have focused on procedural considerations—most significantly, compliance with due process requirements—rather than on the role or effectiveness of intervenors and liquidators. Overall, those interviewed were satisfied with the role played by these supporting institutions. However, some noted that if, under the proposed new General Law of Banks, some of these functions are reassigned to FOGADE, that entity may not have the technical capability to assume such role.

3. Additional Institutions

There are no bailiffs or other private or public entities or officials in Nicaragua (other than courts) to carry out enforcement proceedings. Professional and commercial associations have played no role in legal reform proposals in the commercial sector, although many interviewees feel that the current legal framework for bankruptcy needs to be revised.

E. SOCIAL DYNAMICS

As a practical matter, Nicaragua has no insolvency procedures. According to the interviewees, there are many reasons why Nicaraguans do not resort to bankruptcy procedures. Lack of awareness plays a significant role; many individuals and small entrepreneurs may not know that such procedures exist. Those who do know may fear the label of “bankruptcy” as a social stigma. Therefore, debtors would rather agree to other types of arrangements than face the threat of bankruptcy.

There is no widespread perception in Nicaragua that bankruptcy or reorganization procedures could be used as a device to rescue a company. Moreover, the prospect of facing a lengthy and uncertain judicial process constitutes an additional deterrent. Often companies just close their operations, to the detriment of creditors and *bona fide* purchasers. Creditors also may choose to avoid a judicial procedure fraught with uncertainty and try to collect as much as they can directly from the debtor, or they may simply give up on claims they may have.

As a result, no bankruptcy tradition or culture exists in Nicaragua, and the imperative for reform is much weaker in this area than in other areas of commercial law. Nonetheless, some legal practitioners interviewed as part of this assessment noted the need to amend existing bankruptcy laws and to enact a modern law following international standards.

With respect to bank liquidation procedures, there is a fluent dialogue between public officials and the Association of Banks (which includes representatives from all six banks plus PROCREDIT, the largest microfinance company in the country). For example, the board of directors of the Association of Banks (including representatives from all member entities) meets once a month, and recently committee meetings have convened on a weekly basis to analyze the draft text of the new General Banking Law.

F. RECOMMENDATIONS

- ◆ Nicaragua has no functioning insolvency laws. Therefore, the country lacks an essential component that, if effectively designed and implemented, can enhance confidence in the economy. Nicaragua should consider modernizing its bankruptcy law and harmonizing it with that of its trading partners in the region and beyond. In doing so, it should take into

consideration the World Bank's principles and guidelines for effective insolvency regulation and the concepts contained in UNCITRAL's Draft Legislative Guide on Insolvency Law and other regional and international models. Again it is necessary to emphasize that the country will not benefit from a modern legal framework unless it also undertakes a comprehensive judicial overhaul.

- ◆ Bankruptcy provisions need to be consistent and integrated with the country's broader legal commercial framework. Insolvency reform is often ineffective unless accompanied by parallel reform in other areas of the law; in particular, insolvency and bankruptcy principles need to be consistent with a model uniform regional secured transactions law (see chapter VI. Collateral).
- ◆ For the system to be effective, judges and supporting institutions (e.g., receivers) should receive support and training on the meaning and consequence of sound and effective asset management, as well as greater powers to detect and reverse fraudulent activities. Additional training (seminars, discussions, or roundtables organized by chambers or sectoral associations) should be tailored to the needs of the private sector so that more companies and entrepreneurs are educated on the advantages of enterprise reorganization and rehabilitation to promote a more fluid and transparent business environment.

IX. COMPETITION LAW AND POLICY

A. INTRODUCTION

Recognizing the benefits of a competition law and policy, the government of Nicaragua has engaged in significant efforts to adopt a competition law.⁷⁸ Since initial efforts began 10 years ago, however, no competition law has been enacted, including the most recent effort in 2000. In 1999, however, the *Ministerio de Fomento, Industria y Comercio* (MIFIC) created the *Direccion General de Competencia y Transparencia de Mercado* (DGCTM), a technical advisory body within MIFIC.⁷⁹ For competition issues, the DGCTM has the power to carry out market analysis and undertake surveillance of markets. It lacks, however, the proper specifications on the types of conduct that are to be regarded as “anticompetitive” and the enforcement authority to stop anticompetitive practices. Since its formation in 1999, the DGCTM has built a reputation for fairness and efficiency within the public and private sectors. This year, the DGCTM prepared a new draft of the competition law. Prompted by preparations for CAFTA, as well as frequent public complaints about inappropriate inflation of consumer prices and artificial limitations on the demand for raw materials or intermediate goods (especially agricultural products) by large firms, the President of Nicaragua, Enrique Bolaños, promised to put the proposed law to the Legislative Assembly before the end of 2004. This section provides a brief assessment of competition law and policy in Nicaragua, identifying the degree of development and the status and need for competition policy reform.

B. LEGAL FRAMEWORK

No competition law exists in Nicaragua. Certain laws, however, have competition-related provisions. The Nicaraguan Constitution guarantees freedom of economy activity, and specifically freedom of enterprise.⁸⁰ Various competition-related clauses appear in the consumer protection law, as well as in certain sectoral regulations, including telecommunications and

⁷⁸ Competition law provides a regulatory framework to maintain and improve efficiency in markets, promote competitive pricing practices, and restrain price rises in markets where competition is affected by anticompetitive business practices (including horizontal and vertical restraints, e.g., collusive price fixing, input/output allocation, bid rigging; abuse of dominant position, e.g., exclusion, discrimination, predation; and certain mergers and acquisitions). Competition law by itself does not create competition, but when effectively applied, it can counteract the dangers of private anticompetitive behavior. For example, cartels may deliberately create artificial shortages, with the result that some consumers are able to obtain the product while other consumers pay an inflated, or monopoly, price. Dominant firms may abuse their market power through, for example, tying two products without a legitimate business purpose. Entry to new participants may be blocked by firms with market power that erect protectionist barriers.

In addition to private conduct, competition law can be used to counteract inefficient government regulation and promote efficiency within the public sector. Competition authorities can use the competition law to perform a comprehensive review of existing and proposed laws and regulations, providing suggestions and advice on government policies and measures that promote anticompetitive practices or inefficiencies. Activities often include the review of possible sources of public restraints on competition in trade policies (tariff and nontariff barriers, antidumping duties, and discriminatory export practices), investment policies (exclusionary lists, ownership restrictions, licensing requirements), and sectoral regulation (power, transportation, telecommunications, natural monopolies).

⁷⁹ See Article 22 of the Ley No. 290 sobre la Organizacion, Competencia y Procedimientos del Poder Ejecutivo.

⁸⁰ See Articles 99 and 104 of the Constitucion Politica de Nicaragua.

energy.⁸¹ Apart from the competition provisions in the telecommunications law, sector-specific provisions are used infrequently, if at all, and as written are insufficient to create and protect a market economy.

The most recent draft of the competition law, prepared in 2004 by the DGCTM, appears effective and is a significant improvement over earlier drafts as it incorporates international norms and practices. As a result, the draft law reveals some degree of priority for public sector objectives, although concerns of the private sector—such as how competition policy practices would affect business operations, how to minimize associated private sector costs and interference into business practices—are less well reflected. It might be advisable to invite private sector representatives to comment on the draft and provide input, possibly in the form of workshops or seminars. In addition, a limited number of provisions may benefit from careful consideration.⁸²

1. Agreements

Article 5 of the draft prohibits anticompetitive agreements between competitors, including price fixing, bid rigging, territorial allocation agreements, output restriction agreements, and agreements that create artificial market barriers. The legality of all these agreements is judged on a case by case basis according to the reasonability of the practice in question. Consideration may be given to adopting a different legal standard. In many countries, including in the United States, Mexico, and Panama, the law provides that the most egregious forms of anticompetitive agreements, including price fixing, bid rigging, and allocation of territories or customers are *per se* illegal.⁸³ Use of such a rule eliminates the necessity for the prosecutor or victim to prove that prices are higher than they would have been without the agreement or that prices are unreasonable, prevents the conspirators from arguing that competition should not be the rule in an industry, simplifies the judicial process and provides clear guidance for businesses. In addition, adoption of such a rule would also increase harmonization at a regional level.

Absent from Article 5 are provisions concerning noncartel agreements among competitors, including information exchanges, agreements restricting advertising, agreements to set standards, boycotts and joint refusals to deal, trade associations, and export cartels. This is not problematic and may bring benefits because it avoids overburdening a new agency with sophisticated issues.

⁸¹ TELCOR, the telecommunications regulator, is currently responsible for enforcing the competition provisions in the telecommunications law. Its representatives expressed concern about its ability to do so and are pushing for the adoption of a competition law, including a transfer of jurisdiction for competition-related issues to the competition authorities.

⁸² Although there is no one “right” model of competition law, in recent years agreement has emerged as to principles and scope. In the case of Nicaragua, the government may want to carefully consider promoting regional convergence, if not harmonization, in Central America. Trade and investment would benefit if all countries in the region strove to adopt consistent standards. For guidance, the government of Nicaragua could examine the competition law of Panama, which is similar to the Mexican competition law.

⁸³ In Panama and Mexico *per se* practices are called “absolute monopolistic practices,” as opposed to the other forms of agreements, referred to as “relative monopolistic practices.”) These types of agreements among competitors are intended solely to eliminate competition among companies; they have no redeeming social or economic benefit. “Absolute monopolistic practices” or “*per se* illegal” means that the prosecutor/plaintiff only has to prove that the agreement was made. It is no defense that the agreement was not carried out or that it did not have an anticompetitive effect. Nor does the prosecutor/plaintiff have to prove that the defendants had sufficient market share to raise prices or reduce output.

At a later stage of the agency's development, however, it may be advisable to add provisions that protect against abuses of these types of agreements.

2. Dominance

In keeping with the European civil law tradition of spelling out in detail what is prohibited, Article 6 lists a series of behaviors by a dominant firm or firms that are prohibited. This section is sound, although the legal standard applied to Article 6 may warrant reconsideration, as discussed more fully in the following section.

3. Standard of Review for Agreements and Dominance

Article 7 sets forth the standards of review for anticompetitive conduct. This article could benefit from further clarification and reconsideration. Section I applies to Article 5 (horizontal agreements), and as explained previously, consideration may be given to the adoption of a *per se* standard. Section I further provides an exemption for agreements that would otherwise be illegal under Article 5 if those agreements improve economic efficiency, improve innovation, or encourage productive investment. These types of exemptions are not considered appropriate for the type of agreements covered by Article 5, e.g., price fixing and bid rigging, and are usually reserved for non-cartel or vertical agreements.⁸⁴

Section II sets forth the legal standard for Article 6.⁸⁵ The complainant must show that there was no sound economic reasoning for the practices. For evidentiary purposes, consideration may be given to changing the legal standard to one similar to the standard offered in the Mexican law.⁸⁶ Also, the reference to "*mercado superior*" in II(a) is unclear.

⁸⁴ There are, certainly, some types of agreements that may be harmless, or indeed pro-competitive, and therefore should be outside the scope of the law (usually noncartel agreements or vertical agreements). Although this idea is not controversial, the procedure for applying it is. The competition authority originally chose to address the problem by providing an *ex ante* clearance procedure, involving notification in advance of all agreements sought to be exempted from the prohibition against illegal agreements. This process, which is conceptually similar to the standard in Article 7, did not work well in practice. The competition authority was overwhelmed by a flood of exemption applications. This resulted not only in delays in response time for applications, but consumed an excessive portion of the competition authority's resources in processing the requests. In the end, the competition authority issued a series of block exemptions that covered much of the conduct that had been subject to individual exemptions. Moreover, cartels and most other agreements that were truly problematic were rarely, if ever, notified. Ultimately, the competition authority ended its system of *ex ante* control and moved to an *ex post* system similar to that used in the United States. Under an *ex post* system, a firm may proceed with a business arrangement that it deems compliant with the law, and the competition authority is free to challenge those that it deems illegal. The uncertainty created on the margins can be alleviated through a voluntary advisory opinion procedure.

⁸⁵ In fact, this section refers to those parts of Article 5 not covered by Section I and Article 6. Section I, however, explicitly covers all existing provisions of Article 5, so the reference to Article 5 should be eliminated from Section II.

⁸⁶ See Articles 10-13 of Mexico's "Ley Federal de Competencia Económica," (e.g., "Artículo 10. Sujeto a que se comprueben los supuestos a que se refieren los artículos 11, 12 y 13 de esta ley, se consideran prácticas monopólicas relativas los actos, contratos, convenios o combinaciones cuyo objeto o efecto sea o pueda ser desplazar indebidamente a otros agentes del mercado, impedirles sustancialmente su acceso o establecer ventajas exclusivas en favor de una o varias personas,..." available at

It is unclear whether Section III is applicable to Section I or Section II or both sections. One could read this provision to say that market power is always required. In cases of price fixing, bid rigging, etc., market power is not usually required.

4. Mergers

No provisions exist for jurisdiction over mergers. Although merger *notification* is unnecessary, it may be advisable to empower *La Comision Nicaraguense de Defensa del Consumidor y de la Competencia* (CODECO) with authority to determine the legality of mergers.⁸⁷ In this draft law, Article 7 requires actual abuse of a dominant position, which would prevent the inclusion of prospective activities and therefore preclude CODECO from stopping a merger. This omission is likely the result of the sophisticated and costly nature of merger analysis, which has often been difficult for new agencies, and adding a provision should be considered with this in mind. However, widespread consolidation within the telecommunications sector in Nicaragua demonstrates that a limited provision may be advisable. For example, a provision could be added that allows CODECO to intervene, within a reasonable period (e.g., 60 days), when it believes it is necessary to do so. The provision should state clearly that in the absence of intervention by CODECO, it will be deemed approved.

5. Unfair Competition

Article 8 covers domestic unfair competition. Domestic unfair competition provisions in a competition law should be limited to matters related to maintaining a competitive environment. Prohibitions against deceptive advertising, for example, work with competition provisions to maintain a competitive environment. Some unfair practices, however, are matters of private, not public, concern and should be addressed in private lawsuits between competitors rather than through the competition authorities. It may be advisable to limit the unfair competition provisions to areas of public concern so that CODECO is not deluged by essentially private complaints, which would divert resources away from matters of more important public interest such as cartels and abuse of dominance.

6. Competition Advocacy

Competition advocacy is the ability of the competition agency to provide advice on, influence, and participate in government economic and regulatory policies to promote more competitive industry structure, firm behavior, and market performance. The provisions in Article 9 provide considerable powers for CODECO to engage in competition advocacy and are generally sound.

<http://www.cfc.gob.mx/Contenido.asp?P=DirResults.asp?txtDir=http://xeon2/cfc01/Documentos/cfc99e/Normatividad/Ley%20Federal%20de%20Competencia> (last visited September 30, 2004).

⁸⁷ In Latin America, agencies have a number of different systems of merger notification. Mandatory premerger notification, where transactions of a certain size are not allowed to be realized without agency approval, exists in Argentina, Colombia, Mexico, and Panama. Postmerger notification, where transactions of a certain size must notify the competition agency within a set period of time after consummating the transaction, exists in Brazil. In Chile, Costa Rica, and Venezuela, merger notification is voluntary. If parties believe that their transaction may create competitive concerns in these countries, they can notify the agency to request their approval of the transaction.

C. IMPLEMENTING INSTITUTIONS

The draft law proposes creating an independent agency, CODECO. The agency would be funded by a number of different sources, listed in Article 12. Among the resources, in Article 12a, the law provides that the agency will be funded by fees charged for handling cases (“*los derechos de tramitación de procedimientos, de ser el caso*”). This provision is susceptible to conflicts of interest, whereby the agency has incentives to engage in over-investigation or over-enforcement. It should be eliminated, or at least limited explicitly to matters such as advisory opinions or other matters where it will be shielded from conflicts of interest.

1. Agency Jurisdiction

The draft law entrusts jurisdiction for antitrust, consumer protection, domestic unfair trade practices, and intellectual property with one agency. This scope is considerably broader than most competition laws, and reducing the scope may result in more manageable enforcement. Although benefits are to be gained from the proposed scope, notably in flexible allocation of financial and human capital, experiences in Panama and Peru suggest that there can be disadvantages for competition enforcement and advocacy, which are particularly prone to marginalization.

One striking feature of Article 23 is that it appears to prevent any private right of action for competition, consumer protection, intellectual property, and unfair competition. Although such an approach may have benefits in harmonization of decision-making and policy, as well as in keeping technically difficult areas out of the courts, some areas of law are well suited to private litigation, and it is not necessary to maintain sole jurisdiction. A typical fraud case, for example, would be brought under the consumer protection law. In that type of case, concurrent jurisdiction would be preferable, because there may be insufficient widespread public interest to justify a large expenditure of government resources.

Furthermore, Article 23 may benefit from clarification. It is ambiguous; for example, what does “*controversias*” mean in Article 23(2)? Also, Articles 23(1), 23(2), and 23(4) could be combined in the same provision, or if there are differences that are not immediately made apparent, a clarification of the differences could be provided.

Finally, it is unclear why Article 24 only applies to Article 5.

2. Agency Structure

The draft law proposes a three-member commission, appointed by the Congress for staggered terms. Appeals are to the Supreme Court, whose judges are selected for 5 years by the Congress. These appointments will mean that the Congress has very strong influence over the competition authorities and competition decisions. Many different alternative systems of appointment might be considered. By way of comparison, in Panama the three members are appointed by the President and ratified by the Congress. Also, institutional design should incorporate Nicaraguan

experience with similar models where relevant, including Superintendency of Pensions and the Income Tax Court.⁸⁸

The requirements for qualifications to be appointed commissioner are stronger than they are in other Latin American countries, and consideration should be given to minimizing or eliminating the qualification requirements. For example, in Article 15, commissioners can only be economists or lawyers. Additional flexibility may be considered because there are a number of qualified professionals with backgrounds in engineering or business administration. Other requirements in this draft law include years of professional experience, citizenship, etc. These requirements may be unnecessarily onerous. Other countries in Latin America have much fewer requirements and qualifications. For example, in Mexico, the requirement is also that the members of the Commission be professionals experienced in matters addressed by the law. In Panama, commissioners are only required to have 5 years professional experience, with no specific qualifications regarding subject areas of university or professional qualifications. These types of more lenient requirements have worked well in practice.

3. Investigation

Information gathering, provided for in Article 15(f), is an essential investigatory tool for competition agencies. Experience makes clear the importance of creating, by statute, investigational powers that enable the agency to obtain information essential to identifying violations of the law. The law must permit the agency to compel the production of documents, to interview witnesses and conduct hearings, and to inspect corporate records. The law should also provide strong fines if firms refuse to comply with legitimate requests for information or destroy records to frustrate a pending investigation (see the comments that follow on penalties); small fines will be regarded as the cost of doing business. Consideration should be given, therefore, to redrafting these provisions to make the information-gathering provisions and corresponding sanctions more robust.

Also, although safeguards are needed to ensure that investigators do not make unreasonable requests for information, it is important that investigators receive the information needed in time to analyze it in making their reports. It would be difficult to conduct an effective report session if 200 boxes of necessary documents appeared for the first time at the open session. Consideration should be given to time limits for submission of information.

⁸⁸ There was also discussion of foregoing the independent agency, and instead empowering the DGCTM with jurisdiction over the competition law, with appeals to a specialized court. One difficulty with this proposal is that the original purpose of reforming the ministry in 1999 was to give it power over policy, and not law enforcement. Although DGCTM has the administrative power to register patents, trademarks, etc., the public prosecutor handles enforcement of the law. Incorporating case selection, investigation, and first-level decision-making in a Direccion within the ministry may be problematic for three reasons. First, incorporating all three in the same body may lead to conflicts of interest. Second, this provides the ministry with extensive discretionary power and makes the enforcement of the law extremely sensitive to changes in political regimes. Third, law enforcement is not a traditional function of ministries. The Argentine experience suggests that first-level decision-making should be clearly outside the ministry. If a ministerial model is proposed, Brazil may provide a useful model. In Brazil, the Ministry of Finance or Ministry of Justice can bring a case to an independent, administrative body (which is not part of either ministry or the judiciary) on behalf of the public. The decision whether to prosecute remains with the ministers, but the enforcement decision is handled by an independent body.

4. Penalties

The penalties for unlawful conduct should be clear, designed to correct the competitive injury caused by the offense, and sufficiently stringent to deter future violations. Yet the penalties should not be structured in a way that deters pro-competitive conduct. Articles 18 through 22, which address penalties, may benefit from revision. In particular, the maximum amount of fines should be increased. Fines are used to punish violations of the law, but also to deter violations of the law. Experience has shown that deterrence is one of the most important benefits of a competition law. The size of fines should reflect that amount necessary to deter firms from engaging in violation of the law. If a fine is too low, as is the case here, it will be considered the cost of doing business. For example, the fines for submitting false information can range from 50 to 200 times the minimum wage in the draft law. In Brazil, similar activity is punished by a *daily fine* of 5,000 UFIR (UFIR is an index – a fiscal reference unit used primarily in Brazil but elsewhere in Latin America – currently at 1 UFIR to US\$0.52) and can be increased up to 20 times, in keeping with the violator's economic status.

5. Creation of Agency and Enforcement of Law

Experience in other jurisdictions suggests that it may take time to appoint commissioners, create an agency, and make businesses aware of the law. Providing a time frame is important to avoid unnecessary delays, but 30 days and 60 days, respectively, may be too short. For example, in India, the enforcement of the law is phased in over 3 years.

D. SUPPORTING INSTITUTIONS

1. The Judiciary

The Supreme Court is an independent branch of government whose 16 members are selected for 5 years by the National Assembly from lists submitted by the President and by the parties in the legislature. The Court appoints judges to the lower courts. According to the Economist Intelligence Unit Country Profile, the selection of magistrates and judges has always been political, and judicial independence from executive and legislative pressure is slight. The report continues, “[t]here is no judicial career system based on merit, the training of judges is highly deficient, and public confidence in the fairness of judicial processes is extremely low.”⁸⁹ The weak performance of the Nicaraguan judiciary suggests that an independent competition authority or an independent administrative decision-making body should be entrusted with at least the first level of decision-making. If resources allow, a specialized independent appeals body would be advisable as well, similar to the South African model.⁹⁰

⁸⁹ Economist Intelligence Unit (2004), “Nicaragua: Country Profile 2004” at 10.

⁹⁰ The experience of TELCOR, the telecommunications regulator, is instructive. Its representatives indicated significant frustration in enforcing the competition provisions of the telecommunications law. Appeals to the Supreme Court are met with unreasonable delay, and in at least two instances, TELCOR’s decisions have been overturned by that court. No deferential standard exists for review of TELCOR’s decisions.

2. Consumer Organizations

The two principal consumer organizations, the *Liga de Defensa al Consumidor Nicaragüense* (LIDECONIC) and *La Red de Defensa del Consumer*, are active proponents of the introduction of a competition law. Their activities related to competition law focus on areas important to consumers, including pricing practices in public services and exclusive dealing contracts that limit consumer choice in basic foodstuffs. Although these efforts are noteworthy, these organizations could be utilized more extensively. For example, LIDECONIC publishes a biweekly article in the national newspapers, and perhaps these articles could be used as a source of outreach and education on competition law policy.

3. Industry, Business, and Professional Associations

Certain members of the business community, including chambers of commerce and industry and business associations, are among the foremost supporters of the adoption of a competition law. They view competition law as a necessary element of market reform and a key component of attracting investment. *Consejo Superior de la Empresa Privada* (COSEP), for example, is the principal private sector association in Nicaragua and has been actively involved in promoting the adoption of a competition law, and it fully supports the 2004 draft. Others, however, are neutral. A surprising number of individuals were unfamiliar with competition law, in general, and unaware that the government was considering adoption of a competition law.

4. Law Faculties

No courses in competition law are offered in the law schools in Nicaragua.

E. SOCIAL DYNAMICS

Openness to trade and foreign investment has been a cornerstone of economic policy in Nicaragua since 1990, and a number of sectors have been wholly or partially privatized (including telecommunications and energy). Despite these efforts, however, Nicaragua performs poorly on global competitiveness indicators. In the World Economic Forum's Growth Competitiveness Index Rankings, Nicaragua performed poorly: 90th out of 102. Nicaragua fares worse in the World Economic Forum's Business Competitive Index Rankings: 88th out of 95.⁹¹ By way of comparison, El Salvador is ranked 48 and 63, respectively. In the Heritage Foundation's Index of Economic Freedom for 2004, Nicaragua ranks 67th out of 155, considerably worse than El Salvador (24th) but much better than Honduras (121st).⁹² Overall, considerable efforts on the part of the Nicaraguan government are needed to improve the competitive environment so that Nicaragua can maximize the benefits of CAFTA and a market economy more generally.

⁹¹ The World Economic Forum's Competitiveness rankings are available at http://www.weforum.org/pdf/Gcr/GCR_2003_2004/Competitiveness_Rankings.pdf (last visited September 21, 2004).

⁹² The Index of Economic Freedom is available by country at <http://www.heritage.org/research/features/index/countries.html> (last visited September 14, 2004). It should be noted that on certain indicators, Nicaragua has made important improvements lately. For example, on a 5-point scale, Nicaragua's government intervention score is 1.5 points better in 2004 than in 2003.

In 1993, through the Protocol of Guatemala to the General Treaty on Central American Economic Integration, Nicaragua and its neighbors committed themselves to adopting a competition law. As noted previously, prior efforts have been unsuccessful. A number of recent developments, however, suggest that the current initiative may be more successful than its predecessors. First, MIFIC hired an international expert this year to revise the draft competition law, and the result is an excellent law that reflects both local conditions and international best practices. Second, the President of Nicaragua, Enrique Bolaños, publicly promised early in 2004 that the competition law would be presented to the Legislative Assembly before the end of the year. Third, World Bank conditionalities require a competition law to be passed in the coming year.

The pressures to adopt a competition law stem from the important market reforms undertaken over the past decade, including reduction of trade barriers, privatization of the telecommunications industry and most of the electricity sector, and tax reform. Reforms have benefited consumers much less than expected, stemming at least in part from inadequate protection of consumer welfare caused by a lack of a competition law, thereby creating pressure for the government to adopt one. To realize the full benefits of market reform, Nicaragua needs to provide a central ingredient of a market economy: enforcement of a competition law.⁹³

A recent World Bank study highlighted specific examples of anticompetitive practices that demonstrate the benefits that could be realized with adoption and enforcement of a competition law. The study examined whether the lack of competition affects the competitiveness of Nicaragua. To understand the type of market distortions and competition problems, the study examined four industries: beverages, dairy, fisheries, and freight transport. In all four industries there were concerns about both government policies that restrict firms' ability to compete on the markets and possible restrictive behavior on the part of the firms themselves. To summarize, the report found the following:⁹⁴

- ♦ **Beverages.** Increasing vertical integration in the alcoholic beverages segment with an upsurge in alleged restrictions on effective competition through creating barriers to entry of imported competing products; accusations regarding anticompetitive trade practices by the principal producers of carbonated beverages; high input costs due to cartelization of the sugar industry
- ♦ **Dairy.** Accusations of price fixing agreements between competing firms for liquid and powdered milk; barriers to international competition via high import tariffs and requests from producers for protection and additional support
- ♦ **Fisheries.** Regulation of the sector through licensing and quotas that decrease competitive pressure; vertical integration in processing activities, combined with possible coordination or even price fixing between competing firms

⁹³ As one observer noted, “[t]he fact that Nicaragua has succeeded in attracting relatively large FDI [foreign direct investment] flows, but that they have not significantly helped the country to become more competitive, indicates that Nicaragua has not yet been able to derive the maximum benefit from such investments.” Foreign Investment Advisory Services (May 2003), “Nicaragua: Competitiveness, Attraction of Foreign Direct Investment and Role of Competition Policy,” The World Bank, at 4.

⁹⁴ Foreign Investment Advisory Services (May 2003), “Nicaragua: Competitiveness, Attraction of Foreign Direct Investment and Role of Competition Policy,” The World Bank, at vii.

- ♦ **Freight transport.** Complaints of discriminatory behavior by other governments in the region; possible introduction of protectionist measures in the draft transport law

The principal recommendation emerging from these studies was adopting a competition law and enforcement agency. “A regulatory framework for competition is absolutely necessary....Nicaragua has no formal machinery for dealing with competition problems. This is a serious shortcoming, because it limits the possibility of devising initiatives designed to reform the rules under which the markets operate in Nicaragua....To sum up, it is essential for the Government to set in motion the adoption of a legal framework to promote competition.”⁹⁵

It is important that the political environment is generally supportive of a competition law. In the Nicaraguan context, it is possible that efforts to adopt a competition law will be met with resistance by the National Assembly, as some members are unfamiliar with competition law and others are unwilling to empower an agency to engage in activities that may limit the government’s ability to engage in rent seeking. Similarly, other members of government may be threatened by the proposed competition authorities’ interventions in government policy, notably through review of proposed legislation and regulation and through criticism of existing administrative entry barriers. This resistance would suggest that efforts should be redirected toward building political support for competition law and policy.

F. RECOMMENDATIONS

Competition law, together with several microeconomic, industrial, and commercial policies such as privatization, international trade, and foreign investment, are the main instruments for nurturing market reform. The application and interface between competition law and these related policies can have a significant bearing on industrial structure and the competitive market performance of enterprises in both the private and the public sectors, and on economic development in general. Competition law and international trade liberalization, for example, complement each other in promoting trade, market access, economic efficiency, and consumer welfare. Promoting the objectives of a liberal trade policy supports the objectives of competition law and vice versa. For example, trade liberalization and competition law together can prevent powerful business interests with monopoly power from creating barriers to trade. Similarly, competition law and privatization interact to ensure that a public monopoly is not merely transferred to a private monopoly. When a sector has been liberalized by way of introducing new competitors on the market, competition law and its enforcement can fill the primary role of maintaining competition as well as avoiding distortions caused by anticompetitive practices.

Nicaragua continues to engage in a variety of these market reforms without introducing and enforcing a competition law, and as a result, it has not been able to realize the full benefits of these reforms. Actual and alleged anticompetitive practices cause considerable consumer injury, suggesting that this strategy of market reform without a competition law merits reconsideration. Active proponents throughout Nicaraguan society, combined with an informed business community and select government representatives, suggest that the capacity for successful adoption and enforcement of a competition law exists and needs to be supported by education of the members of the Legislative Assembly.

⁹⁵ *Id.* at xiii and x.

1. Adopting a Competition Law

If the Competition Bill is being submitted to the Legislative Assembly after the municipal elections in November 2004, then the following activities should be considered *high priority* in the *next 3 months*:

- ◆ The substantive provisions of the July 2004 draft of the competition law are very sound and have strong regional symmetries. Consideration should be given, however, to the specific comments made in this section.
- ◆ Regarding the proposed agency structure in the July 2004 draft law, drafters should consider the Nicaraguan experience with similar administrative and judicial models, including the Superintendency of Pensions and Income Tax Court.
- ◆ The DGCTM has made important progress in building support for the current draft with influential groups such as the COSEP. However, as of the date of preparation of this report, certain members of the business community and consumer groups had not seen the current draft. The draft should be disseminated more widely for comments, including to important stakeholders such as the LIDECONIC, *Cámara de Industrias de Nicaragua* (CADIN), and CACONIC. Dissemination should be supported by adequate follow-up; and the DGCTM should engage in *affirmative outreach* with recipients of the draft (phone calls, meetings, etc.). The DGCTM may also wish to consider obtaining signatures from groups that have been consulted, for submission to the Legislative Assembly, as evidence that certain groups and sectors have been consulted.
- ◆ With a view toward regional convergence and harmonization, consider carefully the competition laws of Mexico and Panama, and consult with the drafting committees in El Salvador, Honduras, and Guatemala.
- ◆ Consult with sectoral regulators—Telecommunication Regulator (TELCOR), INAA, Nicaraguan Energy Institute (INE)—to clearly delineate responsibilities and ensure consistency among laws.
- ◆ Based on comments from key stakeholders and regional efforts, revise draft law as necessary.
- ◆ Prepare an advocacy brochure for the deputies who will vote on the bill, explaining in clear, basic language the principal purposes of a competition law in the Nicaraguan context, drawing on examples from previous studies (e.g., FIAS studies on dairy and fisheries, DGCTM studies on beer and potatoes).
- ◆ Disseminate and conduct intensive follow-up with the deputies.
- ◆ Invite members of the Legislative Assembly to attend an educational meeting about the proposed law.
- ◆ Donors and relevant government officials (outside the DGCTM, including, for example, *La Comisión Presidencial de Competitividad*) may want to consider meeting with Minister Aranas to discuss the role of a competition law in trade liberalization and integration.

If the Competition Bill has not been submitted to the Legislative Assembly after the municipal elections in November 2004, then the following activities should be considered *high priority* over the next 6 to 9 months:

- ◆ With a view toward regional convergence and harmonization, consider carefully the competition laws of Mexico and Panama and the specific comments made in this report, and consult with the drafting committees in El Salvador, Honduras, and Guatemala.
- ◆ Consider the Nicaraguan experience with similar administrative and judicial models, including Superintendency of Pensions and Income Tax Court.
- ◆ Consult with sectoral regulators (TELCOR, INAA, INE) to clearly delineate responsibilities and ensure consistency among laws.
- ◆ Disseminate draft widely for comments to important stakeholders. Dissemination should be supported by adequate follow-up; the DGCTM should engage in intensive, affirmative outreach. The DGCTM may also wish to consider obtaining signatures from groups that have been consulted, for submission to the Legislative Assembly, as evidence that certain groups and sectors have been consulted.
- ◆ Donors and relevant government officials may want to consider meeting with Minister Aranas to discuss the role of a competition law in trade liberalization and integration.
- ◆ Revise draft law as necessary.
- ◆ Considering the current USAID project on the arbitration law, and drawing on lessons learned from that experience, promote passage and implementation of a competition law through a twofold strategy: (a) Develop a series of seminars to promote private sector support, focusing on recent experiences, for example, in the telecommunications sector, regional initiatives, etc. (b) Develop a series of seminars to educate the Legislative Assembly about a competition law. The DGCTM may wish to prepare a short advocacy document, as explained previously.

2. Following Passage of the Competition Law

- ◆ Develop a policy strategy to make the law operational, including institutional arrangements (e.g., staffing and training).
- ◆ Develop regional training programs for staff (medium term) and with universities and bar associations (medium to long term).
- ◆ Continue advocacy initiatives, including reviews of government policies and regulations affecting competition, and prepare studies on key sectors (an ongoing effort).
- ◆ Develop an enforcement strategy that focuses on investigating anticompetitive conduct in sectors that are important to consumers and that address Nicaraguan market failures (medium term).
- ◆ Promote a competition culture through public communication including preparing communication and media materials, enhancing the capacity of media in the publication

of competition-related issues through dialogues and workshops with journalists, engaging in dialogues and workshops with related law enforcement officers, other government regulators, and the business and academic communities (an ongoing effort).

X. INTERNATIONAL TRADE

A. INTRODUCTION

Nicaragua is essentially an agricultural country with a small manufacturing base. Approximately 36 percent of the economically active population is devoted to agricultural activities and the use of natural resources; 20 percent to the industrial sector; 20 percent to commerce, communications, and the financial sector; and the remainder to providing government, communal, social, and personal services.⁹⁶ Since the early 1990s and following the end of the revolution and the Peace Accords, the country has taken steps toward establishing a market-based, outward-oriented economy, reversing import-substitution policies and addressing severe economic imbalances.⁹⁷ Export-oriented manufacturing has increased in recent years, particularly in the free trade zones. However, Nicaragua continues to be one of the poorest countries in the Western Hemisphere, particularly due to external—as well as internal—debt service commitments that are a heavy burden on its economy.⁹⁸ Despite several restructuring and forgiveness initiatives (including the Heavily Indebted Poor Country or HIPC initiative),⁹⁹ external debt remains high, while internal debt has significantly increased.¹⁰⁰

Despite progress on structural adjustment measures, the country continues to be highly dependent on donor assistance to balance its accounts. Therefore, it is understandable why, relatively speaking, relevant issues pertaining to facilitating international trade, such as Customs modernization, remain a low priority due to the lack of sufficient resources and in spite of the high level of interest shown by Nicaraguan authorities in this area.

Nicaragua became a contracting party to the General Agreement on Tariffs and Trade (GATT) on May 28, 1950. The country participated actively in the Uruguay Round and became a founding member of the World Trade Organization (WTO) on September 3, 1995.¹⁰¹

Nicaragua is a member of the Central American Common Market (CACM), which also comprises Costa Rica, Honduras, El Salvador, and Guatemala. The CACM member countries originally had plans to complete the Customs Union by the end of 2003.¹⁰² Most recently, December 31, 2004, has been the deadline set by the presidents of the region to implement the Customs Union; according to officials at MIFIC, Nicaragua is committed to meeting that

⁹⁶ Doing Business in Nicaragua—2003-2004, a publication of the American Chamber of Commerce of Nicaragua, on file with the authors.

⁹⁷ WTO Trade Policy Reviews: First Press Release, Secretariat and Government Summaries—Nicaragua, October 1999, at http://www.wto.org/english/tratop_e/tp118_e.htm.

⁹⁸ *Id.*

⁹⁹ For additional information on the HIPC initiative for Nicaragua, see at <http://www.imf.org/external/pubs/ft/scr/2004/cr0472.pdf>.

¹⁰⁰ In April 2002, a couple of months into the Bolaños administration, the President stated that the internal debt amounted to approximately US\$1.6 billion. Of that amount, US\$750 million was associated with the payment of real property indemnity bonds (see Real Property Law Report) and approximately US\$347 million related to “bank rescues” following a number of bank failures in the 1990s and the beginning of this decade (see Bankruptcy Report). Source: <http://www.laprensa.com.ni/> - February 5, 2003.

¹⁰¹ WTO Trade Policy Reviews, *supra* note 99.

¹⁰² See, for example, SIECA, *La Integración Económica Centroamericana*, PowerPoint Presentation (undated) (on file at NLCIFT); and SG-SICA, *Informe de Estado de Avance de la Integración Centroamericana, Enero 2002 al 15 de Junio 2003*, PowerPoint Presentation (June 2003) (on file at NLCIFT).

deadline—at the very least, it wants the harmonization of the common external tariff (CET) to be completed by then.

As part of its open trade policy promoted since the 1990s, in 1997 Nicaragua signed a free trade agreement with Mexico, which came into force in July 1998; this was the first global trade agreement concluded by Nicaragua. Nicaragua has also signed the Central America–Dominican Republic Free Trade Agreement and the main section of the Central America–Chile FTA (the market access protocol remains to be negotiated, so this treaty has yet to become effective). Nicaragua also enjoys the benefits of the Caribbean Basin Initiative (CBI).

Nicaragua is in the process of negotiating free trade agreements with Panama, Canada, and Taiwan. There are no bilateral trade agreements with Japan or the European Union. However, Nicaragua has also signed a number of bilateral agreements on reciprocal promotion and protection of investments, including agreements with the Republic of China, Taiwan, Spain, the United States, Germany, Denmark, the United Kingdom, France, and Argentina.¹⁰³

Despite its regional and international commitments under existing free trade agreements and ongoing negotiations, the country still has significant ground to cover to improve both its investment and its business climates. The free trade zones offer attractive opportunities to foreign investors, and government efforts to combat corruption have yielded positive results with respect to agencies that directly affect international trade operations (including the Customs Service—DGA). However, political instability, an unpredictable judicial system, insufficient infrastructure, and a lack of access to credit at reasonable rates are some of the problems that constrain the system’s appeal to foreign investors and local companies wishing to expand their operations.¹⁰⁴ Another problem is that even though the country does not favor or promote monopolies, there are, in fact, situations that may facilitate monopolistic or anticompetitive practices.¹⁰⁵

B. LEGAL FRAMEWORK

As of January 1, 2003, Nicaragua has implemented CAUCA III (the Central American Uniform Customs Code or *Código Aduanero Uniforme Centroamericano*, as modified by the Second Amending Protocol in April 2000),¹⁰⁶ as well as the Regulation to the Central American Uniform Customs Code (*Reglamento del Código Aduanero Unificado Centroamericano*, referred to as

¹⁰³ WTO Trade Policy Reviews, *supra* note 99.

¹⁰⁴ For a detailed analysis of some of the problems plaguing the judicial system, as well as the problems companies must confront to have access to credit, *see* Collateral Report. *See also*, Commercial Dispute Resolution and Trade Stream Reports.

¹⁰⁵ *See, generally*, Competition Policy Report.

¹⁰⁶ *Segundo Protocolo de Modificación al Código Aduanero Uniforme Centroamericano*, April 27, 2000, http://www.sieca.org.gt/publico/Marco_legal/protocolos/protocolo16.htm and approved by *Resolución No. 60-2000 del Consejo de Ministros de Integración Económica (COMIECO)*, dated September 27, 2000, http://www.sieca.org.gt/publico/Marco_legal/Resoluciones/COMIECO/resolucion_no60-20000.htm. Adopted by Nicaragua June 19, 2002 (Resolution 85/2002). Full text available at <http://www.dga.gob.ni:8500/circulares/CAUCA%20III%20CONCORDADO.doc>.

RECAUCA III), which was approved by the Council of Ministers for Economic Integration in October 2000 on an interim basis.¹⁰⁷

In the past, private sector complaints state that Customs procedures were often applied on an *ad hoc* basis, without a clear legal justification. CAUCA III and RECAUCA III provisions are often not applied directly unless they have been implemented by Nicaraguan Customs (*Dirección General de Servicios Aduaneros* or DGA) through the enactment of technical circulars. Even though procedures and transparency have improved under the current DGA administration, most issues continue to be regulated and require the enactment of specific circulars. On the positive side, access to such documents on DGA's Web site has become more widely available. However, private sector representatives note that finding a circular can become a significant challenge due to the volume of existing documents and because the most recent documents are sometimes not available. In addition, as noted by a DGA official, the Web site makes no distinction between circulars that remain in force and those that have already been abrogated.

Arbitrary customs valuation procedures were another major complaint until the end of 2002, when DGA replaced its customs valuation system based on an internal database and adopted the "transaction value" method and other standards set forth under the WTO Customs Valuation Agreement. The new standards were adopted under Law 421/02¹⁰⁸ and further regulated under Circulars 060/02¹⁰⁹ and 090/02.¹¹⁰ Even though there continue to be some complaints by the private sector regarding valuation decisions, the overall perception has improved, and DGA is continuing to build on its database to improve the system even further.

Although no special import licenses are required for the importation of goods into Nicaragua, the import of certain products is subject to specific administrative formalities. Likewise, generally Nicaragua does not impose restrictions on exports or imports, except as permitted under Article XI of GATT, i.e., export prohibitions or restrictions that may be applied on a temporary basis to prevent or relieve shortages of food or other essential items, as warranted by the public interest.¹¹¹

The Customs clearance system is governed by the *Ley de Autodespacho* and its Regulation.¹¹² The system has recently undergone significant modernization (including the implementation of

¹⁰⁷ *Resolución No. 71-2000 del Consejo de Ministros de Integración Económica*, dated October, 30, 2000, http://www.sieca.org.gt/publico/Marco_legal/Resoluciones/COMIECO/resolucion_no_71-2000.htm. Adopted by Nicaragua December 12, 2002 (Resolution 101/2002). Full text available at <http://www.dga.gob.ni:8500/circulares/RECAUCA%20III%20concordado.doc>.

¹⁰⁸ *Ley de Valoración en Aduana y de Reforma a la Ley 265*, published in the Official Gazette on June 14, 2002, available at <http://www.dga.gob.ni:8500/ley/LEY%20No421-2002.doc>. The Regulation to this Law (Decree 74/2002) is available at <http://www.dga.gob.ni:8500/ley/f325.doc>.

¹⁰⁹ Circular No. 060, enacted September 3, 2002 (Disposiciones Nacionales para la Implementación del Acuerdo Relativo a la Aplicación del Artículo VII del Acuerdo General sobre Aranceles Aduaneros y Comercio de 1994). Available at <http://www.dga.gob.ni:8500/circulares/CT-060-2002%20DISPOSICIONES%20PARA%20LA%20APLICACION%20DEL%20VALOR%20GATT%20.doc>.

¹¹⁰ Available at <http://www.dga.gob.ni:8500/circulares/CT-090-2002%20DISPOSICIONES%20PARA%20TRAMITES%20AUTODESPACHO%20ADUANA.doc>.

¹¹¹ Art. XI, General Agreement on Tariffs and Trade (GATT) 1994, available at http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_05_e.htm#articleXIA.

¹¹² *Ley de autodespacho*, available at <http://www.dga.gob.ni:8500/ley/LEY%20No%20265-1997.doc>. The regulation is available at <http://www.dga.gob.ni:8500/ley/Reglamento%20a%20la%20Ley%20265-1998.doc>.

electronic payments), which in turn has reduced clearance times. However, some documents are still not sent electronically, including cargo manifests, declarations of imported goods destined to free trade zones, and permits to be obtained from other agencies (such as the Ministry of Agriculture or the Ministry of Health).¹¹³ The clearance system is based on the traditional “red–green” random system; most recently, Customs officials in Managua have been using a “yellow” channel for documentary inspections, and they have begun implementing post audit inspections.¹¹⁴

Nicaragua has been using the SIDUNEA/ASYCUDA automated customs system for 14 years. This is the same system used in all other countries within the CACM with the exception of Costa Rica, which has its own system, and Guatemala, whose system has adopted some of the features of the Mexican computerized system. The DGA is considering upgrading to ASYCUDA WORLD,¹¹⁵ but that interface needs to be adapted to Nicaragua’s needs.

Even though significant progress has been made, the Customs Service still needs a flexible platform to create a centralized system. It also needs equipment and an improved communications system. A significant problem lies in the lack of coordination and communication between Customs officials in different areas of the country. Problems often occur because changes in procedures or new circulars are not communicated to the land border posts; in addition, for communications to function smoothly, additional personnel would be required to maintain the equipment.¹¹⁶

Overall, it is difficult to ascertain what percentage of shipments are being inspected by DGA because the system is not centralized and different customs houses may apply different inspection criteria. Customs inspectors at the Managua airport indicated that they inspect approximately 15 percent of shipments (red channel), while documentary inspections (yellow channel) involve approximately 8 to 10 percent of shipments.

Profiling for risk management purposes is based predominantly on a list of pre-identified high-risk importers, as well as on the nature of the goods, including some that have traditionally been undervalued. The country of origin of the goods is also taken into consideration, with particular attention being placed on goods originating in Panama, again, based predominantly on undervaluation considerations.¹¹⁷

1. Tariff Regime

Nicaragua applies the Harmonized Commodity Description and Coding System at the six-digit level, with two additional digits for the Central American region plus two other country-specific digits, making a total of ten digits.

¹¹³ See further, Chapter XI, Report on Flows of Goods and Services.

¹¹⁴ *Id.*

¹¹⁵ See at <http://www.asycuda.org/asyworld/introduction.htm>.

¹¹⁶ By way of example, if a virus affects a computer at a border customs house, a technician must be sent from the Central Office in Managua to address the problem, resulting in long interruptions in the service.

¹¹⁷ Nicaraguan Customs officials have received training on risk management techniques and procedures from Canadian experts; although officials believe that they could benefit from additional training in this area, it is worthwhile noting that the system has significantly improved and it is, in fact, one of the most advanced in the region.

Arbitrary and unpredictable changes in tariff classifications have been identified as a problem by private sector representatives interviewed as part of this assessment, although they also noted that there have been some improvements in this area. The general perception is that there is adequately trained staff at DGA headquarters. The Department of Tariffs and Valuation within the Technical Division of Customs is responsible for tariff classification. It is divided into two sections: one specialized in tariff classification, the other in customs valuation. It also has access to a customs laboratory.¹¹⁸ However, private sector representatives noted that personnel in other areas of the country are insufficiently trained—this is particularly noticeable at border ports.

Interested parties can request an advanced ruling relating to tariff classifications. There is also an appeal procedure before the director of Customs; in turn, that decision can be appealed to the Customs Valuation and Classification Commission. This commission comprises representatives from both the public sector (including MIFIC) and private sector (e.g., the Chamber of Commerce). The commission meets regularly, but it is rare for a classification dispute to be brought before the commission.

There are no customs courts. Appeals from a decision of the Tariff Commission may be made to the administrative courts (*contencioso administrativo*). In theory, the court can review both the substance and the procedural aspects of the decision. However, according to private sector representatives, the courts are generally unfamiliar with customs issues and only address matters of form, not substance.¹¹⁹

2. Free Trade Zones and Other Preferential Systems

Nicaragua maintains two types of investment and export promotion regimes: the free trade zone regime and the regime for goods subject to active processing (*perfeccionamiento activo*). Both regimes provide for an exemption on the application of duties and taxes; they are regulated by Decree 46/91 (Industrial Free Zones for Export Law) and by Law No. 382/01 (Law of Temporary Admission for Active Processing and Facilitation of Exports).

Even though these regimes are, for all practical purposes, export subsidies and could be construed as an unfair advantage vis-à-vis other countries, they are acceptable under the WTO framework until such time as Nicaragua's per capita GDP exceeds \$1,000. This provides an additional incentive and flexibility for investors who want to set up operations in Nicaragua.

However, there are also downsides to the system. The Free Trade Zone Law, as currently structured, does not promote agribusiness, although a proposed law that is now being considered by the National Assembly purportedly contemplates the creation of free trade zones that would benefit agro-industrial sectors. The proposed law also attempts to solve a recurring problem: Under the current system, companies benefit from a 100 percent exemption on their income tax during the first 10 years of operation. In practice, many companies close their operations once

¹¹⁸ See further, Chapter XI, Report on Flows of Goods and Services.

¹¹⁹ As a practical matter, the private sector does not resort to the court system. In addition to lack of technical expertise, the judicial system is considered to be unreliable and highly politicized (see further, Collateral Report). In addition, to have the goods released while the tariff classification is being challenged, the importer must post a deposit. It can take years to get a refund of the deposit if the decision is in favor of the importer. Often the importer simply pays the duties and taxes rather than challenge the classification.

the initial 10 years are about to expire and reopen the company under a new name.¹²⁰ Purportedly, the new law would address this situation and offer additional incentives so that companies will reinvest and continue operating in a regular manner following the initial 10 years.

3. Other Trade Rules and Laws

Nicaragua has signed both regional and international agreements in areas pertaining to trade in services (GATS); antidumping, countervailing, and safeguard measures; rules of origin; and sanitary and phytosanitary measures. MIFIC is the entity in charge of conducting all administrative procedures pertaining to antidumping cases, countervailing duties, safeguards, and rules of origin (see the following section). In turn, the General Directorate for Agricultural Protection and Health (*Dirección General de Protección y Sanidad Agropecuaria*) of the Ministry of Agriculture and Forests (*Ministerio Agropecuario y Forestal*) is the entity in charge of overseeing the country's compliance with sanitary and phytosanitary measures, as provided for by the WTO and the free trade agreements to which Nicaragua is a party.¹²¹

Overall, interviewees indicated that the legal framework is sufficient. However, additional training of officials at MIFIC, DGA, and other entities—as well as within the private sector—remains essential.

C. IMPLEMENTING INSTITUTIONS

Law No. 290 on the Organization, Functions and Procedures of the Executive Government designates MIFIC¹²² as the entity in charge of the application of trade laws. As part of its functions, MIFIC is also the entity in charge of conducting all administrative procedures pertaining to antidumping cases, countervailing duties, safeguards, and rules of origin.

Currently, Nicaragua's trade negotiating team comprises 20 officials, 8 of which are from MIFIC. The rest are drawn from other government departments, including Foreign Affairs, Customs, and the Ministry of Agriculture.

Generally speaking, the executive government has actively supported and encouraged the negotiation of free trade agreements (including CAFTA) with other countries. Nicaragua has also taken initial steps to negotiate an FTA with Taiwan. Generally speaking, MIFIC authorities noted that many of their officials are highly trained and have significant experience in trade issues; however, they also indicated that they have insufficient staff and resources to carry out their functions. According to private sector representatives interviewed, these insufficiencies become particularly apparent at the time of the implementation of the relevant trade agreements—a fact that may prevent the country from planning and putting into effect a coordinated strategy to adapt to the relevant requirements, as well as from effectively benefiting from these agreements.

¹²⁰ See *¿Maquillan a las Zonas Francas?* (Make-up for Free Trade Zones?), La Prensa, August 18, 2004, at 1C, reporting on a practice frequently followed by textile operations.

¹²¹ See further, Chapter XI, Flows of Goods and Services.

¹²² See further www.cetrex.com.ni.

MIFIC is also involved in significant efforts to promote import, export, and investment activities, including the following:

- ♦ As a member of the Board of Directors of the National Commission for the Promotion of Exports (*Comisión Nacional de Promoción de Exportaciones* or CNPE), MIFIC participates in CETREX (*Centro de Trámites de las Exportaciones*—Export Processing Center), a joint public–private sector entity created to simplify, centralize, and expedite export procedures.
- ♦ MIFIC houses the one-stop window for investments (*Ventanilla Única de Inversiones*), a pilot project undertaken in Managua with funding from the IDB. The VUI concentrates in one office all administrative procedures required for foreign and local investors to register their activities.¹²³
- ♦ The *Instituto Nicaragüense de Apoyo a la Pequeña y Mediana Empresa* (Nicaraguan Institute to Support Small and Medium-Sized Businesses or INPYME) is a decentralized entity within MIFIC that was created in 1994 to promote the development of small and medium-sized companies, including implementing plans to facilitate access to credit for such companies.¹²⁴
- ♦ MIFIC also participates in the Presidential Commission for Competitiveness (*Comisión Presidencial de Competitividad*, also known as CPC or PROCOMPE), a joint public–private sector commission whose purpose is to improve the business climate in Nicaragua and encourage increased competitiveness in the Nicaraguan private sector. Among other efforts, the commission has implemented a cluster approach to support specific sectors, with particular success in the dairy and coffee sectors.¹²⁵
- ♦ MIFIC also participates in various public–private sector commissions as part of the coordination of the country’s overall trade policy (see the following section). Private sector interviewees reported that the dialogue among MIFIC, other government agencies, and various associations has improved under the current administration, but there is much room for further improvement.

D. SUPPORTING INSTITUTIONS

1. Customs Service

In the past, the DGA was an agency of the General Income Board (*Dirección General de Ingresos*). Since early 2002, it has become an autonomous entity, although hierarchically it is still under the Ministry of Finance and Public Credit (*Ministerio de Hacienda y Crédito Público*).¹²⁶

¹²³ In addition to the physical concentration of procedures that in the past required a visit to various government offices—an advance that has already been achieved—future steps will include legal and procedural reforms, including process automation. *See further*, Company Law Report.

¹²⁴ *See at* www.inpyme.gob.ni. *See also*, Collateral Report.

¹²⁵ For additional information on the cluster approach, *see* www.competitividad.org.ni/clusters.htm.

¹²⁶ Law No. 339/2000, as regulated by Decree 20/2003.

Interviewees indicated that, overall, the situation in Customs has improved in recent years. A representative from the CACONIC noted much improvement in the relationship between Customs and the private sector, and the chamber and other associations meet with DGA on a regular basis. Meetings include consultations regarding draft circulars and policy considerations—a significant development compared to the manner in which decisions were made in the past.

Customs information is disseminated through a Web site maintained by DGA (www.dga.gob.ni). Although the system is slow and it is sometimes difficult to locate rules, there is a perception that the Web site has significantly improved during the past few years as additional information (particularly circulars) has become readily available. Pending concerns include the lack of sufficient information on quotas and the absence of consistent statistics; interviewees noted that MIFIC, DGA, CETREX, and the Central Bank all have different statistics with respect to import and export operations.

Training of technical personnel at DGA is generally good. There is a training center (*Centro de Capacitación*) within Customs that provides training to Customs officials and private individuals. However, both DGA and the private sector feel that additional training is required at all levels and for all customs houses. The private sector would also significantly benefit from training on various customs issues, including valuation and tariff classification issues. Customs officials interviewed also favored the idea of setting up a regional Central American Training Center.

2. Professional Associations and Specialized Services

There are many individual lawyers and economists with expertise in matters of international trade. There is no specialized association dedicated to international trade issues.

The private sector participates in the country's trade policy design and negotiations through various commissions, chambers, and associations. These entities (some of which also involve, to a greater or lesser extent, public sector participation) include the following: CADIN;¹²⁷ CACONIC;¹²⁸ the Nicaraguan Federation of Professional Associations (*Confederación de Asociaciones Profesionales de Nicaragua* or CONAPRO); the Association of Producers and Exporters of Non-Traditional Products (*Asociación de Productores y Exportadores de Productos no Tradicionales* or APENN);¹²⁹ the National Council for Economic and Social Planning (*Consejo Nacional de Planificación Económica Social* or CONPES);¹³⁰ ProNicaragua (an investment promotion and facilitation entity);¹³¹ the Export Promotion Center (*Centro de*

¹²⁷ See at www.cadin.org.ni.

¹²⁸ See at www.caconic.org.ni.

¹²⁹ See at www.apenn.org.ni. APENN promotes the growth and development of nontraditional exports in Nicaragua by providing training services through its School of Foreign Trade, facilitating the exchange of information and analysis, and promoting the development activities of the country by including small and medium producers in the exporting process.

¹³⁰ See at www.conpes.org.ni. The purpose of CONPES is to act as an advisor to the President in matters pertaining to economic and social policies, as well as public interest issues.

¹³¹ See at www.pronicaragua.org. The purpose of ProNicaragua, created in 2002, is to provide support to foreign investors who seek opportunities in Nicaragua. Most of the companies ProNicaragua has attracted have established a presence in the free trade zones. Examples include textile companies, auto-part manufacturers, and

Promoción de Exportaciones or CEI);¹³² COSEP;¹³³ the Inter-Institutional Commission to Improve Trade (*Comisión Interinstitucional para el Mejoramiento del Comercio* or CIMCO);¹³⁴ and AMCHAM.¹³⁵

In fact, there is no shortage of commissions and associations in Nicaragua. Many of these entities have been successful in promoting a meaningful dialogue between the public and private sectors, as well as in raising awareness with respect to a number of issues, including the needs of specific sectors (clusters) and, most recently, the need to introduce reforms to the country's judicial system. However, some of those interviewed remain skeptical of the effectiveness of some of these entities and emphasized the need to streamline and further coordinate all these efforts. Micro, small, and medium-sized businesses also believe that much remains to be accomplished to ensure that smaller businesses have a unified voice and can benefit from coordinated efforts. Although progress has been made in specific sectors, they feel that there are no clusters for micro businesses. Business representatives identified the need for specific policies for micro and small businesses, including tax incentives and, according to some, the creation of a development bank.¹³⁶

Private sector representatives interviewed were highly supportive of the Customs unionization process and of CAFTA. However, many also emphasized that Nicaragua has a large rural population that has little or no knowledge of CAFTA and its impact. Nicaragua is a predominantly agricultural country. Many feel that agricultural activities are not sufficiently promoted, or even supported. A significant number of people remain skeptical about the benefits of CAFTA for Nicaragua and what its ultimate impact will be if the country and all production sectors are not adequately prepared for it.

E. SOCIAL DYNAMICS

There are many implementation issues that remain to be resolved before Nicaragua and the region can fully take advantage of free trade. Most interviewees agree on the need to build consensus on the country's commercial policy, with the public and private sector joining efforts to overcome existing challenges. Some of the issues to be overcome include the lack of an adequate investment climate, the high costs of transportation, the lack of or insufficient training

sewing plants. ProNicaragua officials consider that it would be essential to invest in training (e.g., English language training and technical skills) so that the country can develop its services sector and become a hub for, among others, call centers and tourist-related activities.

¹³² The board of directors of CEI includes representatives from CACONIC, APENN, MIFIC, and other public and private entities. CEI works in conjunction with CETREX to facilitate export procedures and to become a source of information and support for exporters. *See further at* www.cei.org.ni/new.

¹³³ *See at* www.cosep.org.ni. COSEP, a nonprofit institution, was created in 1972 with the purpose of bringing together various sectors (including industry, trade, and producers) to address economic, social, and political issues within a democratic environment.

¹³⁴ As part of CAFTA implementation efforts, trade facilitation commissions have been formed in each of the five Central American countries, funded in part by USAID. CIMCO is the Nicaraguan section of this undertaking. The commission meets twice a month.

¹³⁵ *See at* www.amchamnic.org.ni.

¹³⁶ For a discussion of this recommendation, *see* Collateral Report.

in customs-related areas, and the uncertainty underlying property rights¹³⁷ as well as weaknesses in the political and judicial systems.¹³⁸

Legal practitioners interviewed relayed anecdotal evidence of investors whose efforts to start a business in Nicaragua have been frustrated. Some of the problems that discourage investment and economic growth in the country (e.g., the uncertainty of property rights and the need to modernize the Public Property Registry, the unpredictability of the judicial system, and the lack of sufficient access to credit at reasonable interest rates) could be solved in the short to medium term. However, there is a perception that there is insufficient political will to bring about the required changes.

There are, however, some notable cases of new investments in the country; for example, Gildan Activewear Inc. has announced its intention to set up a \$60 million knitting facility in Nicaragua, invoking the free trade zone benefits, a system that is perceived to be relatively straightforward and predictable.

Local companies are also confronted with problems—in particular, the difficulty in obtaining access to credit at reasonable rates. Without adequate access to credit, companies cannot grow and produce the volume and quality of products that their foreign clients demand; they cannot invest in technological innovations to improve and streamline their production; and they cannot pay additional employees to guarantee on-time delivery.¹³⁹ Another common complaint are high tax rates, which do not permit companies (particularly micro and small companies) to compete with an increasing number of companies that operate in the informal market. High tax rates also prevent compliant companies from accumulating the resources they need to reinvest in technological innovations, personnel, etc. In addition, a representative from a local company indicated that the legal framework for taxes is constantly changing; at points, there have been up to three tax reforms within the same year. It is very costly and time consuming for a company to subsist, let alone thrive, in that kind of unstable environment.

F. RECOMMENDATIONS

Nicaragua has made significant strides in negotiating free trade agreements, streamlining customs procedures (including improved risk management policies), combating corruption in the Customs Service, and promoting an increased dialogue among public and private sector representatives. These efforts need to be supported and strengthened.

- ◆ An efficient, well-staffed, honest, and transparent Customs Service is absolutely essential to ensuring free trade. Efforts should concentrate on continuing to expedite the clearance process (including improved risk management systems and targeting methodology); further reducing opportunities for corruption; helping deter smuggling, drug trafficking, and terrorism; and generally promoting a healthy trading environment.
- ◆ Continued training to DGA staff is required. Areas identified as a priority by DGA include training on better internal procedures to apply risk management criteria and

¹³⁷ See further, Real Property Law Report.

¹³⁸ See, e.g., Collateral Report and Bankruptcy Report.

¹³⁹ *Id.*

create profiles, methodologies to detect fraud and undervaluation, and computer and technology areas.

- ◆ The private sector would also benefit from training. There is insufficient training on commercial and customs issues, including classification and valuation of goods, additional steps must be taken to avoid setbacks in the future. Producers must increase their productivity levels to compete under a free trade regime. Even though the trade liberalization period is lengthy, producers and beneficiaries from export promotion regimes—which will eventually phase out—will need enhanced investment and modern technology to adapt to the new requirements and improve productivity and competitiveness in their areas of activity.
- ◆ Meeting trade capacity challenges depends on affordable and accessible trade finance. It is essential to facilitate access to credit (to local and foreign companies and investors) by modernizing and harmonizing laws relating to the provision of collateral on a regional basis and creating a centralized registry of debtors and collateral (see VI. Collateral). A related key factor will be the modernization of the country's legal framework on electronic documents and electronic signatures.
- ◆ It is necessary to encourage regional solutions to problems in the trade facilitation, investment, and customs areas. Technical assistance should be provided to establish a regional customs school and to promote regional dispute resolution systems, among others (see VII. Commercial Dispute Resolution).

XI. FLOW OF GOODS AND SERVICES

Despite recent improvements, the trade-related institutions still encumber traders with trade transaction costs through delays and administrative burdens. By eliminating the unwarranted and onerous constraints embodied in laws, regulations, and procedures, Nicaragua can capture greater savings and efficiencies. In fact, improving the trade facilitation environment can reduce trade costs by as much as 15 percent of the value of traded goods. Even in Nicaragua's relatively small market, where just over \$3 billion in goods and services were exchanged in 2003, improved trade facilitation can lead to significant savings.¹⁴⁰ In turn, these savings will make Nicaraguan exporters more competitive, lead to lower prices for Nicaraguan consumers, and enhance Nicaragua's overall attractiveness as an investment opportunity.

A. INTRODUCTION

In 2003 flows of goods measured over \$2.5 billion with \$605 million in exports and almost \$1.9 billion in imports. Service flows totaled \$562 million with \$349 million in imports and approximately \$213 million in exports. Nicaragua's top five trading partners are the United States, Venezuela, Costa Rica, Guatemala, and Mexico, with the United States accounting for almost 33 percent of exports and a 25 percent of imports and other traders accounting for approximately 10 percent or less.¹⁴¹ Major products flowing out of the country include coffee, sugar, and textiles. Major products flowing into the country include consumer goods, automobiles, food, raw materials, and capital goods.

To further facilitate goods and services flows, Nicaragua must improve the laws, institutions, and operations of its trade-related institutions, including its customs agency ("Customs"). Modern institutions that are managed, staffed, and equipped to achieve the appropriate balance between facilitation and control will provide reduced trade transaction costs. Nicaragua's trade-related institutions are making progress in developing more modern and reliable public services through numerous and significant changes to its regulations, organizations, and operations.

Although progress has been made, significant obstacles hinder the efficient and secure movement of trade across Nicaraguan borders. Major challenges facing Nicaragua include (a) further streamlining Customs clearance processes, (b) greater integrating of border institutions, (c) enhancing risk management, and (d) addressing border agencies' infrastructure needs.

This section analyzes the legal, institutional, and operational constraints that impede trade expansion and recommends ways to minimize those constraints. The analysis focuses on (a) legal framework for the primary border institution, (b) the institutional issues regarding Customs management, organizational capacity, and operations, (c) other key public institutions involved in trade facilitation, including the Ministries of Agriculture and Health and the National Police, and their role in trade facilitation, and (d) major recommendations to improve trade facilitation in Nicaragua.

¹⁴⁰ <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=SV,NI>.

¹⁴¹ *Id.*

B. LEGAL FRAMEWORK

The state of the law is one of the least problematic areas for trade facilitation in Nicaragua. For trade facilitation, it is most important that the legal and regulatory framework provides the following: (a) adequate and coherent authority structure for the essential trade-related institutions and (b) clearly stated regulations and procedures for implementing these authorities that strike the balance between facilitation and necessary control. Nicaragua's legal framework is in place for an orderly and well-functioning trading system. There is adequate authority for Customs and supporting institutions, particularly the National Police and the ministries of agriculture, health, and the economy, to perform their functions in facilitating the efficient and secure flow of goods and services. In particular, the law provides appropriate authority for all essential Customs activities, including personnel, integrity, procedures, automation, and adjudication. Important areas for legal improvements include steps that will facilitate CAFTA implementation..

1. Legal Authority Supporting Trade Facilitation

There is adequate and coherent authority for facilitating trade flows under Nicaraguan law generally. The law and implementing regulations that govern customs in Nicaragua are Código Aduanero Uniforme Centroamericano (CAUCA) III and the Reglamento Del Código Aduanero Uniforme Centroamericano (RECAUCA). The Central American Law on Customs Transit governs transit through Nicaragua. In addition to the Central American Common Market (CACM) and CAFTA, Nicaragua also has free trade agreements with the Dominican Republic, Mexico, and Panama. (Negotiations are ongoing with the European Union, Taiwan, Canada, Chile, Colombia, and Venezuela.)

As was learned during interviews performed for the assessments, Nicaragua passed laws to provide Customs with additional authority and to complement regional legislation, including (a) the *Autodespachio* Law, which expands self-determined declaration filing and (b) Law 42, which covers penalties and other actions concerning the defrauding of Customs. Along with specific customs legislation, there are various laws within other agency codes that involve customs procedures or actions.¹⁴² These laws provide Customs and supporting public institutions with ample authority to perform their functions. The lines of authority are clear. Customs has the authority to regulate the clearance and movement of goods crossing borders. Customs has limited law enforcement powers; these are handled by the National Police. However, Customs does have authority to control “blind spots” at borders and to perform surveillance activity. Customs officers are not armed, and in cases of smuggling, they work with the National Police. Legal authority supports Customs management, operations, and procedures. In particular, the law provides that Customs receives 3 percent of revenue collections for its budget as well as a portion of the revenue generated from seizures and penalties. In addition, interviewees stated that the law provides for Customs to establish service fees; at this time, however, Customs is not benefiting from these provisions.

Knowledgeable personnel informed the assessment team that the law provides appropriate authority for personnel management, including recruitment, training, and retention. In addition,

¹⁴² Those sections are being incorporated into CAUCA complementary legislation, which is currently in draft form and, when completed, will be presented to the Nicaragua National Assembly.

the law provides incentives to encourage personnel to maintain high levels of integrity. For example, Nicaraguan law provides officers, who identify specific infractions, with a portion of the proceeds. There is a written code of conduct that prohibits bribery, and the public is encouraged to report all instances of employee requests for facilitation fees. This law provides for removal for cause.

The law grants the legal foundation for the efficient processing of goods by international standards. Customs procedures are generally in conformity with the Kyoto Convention on the Simplification and Harmonization of Customs Procedures. Customs uses the Central American Tariff System, which is based on the World Customs Organization (WCO) Harmonized Classification System. In September 2002, Customs implemented the General Agreement on Trade and Tariffs (GATT)/WTO Valuation Agreement. The law allows for pre-arrival processing and for the electronically transmitted declaration to be recognized as the legal document. Nicaragua became a member of the WTO in 1995 and is an active member of the WCO.

Customs has a process for importers to request binding rulings for commodity classification, which on receipt must be published in the *National Gazette* at the expense of the requesting party and is binding for those products. Rulings are sometimes coordinated with the WCO. (Nicaragua and Costa Rica are the only CAFTA member countries to have binding rulings, a requirement of the trade agreement.)

All laws, regulations, and administrative circulars, including binding rulings, are published on the customs website (<http://www.dga.gob.ni/>).

CAUCA III provides for an efficient appeal process, and appeals are handled at the lowest possible level. The importer has a right to an administrative review and can petition the courts for further review.

Interviewees also stated that penalties are reasonable and well defined. Clerical errors are covered by administrative penalties within a \$5 to \$50 range. Major penalties are for substantial amounts, which include the loss of revenue plus twice the value of the merchandise. Criminal penalties involve the loss of revenue plus three times the value of the merchandise and up to 6 years in prison.

Those closely associated with the customs system stated that the law effectively regulates the security of goods in the trading system by providing coherent and effective provisions for handling restricted goods, and these restrictions are published in manuals. Arms, dual-use goods, and weapons-grade materials are controlled through licensing or are prohibited as an import/export.

Nicaraguan regulations adequately govern the brokerage community. Those knowledgeable of this area stated that brokers are tested and licensed, and the license can be suspended for a period of time or revoked for cause.

2. Legal Issues to Address

The legal framework is not generally an impediment to the facilitation of trade or control; however, certain limitations must be addressed.

In particular, interviewees stated that criminal prosecution is a limiting factor. The courts are weak in criminal prosecutions of customs offences, and the Customs Agency prefers to deal with cases under the administrative penalty provisions. The threshold for criminal penalties is set too high, as infractions do not become criminal unless the merchandise exceeds \$50,000. This high level leaves room for abuse. Generally, if a case is brought before the courts, the violator is not penalized as provided by law.

Customs has no authority to detect and seize goods in violation of intellectual property provisions and can only detain for suspected violations in this regard based on judicial order. Interviewees described cases when Customs has detected such a possible violation and brought this to the attention of the owner, but there has been no interest in obtaining a judicial order. This area needs to be addressed.

Funding for Customs modernization and operations is provided by law, but since 2001 these funds have not been made available to Customs as required. This limiting factor must be addressed to provide Customs with the proper funding to modernize functions.

C. IMPLEMENTING INSTITUTIONS

Customs is an agency within the Ministry of Finance but functions as an autonomous entity. A Director General and two sub-directors lead the organization. One sub-director covers administrative functions, and the other is in charge of technical areas. Currently there are 820 employees; 380 are assigned to the headquarters office, which oversees all functions from the central office. The other 440 are assigned to the 13 field locations and free zones. The budget is administered by headquarters, but each Customs post has a small operating cash fund.

Nicaragua's trade policy is focused on promoting international trade, which includes efficient and modern Customs functions. Within the past two years, Customs was tasked with streamlining functions and to becoming transparent in operational procedures and as a result improvements have been made. Audits that used to take three months have been reduced to two days, delays for some procedures of up to three weeks have been reduced to several hours. Yet, capacity remains low, and there is much work to be accomplished. Key priorities include (a) increased funding, especially for salaries and equipment, (b) additional practical training in valuation, (c) assistance in encouraging cooperation among those in the field, and (d) a focus on creating a more user-friendly, transparent environment.

1. Customs Management and Operations That Support Trade Facilitation

a. Customs Management

Customs has a management vision that seeks to provide standardized services efficiently, while balancing control with facilitation. Customs has a modern management and organizational structure that includes the following divisions: technical, operations, modernization,

administration, quality control, enforcement, international affairs, risk management, and user support.

At the borders and in headquarters, Customs coordination with other public agencies, the private sector, and international counterparts is adequate. In most cases, agency officers at borders work in the same office using a single window concept for processing commercial cargo. Moreover, the agencies are working to further integrate processes. Customs cooperation with the private sector is strong. Customs meets regularly with commerce and industry groups to promote transparency and work on improving the process. Customs cooperation with its counterparts in Honduras and Costa Rica is good. Customs is working with Honduran Customs authorities to provide a more streamlined approach to processing at border sites, with the eventual implementation of a fully functioning Customs Union. Border stations with Honduras are now operating 24 hours a day, 7 days a week.

Customs has made gains in improving human resources, personnel, and training. In 2002, Customs implemented a new hiring process that requires interested candidates to undertake a three-month seminar and pass six specific modules. Passing candidates then receive a certificate and a place in the Customs database from which new hires are selected. There is no salary during the training process and no guarantee of a job in the near future. In the most recent class, only 20 percent received a certificate. When a vacancy occurs, personnel from within are considered first, and new hires fill the positions left vacant by the promoted individuals. With respect to continuing education, training is both done in-house and through outside organizations. Nicaragua Customs officers have received training from Secretaría de Integración Económica Centroamericana (SIECA), WCO, Argentina, Canada, Spain, and the United States, where several officers have attended training at the U.S. Federal Law Enforcement Center. For example, personnel have attended a U.S. Customs courses on customs automation held at the Federal Law Enforcement Center.

Customs positions are considered desirable because of stability, and the training opportunities improve employment potential outside Customs. Even though salaries are low (the average inspector salary is approximately \$300 per month), turnover is relatively low with about a five percent annual attrition rate. There are written job descriptions based on both the labor code and the specific Customs function, that include degree requirements and salary. .

Customs has improved the integrity of the agency, and this is not seen as a major issue. The hiring process has helped. Also, the public is encouraged to report instances of bribe solicitations. All operational Customs personnel wear uniforms and have identification (ID) badges, and in-house administrative personnel display ID badges.

b. Procedures

Customs is working to streamline and simplify procedures. In 2003, Customs handled approximately 157,000 import and 50,000 export transactions. In 2004, 10 unnecessary procedures have been eliminated. In 2003, at least six documents for imports and five for exports were also eliminated, thereby streamlining the process. All personnel have procedural manuals, and procedures are posted on the Customs Web site for review by interested parties.

The risk management system is nascent but within the region it is second only to El Salvador. The system was created in 2003 and has greatly decreased examination rates and increased discrepancy rates, leading to additional revenue of approximately \$500,000. Interviewees stated that based on better targeting, the Managua Customs office, which provides 60 percent of all Customs collections, has exceeded projected revenue targets in recent months and overall since 2001, revenue collections have increased by 50 percent. Customs is continuing to work for greater reductions and more emphasis on post verification and targeted post audits. The risk group has a staff of eight officers (some trained by Canadian Customs). The team analyzes trade patterns and creates risk profiles of commodities and importers. The system randomly assigns the examining officer, a practice that lowers the opportunity for corruption. Goods identified as posing revenue risks are electrical goods, apparel and shoes, cigarettes, liquor, and automobile parts. Also there are risk profiles for those commodities that are viewed as non-revenue risks, such as dual-use goods that could be used in weapons manufacturing and prohibited goods, such as artifacts or endangered species.

There has been cooperation in information sharing and intelligence gathering between Customs and police through both local and regional sources to create a better knowledge base. This process has promoted better targeting for cargo examinations and the post audit process. Central American risk teams meet monthly to share information and discuss case studies. Information is also received from other government entities such as the National Police and internal taxing authority. Profiles are generated and used for either conducting a targeted physical examination or scheduling importers for a post audit.

Customs broker regulations are sufficient according to those closely involved with the issue. All declarations over \$1,000 and outside the CACM require the use of a broker. There are approximately 120 customs broker agencies required to have a licensed broker onsite. Customs licenses and tests brokers also post a bond guarantee. Some brokers are viewed as excellent, and others, knowing the Customs system and its weaknesses, exploit that knowledge to benefit their clients. Suspension of license can occur, but this is passed through the Ministry of Finance and is a complex and rarely used process. The suspension process should be streamlined.

c. Field Operations: Managua Inland Facility

The Managua Customs facility, which generates approximately 60 percent of all Customs revenue collections, is well designed and managed. It has specific windows for declaration processing. Personnel have limited contact with filers. Only Customs is onsite, although agricultural and police personnel work at the warehouses. With the new risk targeting initiative and with the lowering of the exam and review rate, Managuan Customs has regularly and significantly exceeded revenue targets.

According to interviewees, the 120-person Customs staff receives approximately 4,500 monthly. On average, the staff immediately releases 60 percent, physically examines 26 percent, immediately reviews the documents of 10 percent, and subjects 4 percent to post verification review by the audit section. The examinations are performed at the Customs warehouses.

Managua provides adequate service by providing Customs services during regular working hours for no fee and after hours on a reimbursable rate.

d. Field Operations: Airport

Customs operations at the airport are adequate. The 59-person Customs airport staff provides 15 percent of the Customs national revenue, ranking second to Managua in overall collections. Business is increasing. Revenue collections on courier imports have quadrupled in the past two years with the addition of three more courier companies. Customs airport cargo receives about 150 declarations a day from the two to three daily cargo flights. Part of the facility has been under major renovation.

Customs has respectable cargo examination rates of roughly 20 to 30 percent. Most goods are released within 24 hours of arrival. Goods not requiring examination are released on receipt of duty paid declarations.

As on-site visits revealed, courier goods are not unnecessarily delayed. (The new facility has an x-ray machine, yet there is still need for equipment.) Courier documents and packages under \$50 are released immediately; packages valued from \$50 to \$1,000 are released in about two hours under the informal process using form LAD011 with duty paid the next day. All packages over \$1,000 must go through the declaration process but are usually released within 24 hours. In the latter half of 2004, a courier module was to have implemented and the renovated facility will be used by couriers to store their goods in separate secure cages. The outcome of these efforts is not yet known. The IDB is funding the courier module, renovation, and x-ray scanning equipment that should make this process more efficient.

e. Field Operations: Land Border Crossings

Inspection of the Peñas Blancas border crossing showed that it has adequate service and staffing with 55 people covering approximately 200 to 250 commercial import and export vehicles a day. In the past six months, Customs has made progress in simplifying procedures and expediting flow. Clearance time has been reduced from three hours to 25 minutes. The importer has the option to clear at either Managua or Peñas Blancas. Of these, about 25 to 35 shipments are cleared at Peñas Blancas with a 25 percent exam rate. Clearance times with physical examination are approximately 1 hour. Clearance times without examination are 10 to 25 minutes.

Peñas Blancas operations provide a preview of the transition to a full Customs Union. Customs officers from Honduras, Guatemala, and El Salvador occupy the transit office alongside Nicaraguan Customs staff. These officers process documents presented for transit goods destined to their respective countries.

f. Security

There is no major problem in the area of cargo security and very little theft of cargo in Nicaragua. This is of little concern with Customs cargo inspections as well because these occur at warehouses located at the Customs facilities.

There is some enforcement authority within Customs, and officers have authority to perform some surveillance activity on roads and to control the green areas/blind spots on the frontier. However, they are reluctant to take action on their own because they are not armed. Customs relies on the National Police or the Army for assistance.

2. Customs Management and Operational Issues to Address

The gross under-funding of Customs' budget blocks modernization. The agency's current operating budget is about \$7.2 million, 70 percent of which covers salaries. In 2003, Customs collected approximately \$200 million, which accounted for 33 to 36 percent of all national revenue. The revenue collected by Customs is only 20 percent duty, while 60 percent is value-added tax and 20 percent is excise tax on items such as liquor and cigarettes. (The value-added tax is set at 15 percent of the Cost, Insurance, Freight (CIF) duty paid value of the goods.) By law, Customs' budget should be augmented by three percent of collected revenue, various service fees, seizures, and penalties. However, interviewees stated that these funds have not been returned to Customs since 2001, and the agency is significantly weakened. In the past, when Customs had access to this revenue, modernization projects were implemented. For example, the renovation of the Peñas Blancas border station was funded by Customs contributing 55 percent and the government providing the remaining 45 percent.

Nicaragua faces a serious undervaluation problem. This problem stems from poor institutional capacity and a noncompliant trade community. Supplier invoices from Panama are said to be particularly problematic. However, in the past three years, there has been a positive change, and more revenue has been generated as Customs has enhanced its ability to address this problem through valuation training provided by the WCO and Canadian officials. Additional training on various functions has been provided by Spain, the IDB, the Dominican Republic, and Argentina.

Customs capacity in specialized functions, including valuation, risk management, and post audit, is inadequate. To evolve into a modern customs organization, where the focus is on balanced trade facilitation and control, creating capacity in these specialized functions is essential. Currently, the trade community is seen as noncompliant, and undervaluation poses a serious risk. Customs can combat this problem through further development of risk management and post audit functions. The current post audit function is being restructured due to its inadequacy, in part because it is understaffed. Twelve auditors are assigned to a post unit that needs 30. Five document review personnel are available, but 20 are needed. This current staffing structure can only complete approximately 70 audits per year. This situation is compounded by reduced physical exams. The process is being improved through simplification so that most audits will be less intrusive and jointly conducted with internal revenue auditors, with whom information is shared.

Key Customs infrastructure needs investment. For example, the main obstacle to efficient processing at the airport facility is the inadequate system for receiving merchandise. At the Managua facility, key instruments to reduce fraud are missing, including floor scales for weighing incoming and outgoing cargo to confirm package weight and cameras in the airport warehouses. Also, a manual cargo locating system is used when this function should be automated. Another example of poor customs infrastructure is the lack of paving at Peñas Blancas, where the parking area is muddy and almost impassible.

Customs' IT systems are lacking in terms of software, equipment and personnel capacities. With respect to software, "Automated System for Customs Data," or ASYCUDA has been in use since 1992 and the current system currently runs ASYCUDA ++ v.1.17. This version limits Customs' ability to efficiently manage traded goods, and Customs would like to implement the new

version ASYCUDA World. ASYCUDA World is an Internet-based, open-system modular application that requires \$90,000 for trainers and technical personnel. With respect to personnel, Customs lacks the funding and training for IT staff. Currently, there is a staff of 17, including four programmers. There is no funding for additional training or courses, such as database management, which are much needed. Additionally, the technology staff's low salaries lead to high turnover rates.

Customs lacks the ability to fully conduct electronic clearance due to the inadequate network infrastructure. Declarations are transmitted through the Internet, but do not receive electronic release notification. There is no electronic manifest transmission, although there are implementation plans once all the areas are online and communication via satellite is available, which was expected to be completed in late 2004 (however, no update was available in time for the report). The Atlantic coast is not automated. Communications failures with areas outside Managua are frequent because the microwave communication is disrupted during heavy rain. The free zones are not automated and are reluctant to automate. Recently, they were instructed to automate by the end of 2004 or Customs would remove onsite personnel (again, no update was available).

Lastly regarding IT, Customs lacks the appropriate hardware. Customs has approximately 140 workstations to serve the entire country. In 1998, the IDB provided \$500,000 for these computers, but they are now outdated. There is no funding to upgrade this equipment or provide for other needed equipment, such as a central server to maintain profiles. Currently, all "server type" information remains on one workstation.

With respect to Customs' laboratory facilities improvements are needed. The lab is small and housed in a shipping container. It is understaffed and under-equipped. This facility needs equipment and resources to better determine proper classification of goods and identify areas of concern or danger. Currently only two staff members work in the laboratory, under difficult and cramped conditions and lacking the proper modern equipment needed to perform their required functions. In some cases, samples are sent to Mexico and the United States for analysis, which is expensive and time consuming.

Enforcement of Customs' criminal penalties is functionally inoperative. Although Customs has efficient and transparent penalty procedures, the courts lack the will to prosecute criminal cases. As a result, Customs is forced to significantly alter criminal valuation cases involving gross undervaluations into administrative actions just to pursue violators.

There are significant costs to and delays of the transit of free zone shipment because of the cumbersome, intensive, and burdensome Customs oversight requirements. For example, regulations require a Customs guard, reimbursable by the user, to accompany all movements traveling among the free zones. This regulation affects many shipments as goods are commonly processed and transferred among various zones. Another problem is the lack of automation in zone procedures and documents. However, efficiency gains were to have been made by the end of 2004, when free zone operators will provide hardware and communication capability to the onsite Customs officers. The results of this effort are not yet available.

Customs service hours are not adequate at some locations. For example, at the Peñas Blancas border crossing, Customs services are only available from 6:00 a.m. to 8:00 p.m. This is attributed to Costa Rica's unwillingness to expand operating hours.

Transit operations are inadequate. There is still an over reliance on documents and Customs automated processing systems within the region are different and not linked. Therefore, transit movements, which should move unhindered once they reach the exterior border of the union, must be re-input into each national system upon both arrival and departure, slowing movements. An integrated Central American transit system is needed.

D. SUPPORTING INSTITUTIONS

1. Public Supporting Institutions

Although Customs is the main implementing institution for the movement of goods, an efficient trading system relies on an interdependent process that includes other trade-related public sector institutions and the users of the system. Their capacities and performance can result in significant costs (or savings) within the trading system, and optimized trade facilitation depends on their active involvement.

Major public institutions involved in trade facilitation include the Ministries of Agriculture, Health, and Economy; CETREX (export process agency); National Civil Police (PNC); Organismo Internacional Regional de Sanidad Agropecuaria (OIRSA), the regional agricultural standards body; and the Intellectual Property Rights (IPR) Agency. Each of these organizations plays a role in the trading system, and each has a significant impact on trade transaction costs. The Nicaraguan government recognizes the need to enhance trade facilitation. However, its efforts have been directed primarily at the modernization of Customs even though, according to interviewees, 20 percent of all exports and even more imports require review from various other institutions, such the Ministry of Agriculture and Forestry (MAGFOR) and the Ministry of Health (MINSA). These and other agencies have not been included in facilitation initiatives, because of a lack of resources or the government's failure to recognize their critical roles. A meaningful trade facilitation strategy must incorporate all links in the trade chain to have a real impact on the overall business environment. These other institutions in the trade chain have limited capacity to modernize procedures due to staffing shortages, budget constraints, limited technical capacity, and a lack of innovation and decision-making at the working level. As a result, trade moves more slowly and at higher costs than necessary.

Major issues involving Nicaraguan supporting public sector institutions include (a) reduction of cumbersome, unnecessary bureaucratic demands and procedures within the import/export process to provide better security, faster delivery, and reduced costs to the trader; (b) adoption of a pro-business, client-orientated approach; (c) consistent policy of dissemination of information on procedures and requirements to the business community; and (d) public-private cooperation to resolve issues or develop streamlined procedures.

a. President's Committee on Competitiveness

The President's Committee on Competitiveness, under the umbrella of MIFIC, has recently started focusing on administrative reforms to improve the business climate in a comprehensive manner.

i. Committee's Efforts That Support Trade Facilitation

This is an excellent program, whose whole objective is to cut costs and time from the process of establishing and conducting business as an international trader, including all aspects from placement of the order to delivery of goods. Only through such an approach will modernization and simplification efforts have a substantial and sustained impact on the business environment. The staff of three dedicated to this project is developing a work plan and has had its kick-off meeting with the private sector to determine how the project is to be organized and how best to use the existing business sector clusters. In conducting its work, the committee is including other public institutions that regulate trade.

ii. Committee Issues to Address

It is imperative for the donor community support this effort. Through it, Nicaragua will be able to offer itself as a predictable, efficient trade partner, with clear and simple rules for investing, importing, and exporting.

b. Ministry of the Economy: CETREX

To help streamline the export process and move more players and commodities into the marketplace, CETREX was created in 2001. The goal is to establish CETREX as a one-stop center for all export transactions (except free zones). CETREX was funded through a loan of \$300,000 from the IDB.

i. CETREX Efforts That Support Trade Facilitation

CETREX's board of directors consists of public and private stakeholders in the process and is an example of the trade sector and the public sector working together to design a more facilitative export procedure. The CETREX filing process takes only 10 to 30 minutes and its fees cover all its operating costs in Nicaragua.

ii. CETREX Issues to Address

CETREX's goal of a one-stop shop is far from complete. Fully automated integration and interaction with the export community and the appropriate public institutions is not expected to occur by the 2005 deadline.

The failure to reengineer the paper process before automating remains one of the most significant impediments. Presently, only certificates of origin and MAGFOR export certificates can be obtained through the system. The exporter still must secure many other agency forms that apply to large segments of the export community, such as fishery products, wood, and pharmaceuticals, directly from the issuing agency.

CETREX is not electronically linked to the exporters. Paper documentation must be brought to one of the 10 CETREX offices located throughout the country for processing. One of the 22 CETREX employees then manually inputs the data and electronically transmits it to Customs. Customs does not process the electronic transmission until the shipment is physically at the border. Customs still has to perform its regular acceptance and selectivity processing.

CETREX fees are relatively high. El Salvador's one-stop export shop charges a flat fee of \$4 per transaction on a total of about 145,000 transactions per year. However, CETREX, which offers a much less comprehensive service, charges from \$3 to \$31 depending on the export value.

CETREX does not waive the filing requirements for low-value commercial shipments from occasional exporters. For example, a \$43 export shipment of shoes resulted in the payment of \$10 in CETREX fees. This provides a significant disincentive to comply and encourages black market activity.

Although CETREX's management is committed to the process, the programming expenses and limited technical capabilities are seriously hampering progress. On the national and regional bases, the donor community and the countries themselves should look for existing "best practices" to duplicate, borrow as much as possible from the existing best examples, and adapt them to the local environment. This approach would drastically reduce costs and delays in creating a more facilitative trade regime.

c. Ministries of Agriculture and Health

The public supporting institutions generally emphasize and view their principal responsibility as one of control rather than facilitation. Currently the two principal institutions that have major regulatory control over significant segments of the trading community, MAGFOR and MINSA, have no ongoing efforts to simplify and harmonize procedures. As a result, long standing, cumbersome, and unnecessary bureaucratic procedures continue to add delays and costs to the transaction which most affects small and medium-sized enterprises that have limited capacity to absorb the costs and time required. Excessive documentation and procedures also discourage new entrants into the market place.

MAGFOR is responsible for ensuring the safety of processed and raw food products for both human consumption and agriculture entering and exiting Nicaragua. This includes onsite visits to foreign production facilities to certify that the imported product is produced or grown in sanitary conditions, the registration of controlled products, and the issuance of import permits for these same items. Registrations performed by MAGFOR are valid for 10 years, cost \$250 each, and are required for animal feed, veterinarian products, and chemicals used by the agricultural industry. According to interviewees, approximately 2,500 are issued each year, and approval times range from 1 to 2 months. In regard to exports, this agency issues SPS certificates required by importing countries. With the full implementation of the CACM, requirements for some 500 presently controlled products by MAGFOR will be reduced or eliminated. Some 150 products have already been targeted for the elimination of import permits. MAGFOR has a staff of 500 to handle these responsibilities, with 350 of these positions stationed in the field.

The registration of pharmaceuticals, food, and medicines handled by MINSA was simplified for Central American products in November 2002. Such products imported into Nicaragua undergo

an abbreviated “recognition” registration process. This allows acceptance of the certification from the producing country’s authorities as to the safety of the product in lieu of laboratory analysis. However, the 450 to 500 such requests per month still take approximately 8 days to approve at a cost of \$100 each. The approval process for the approximately 240 monthly registration requests for products originating outside Central America take a minimum of 3 months to approve at a cost of about \$500 per item. Registration and recognitions are valid for 5 years. MINSA issues about 650 of these each week, and approval takes about 2 days. Each request costs \$2. Fees for import permits for MAGFOR, which number about 150 per day, depend on the product and volume and range from \$3 to \$100 per shipment.

i. MAGFOR and MINSA Efforts That Support Trade Facilitation

The IDB is sponsoring a \$7.3 million project to harmonize the food safety agencies under one administration. However, this does not include a review of procedures and documentation requirements to determine value added to the trade process and public safety. In addition, OIRSA, a regional organization which deals with health related issues, supports trade facilitation by performing fumigation services for Nicaragua’s MAGFOR. A percentage of its service fees is remitted to MAGFOR.

ii. MAGFOR and MINSA Issues to Address

MAGFOR and MINSA are hampered by excessive documentation and procedural requirements, and there are inadequate resources to facilitate the process through the introduction of automated systems that link the trading community. Moreover, there are no blanket permits to allow for repeat, customary imports. In addition to the registration process, MINSA and MAGFOR must issue an import permit for each incoming shipment. The permit process itself is manual with no interface with the traders or Customs, and permits can only be issued by the headquarter office. As a result, approval times are slow and often have complicated requirements. For example, MAGFOR approvals take about 1 to 2 days. In addition, the field inspector can accept permits for product overages of less than 500 kilos or 1,100 pounds. If this is exceeded, a new permit must be obtained from headquarters.

MAGFOR has inadequate funding, making it difficult to conduct training programs to update staff on new threats and technologies, as well as purchase new equipment. Approximately 50 percent of the operating budget (\$2.5 million) is collected through service fees, and the other half is provided by the donor community, principally the United States, Taiwan, Denmark, and OIRSA. In addition, employee salaries are inadequate, which results in high turnover rates and low expertise. MAGFOR field inspectors have specialized degrees in the agricultural field, and 80 percent receive less than \$400 per month, with 50 percent paid less than \$250 per month. MINSA personnel receive even less; the technical officers are paid about \$250 per month and administrative support about \$200.

d. Law Enforcement

Currently, Nicaragua’s security, both in terms of public safety and security of international transport movements, is among the best in Central America. The country has the lowest crime rates in the region. For example, one interviewee stated that Nicaragua has only 8 car thefts per

month, whereas Costa Rica has 17 per day, El Salvador 30, and Guatemala even more. In 2003, only one bank robbery occurred, and in 2004, none.

The National Police have a staff of 6,200 active duty officers who work to provide a secure environment within the country. Those units within the National Police that are directly involved in the interdiction of contraband into the country are the Narcotics Division and the Commercial Police. Together, they have a staff of about 300 officers—260 dedicated to narcotics interdiction and the rest to the interdiction of other smuggled goods. The majority of the narcotics officers (100) are stationed in Managua, with 8 officers and 3 canine teams assigned to the Peñas Blancas border.

i. Law Enforcement Operations That Support Trade Facilitation

In general, there is a good cooperation between Customs and the police. Customs contributes about \$3,000 per month to the budget of the Commercial Police to fund anti-smuggling activities. Police share intelligence concerning a shipment and work with Customs in detaining it. Commercial Police officers are stationed in the Customs risk management unit to exchange intelligence information and help with targeting. When Customs detains shipments, the police conduct subsequent investigations and arrests. The police work closely with communities to identify ongoing and potential criminal activities. This cooperation leads to preventive actions that help suppress crime.

ii. Law Enforcement Issues to Address

A visit to the site revealed that police procedures at Peñas Blancas unnecessarily delay trade. The site is understaffed and poorly designed, and the operations are redundant and poorly executed. At this border crossing, all commercial traffic is diverted to a special examination station, where targets are selected for inspection. One person, who also conducts examinations, handles selection. The selection process takes about 2 hours. The examination rate is 25 percent. Examination results are poor with a single discovery of drugs in the last year. A similar narcotics review is conducted on the other side of the border before the truck exits Costa Rica at facilities also funded by the United States. Little or no cooperation or sharing of information is exchanged between the two national authorities. There is also a lack of trust on each one's part as to the reliability of the results of an examination conducted by the other.

The police must balance security and trade within the Customs Union. If not properly implemented, the Customs Union could result in further delays. With the removal of the Honduran border crossings, the police anticipate a negative impact on the security environment. In response, the police are contemplating a significant increase in the number of road stops. For example, the Guasaule-Managua route currently has four checkpoints, and the police are considering increasing this to 27 under the Customs Union.

Smuggling remains a difficult problem. Police are unable to conduct sufficient routine surveillance of the unprotected border areas (“blind spots”) because of lack of personnel. The police believe that most smuggling schemes are now conducted through these points. An evaluation of the effectiveness of border sensors should be studied to determine their effectiveness in controlling the most vulnerable of these areas.

Panamanian imports pose a significant problem. Some 45 percent of all consumer goods for Nicaragua originate from the free zones in Panama. It is estimated that 85 percent of these shipments are undervalued significantly to reduce duty and tax obligations. It is claimed that the Panamanian authorities do not cooperate with either the police or Customs to establish the actual price paid. If true, the problem is a significant one for the region, and a regional strategy for eliminating or at least reducing this problem should be developed.

Better equipment is necessary. Tentative plans are now under way to secure high-tech scanning equipment that would allow the scanning of all trucks moving northward at this site. Tools such as density meters and probes are needed to increase examination results.

Judicial enforcement is inadequate. The Commercial Police also are in charge of the government's anticorruption investigative efforts involving allegations against public officials. However, because of the current state of the judiciary, prosecutions are difficult to secure. Nevertheless, thorough police work has led to successful prosecutions. These convictions, in turn, have lessened corruption within public institutions, especially Customs.

e. Registry of Intellectual Property Rights (IPR)

The IPR Registry office within MIFIC is staffed with 25 employees. It is divided into the four principal categories of IPR registration: trademarks, copyrights, patents, and new plant varieties. Trademarks are officially recorded within 6 to 9 months of submission at the cost of \$50 per item. Copyright registration is a 1-month process with a flat fee of \$40 plus additional fees from \$20 to \$100 depending on the product. Application fees for patents are \$200 with a 6-month processing time.

i. IPR Operations That Support Trade Facilitation

The IPR unit is committed to IPR protection and recognizes its importance in fostering innovation and creativity. Nicaragua is now compliant with the WTO TRIPS Agreement, although some modifications will be required for CAFTA. The IPR unit has automated databases to control the recorded items and information.

ii. IPR Issues to Address

The automated database system needs improvement. It is not sophisticated enough for the recording of visual material, which is especially beneficial for trademarks. Also, the system is not linked to other users, such as Customs, the Attorney General's office, or the National Police. An equipment upgrade that captures visual data and is linked to the enforcement agencies is necessary to meet CAFTA IPR requirements.

IPR protection has been a troublesome issue for Nicaragua. In general, enforcement is weak and ineffective as there is considerable ongoing infringement of copyrights pertaining to video and sound recordings. The IPR unit has no dedicated enforcement capabilities, and the few dedicated IPR prosecutors in the Attorney General's office are uninterested and untrained in IPR issues, leading to few cases being pursued. Presently approximately seven criminal cases are before them for prosecution, most of which have been pending for over 1 year and some for 4 years. Criminal prosecution is too lengthy, and often the few judgments rendered are unsound.

Due to long delays, high costs, and unpredictable results from the judiciary, many owners of IPR-registered items attempt to resolve issues through filing written complaints with the IPR Registry office. Once received, the office will meet with the alleged violator and seek an informal settlement such as payment of damages or license fees or the destruction of the infringing articles. Last year 50 such complaints were received and resolved, with only two moving to criminal proceedings because of failure to reach agreement between the holder and the violator.

Despite the sincere commitment of the Registry office, more training for staff, police, and Customs is required, through groups such as the Anti-Counterfeiting Coalition and the Business Software Association (BSA).

Presently the Customs officer at the border will look for and detain a potentially IPR-infringing article only if a judicial order has been issued based on a formal request of the owner. Under CAFTA, Customs will be responsible for the discovery and detainment of potential IPR infringements for both inbound and outbound merchandise. The National Police will also have a more important role in this process. Tools and training to assume this task and to increase the level of commitment and understanding of the importance of IPR protection to the overall business environment within this group must be provided as soon as possible.

2. Private Supporting Institutions

Private sector entities also contribute to trade facilitation. The strength of the trading community and its level of cooperation with the public sector directly affect the costs and speed of delivery to market for the international trader. These groups include customs brokers, the trucking community, vessel carriers and agents, freight forwarders, free zone operators, couriers, and bonded warehouse proprietors. Generally, the quality of these private institutions that serve the Nicaraguan importer and exporter is insufficient. Further, trade facilitators are in more than sufficient supply to meet current and future market demands. However, in some critical areas, such as the warehouse, free trade zones, and trucking sectors, major investment is needed to upgrade the facilities and streamline procedures that would reduce costs.

a. Import/Export Community

The export community and its trade patterns are somewhat unique in Nicaragua in that they are largely concentrated in a few exporters and few exported products. According to interviewees, there are currently 1,500 registered exporters, which recorded 39,020 commercial exports in 2003 and anticipate 44,000 this year, a 13 percent increase. However, 50 exporters and 20 commodities account for 75 percent of all the export trade. (These figures do not include activities within the foreign trade zones.) In addition, 70 percent of the export trade is destined for countries within the CACM and only 30 percent for the international market place. This places the continued progression of the Central American Customs Union and full regional integration as a major priority for Nicaragua.

i. Importers/Exporters' Efforts That Further Trade Facilitation

The Nicaraguan import/export community is well organized. Interviewees stated that there are 10 to 15 major associations within Nicaragua that represent the vast majority of the private sector

industries and services involved in international trade. Most have established themselves as influential and respected partners of the Executive Branch in advocating the views of their constituency. Some of the largest are the Chamber of Commerce, which includes 85 percent of the importing community and associations representing the service sector, such as customs brokers and freight forwarders, and the Chamber of Industry, a group whose 150 members represent 60 percent of the industrial sector. The umbrella organization to which 11 of these chambers belong is COSEP, which collectively represents 80 percent of the business community.

The Nicaraguan business community and the Executive Branch are engaged in an active dialogue to improve the business environment. The extent and effectiveness of this partnership vary between the public agencies and are most evident at the higher levels of the public organizations. For example, private sector representatives lead positions in working groups under its direction that will drive efforts to reduce the bureaucratic burden and therefore the costs of the import and export process.

One of the most recent innovations to improve communications between the public and private sector is the establishment of CIMCO, a committee that includes 40 representatives of 15 private organizations and the public agencies involved in international trade. This group meets twice a month to resolve issues between these two sectors as well as among themselves, ranging from security and infrastructure to Customs and transport. This same type of committee is now present in each CAFTA country, and the hope is that their regional meetings will strengthen regional harmonization efforts.

Trade associations are also active in regional groups that represent their constituency on a Central American level. Such regional entities should be a major force in the expansion of regional cooperation and strategic planning to make Central America more competitive.

ii. Import/Export Community Issues to Address

The government should encourage these national associations to promote harmonization efforts. Investors often look at the area as one entity and require security of transit throughout the region and a facilitative, standardized, and seamless process in crossing from one country to the next. In addition, economies of scale in such areas as transport improvements only make economic sense when considered on a regional basis.

The decisions made at higher levels of public-private sector coordination must be implemented through the lower levels. Agreements often fail because there is no, or poor, follow through with working-level employees. Public agencies must correct this situation through training efforts.

Employees at all levels of public institutions must be involved in the process re-design to secure their full commitment and cooperation in successful implementation.

Effective regional-level working groups are key to competitiveness. Although CACM requirements state that all merchandise moving within the CACM can be carried by any of the region's registered truckers, many of the countries, aiming to protect their national transport industry, require national products to be transported only by in-country truckers. Because of recent action by Nicaragua, this issue is a major source of contention within the region.

b. Transport Industry

Nicaragua has an underdeveloped and inefficient transport industry. There are approximately 18 vessel agents and 49 freight forwarders registered to do business in Nicaragua according those knowledgeable of this issue. In addition, about 10 to 20 companies operate informally. There are approximately 3,600 trucks in the current trucking fleet. This fleet is spread among 200 companies plus many sole operators of one truck. Five major courier companies carry 90 percent of the country's express packages.

i. Transport Industry Efforts That Further Trade Facilitation

The new Transport Law pending before the National Assembly at the time of the assessment will impose regulatory requirements on freight forwarders and require the posting of a \$7,000 per year guarantee to ensure professional conduct. The result should be the upgrading of quality standards and the elimination of small, unscrupulous operators who cannot be held responsible for misconduct from the marketplace.

The Nicaraguan Couriers Association enjoys an excellent working relationship with Customs, and together they are acting on reducing delays, controlling smuggling via their services, and developing a courier manual for procedural clarity and training of their respective personnel.

Competition in the market for freight forwarders has forced this sector to improve its level of service and streamline costs to remain competitive.

ii. Transport Industry Issues to Address

The sector most responsible for the high costs of international transport in Nicaragua is the trucking industry. This industry has the most pressing problems, and without some attention, it will not be able to meet the growing demand efficiently or lower its costs enough to make the movement of Nicaraguan imports and exports more competitive. Oversupply in the trucking community has impeded modernization of the fleet and resulted in higher transport costs because economies of scale cannot be realized.

Transporters are faced with security problems in Puerto Cortes in Honduras. Interviewees stated that many truckers only travel between 6:00 a.m. and 6:00 p.m., and hire armed guards to accompany them through the territory (at a cost of \$150). Truckers are faced with bribes at the Honduran border and as many as 12 checkpoints on the highway between Cortez and the Nicaraguan border where bribes are demanded. These factors can add up to 6 hours per trip. Thus, a journey that should take 32 hours takes 48 hours, resulting in an average speed of 15 kilometers per hour along the route.

In addition, Nicaragua's dependence on its neighbors adds significant costs and delays. Despite the advancement of the Customs Union between Honduras and Nicaragua, which has border delay times down to at most four hours, Honduran Customs often imposes additional requirements either at the border or at Puerto Cortes. Delays at Peñas Blancas average *1 to 3 days*, primarily due to Costa Rican procedures. Better cooperation with Costa Rica is imperative.

Practicalities directly associated with truckers also add costs. The price of fuel adds significant costs. Nicaragua has some of the highest fuel prices in the region. It also has the oldest fleet,

which results in high consumption rates and higher rates of repair. In this regard, truckers need new mechanical skills to service updated vehicles. In general, the trucking fleet is outmoded. However, low demand and lack of access to credit at reasonable rates hamper modernization. Almost all updating is through the purchase of used vehicles from the United States, at a cost of about \$25,000 per unit. Current interest rates for such purchases run around 18 percent with collateral required in the form of property or real assets at 1.5 times the amount of the loan. The lack of a regional vehicle insurance system adds significant costs. Multiple policies and premiums are required to operate, driving up costs.

Couriers also face numerous obstacles, although improvements are being made. Lower value courier packages are processed rapidly, while higher value packages move slowly. Reportedly, packages under \$1,000 are released within 2 to 4 hours of arrival. However, in an industry in which speed is everything, those exceeding \$1,000 can take from 6 hours to 3 days. The courier process would benefit from automation which would allow the manifest data to be downloaded to the Customs system in advance of arrival, so that most merchandise releases would occur simultaneously with arrival. Customs, however, does not have the funding for such modernization efforts.

c. Foreign Trade Zone and Warehouse Operators

Efficient free zone operators are critical factors in attracting investment and expanding zone activities. Free zone activity is an area where Nicaragua is in a unique position within Central America to attract new business. Labor costs are the region's lowest. The WTO has authorized continuation of the zone's lucrative tax incentives until the average yearly income reaches \$1,000.

Efficient warehouse operations are important as well. The rate for a full container stored on a lot is \$55 per container. Containers under-roof include four separate charges: labor at \$30 to load and unload a container, 20 percent of CIF value for storage after 15 days, 15 percent of CIF value plus taxes for insurance, and \$3.50 per metric ton handling charges.

i. Foreign Trade Zone and Warehouse Operators' Efforts That Support Trade Facilitation

Numerous aspects of free zone operations facilitate trade. Customs is onsite to oversee operations. Customs oversight should provide sufficient control at minimal costs and delays to the user. The warehouse proprietor provides the officers with space, hardware, communication lines, and all supplies. Recently a proprietor paid more than \$6,000 to establish one such office. Although this procedure adds transaction costs, it is *elective* and viewed as a cost-effective service for a large segment of the importing community. The operators provide a quality service as indicated by a zero termination rate since the 1990 zone inception. Lastly, warehouse facilities are adequately secured with little loss noted, and security cameras are used to monitor activity.

ii. Foreign Trade Zone and Warehouse Operators Issues to Address

Nicaragua is working to overhaul Customs zone procedures. This effort should be supported, include the adoption of risk management and post audit techniques, and lead to a significant reduction in Customs intervention and an increase in detection of irregularities. The result could

serve as the “best practice” model for the region because streamlining the Customs free zone processes is required in all CAFTA countries.

Operators are often pressed to find required capital to build facilities to suit potential customers who only want to rent the building under long-term lease agreements. There is no existing supply of buildings in good condition that could meet this need.

Free zone operators must automate their control systems to link it with the users and Customs. An available software package for zone operators should be located and adapted by the operators.

Warehousing adds significant costs to import shipments, because the warehouse is used only for a few days. Warehousing is not the traditional concept of long-term storage for duty and tax deferral. The current 16 warehouse facilities are used for short-term storage (20 days or less), during which the owner can examine the merchandise and determine whether he or she wants to accept the shipment. Approximately 40 percent of all imports transit through these facilities, and most remain there only a few days. As a result of the constant use, warehouses are in poor condition. Operators and investors are unwilling to make substantial improvements to the facilities due to political uncertainty.

d. Customs Brokers

Nicaraguan customs brokers rank with El Salvador as the most professional in the region, due in large part to the active training program of the Nicaraguan Chamber of Customs Agents. Currently, there are 220 licensed custom brokers operating 160 companies. About 5 companies handle 50 percent of the business.

i. Customs Brokers Actions That Facilitate Trade Facilitation

Customs brokers’ training program includes both a 3-month course for all applicants as well as ongoing weekly programs on specialized topics such as valuation and procedures. Through such courses, standards for customs brokers have been raised. Moreover, as of February 2002, due to new CAUCA requirements, all new broker applicants must have a university degree and pass a competency test administered by Customs.

The brokers have an effective and open relationship with Customs. For example, there is a long-standing policy for Customs to share draft policies or procedures with the brokers association for comment prior to implementation.

Other required providers of services to the trade community, such as express consignment companies, freight forwarders, and vessel agents, are in good supply, of professional quality, and cost efficient. However, all stress the need to continue simplifying and standardizing procedural requirements, particularly with Customs processing, to reduce delays and lower costs.

ii. Customs Brokers: Issues to Address

Customs brokers must continue to upgrade their capacity and professionalism. Currently approximately 60 percent of the brokers lack the required university degrees. Moreover, despite

generally adequate cooperation, customs brokers do not always receive advanced notification on changes to and opportunity to comment on customs rules.

E. SOCIAL DYNAMICS

Nicaragua's present government has a strong pro-trade facilitation agenda. It has already identified major areas of required reform and initiated some programs and working groups to resolve them. The business community, whose influence has been increasing, has been willingly pulled into this effort, and both now view themselves as partners in improving Nicaragua's competitive position within the region and internationally. The leadership at the top level of the government has issued strong signals to the public agencies, traditionally not prone to innovation or customer service, to reform the import/export process. Some, like Customs, have been more responsive than others.

Nicaragua suffers from deep political divisions and unusual coalitions that distort the decision-making process and permeate all phases of governmental and business activity. "Bending the rules" to favor the politically connected is not uncommon. The National Assembly has been unpredictable and at times unsupportive of the Executive Branch's economic reform agenda. When proposed legislation drafted in conjunction with the trade community to develop a more open and competitive environment is submitted to the Assembly, it either is not acted upon or results in passage of a law substantially different from the draft. These changes are made without consultation with the trading community or Executive Branch and often defeat the original intent. Legislation is often adopted based on personal interests, not national priorities. To avoid the legislative process, ministries effect changes through the issuance of presidential or ministerial decrees where possible.

The Executive Branch's anticorruption campaign was initially aimed toward previous government officials and had little impact on other public employees. Ethics training for government personnel is still not in place. However, efforts are under way to push the anticorruption message through the ranks. The result has been a significant reduction in corruption among public officials, especially within Customs, where strong leadership has produced results. The trading community readily acknowledges this improvement and has assisted in the effort through the reporting of offenses.

The government's commitment to and success in combating corruption is recognized internationally as evidenced by the August 2004 formal partnership agreement between Nicaragua and the G8 countries whereby the latter will assist the government's efforts to promote transparency. The country was selected for this assistance based on its sincere efforts to be a good example in the fight against corruption.

The media plays a significant role as "watchdog" in Nicaragua. Currently two major newspapers and four television networks are considered to be truly independent and capable of balanced editorials. Generally the press in all its forms operates free of political pressure and works often with the Executive Branch to uncover and pursue unscrupulous behavior on the part of public officials. This was demonstrated recently with the campaign to remove impunity for the ex-president and other high-ranking officials.

F. RECOMMENDATIONS

- ◆ Improve funding for modernizing trade-related institutions. Provide customs access to the revenue generated by current service fees, and develop and promote WTO compliant user/service fee for declaration processing to augment the budget or create a fund. This funding should be allocated to priority areas, such as payment of salaries, purchasing equipment and tools, modernizing Customs, and upgrading facilities to help develop a process of electronic pre-arrival payment and release.
- ◆ Assist Customs in advancing its modernization efforts. Provide additional training and a training curriculum to promote sector specialization and increase the capacity of those officers specialized in (a) Customs classification and valuation; (b) commercial fraud detection techniques; and (c) incorporating existing risk assessment procedures into a comprehensive risk management program to include advanced IT capabilities/support, strategic sector analysis, and a well-developed post audit procedure.
- ◆ Improve Customs' infrastructure. Identify and provide funding for additional tools for Customs examination sites and for upgrading the current small laboratory facility, including the following: (a) modern tools for personnel dedicated to examining cargo; (b) resource materials and software for the laboratory; (c) updated equipment for the laboratory; (d) floor scales to weigh incoming and outgoing cargo; (e) major equipment such as container scanners for a less intrusive but more productive approach to detecting weapons, drugs, and contraband and improving border protection; and (f) cameras for goods warehouses and commercial cargo lots to prevent access to or pilferage of goods under Customs' control.
- ◆ Implement compliance and criminal prosecution. Assist in the following activities: (a) support the reform of the judicial system to further the prosecution of Customs criminal offenders; (b) strengthen broker penalties and provide Customs with greater ability to discipline those brokers who assist and promote noncompliance within the trade community; (c) review minor penalties and refrain from charging penalties for clerical errors unless it seems that reasonable care was not exercised; and (d) support and reward compliance by providing benefits such as expedited processing and release to compliant traders.
- ◆ Work with Central American countries to create a regional laboratory. Develop a regional laboratory for the complex analysis that local national laboratories cannot accomplish due to the expense of equipment and a lack of local capacity
- ◆ Streamline trade-related processes. The import process should first be streamlined to reduce requirements. A critical in-depth analysis of each step in the process must be documented and analyzed to determine whether it is essential to public safety and its impact on the facilitation of international trade. The trade community must be an essential player in this process. The number of documents must be reduced and the requirements for signatures and stamps be eliminated. Issuance of blanket import permits for a period of time or elimination of them altogether should be explored, particularly considering what will happen with Central American goods with full CACM implementation and the fact that the product has been tested and deemed safe by the

agency in the registration process. If full registration requirements can be waived for Central American products, thought should be given to providing the same simplified procedure to like items from the United States and those European nations whose regulatory agencies are considered of high quality. The rationalization of the current paper-based system does not require major investment and can yield significant results.

- ◆ Modernize trade-related processes. Only when trade-related processes have been streamlined and simplified should steps be taken to incorporate IT and electronic processing into the dynamic. However, this is an important second step. Such automation, which is nonexistent presently, must link to both the trade community and the Customs processing system so that the trader can submit requests online and receive notifications electronically through a Web application. MINSA must have Internet access to query the U.S. Department of Agriculture (USDA) site to review approval and technical information on U.S. pharmaceutical products being introduced into the Nicaraguan market. MAGFOR field offices and the laboratories of both these agencies must be incorporated into the system to expedite notifications to trade and field offices. This will require a major investment and require support from the international community.
- ◆ Upgrade and reevaluate MAGFOR field operations. Little risk profiling and analysis is conducted by the agency or field personnel, and examinations on products such as rice and grains are routinely made without significant findings. The lack of automated capabilities within the agency severely hampers its ability to analyze examination results to verify the compliance of importers and exporters—that is at the very core of a risk management system. However, even in the present situation, the concept of selectively could be introduced at each field border. The products and shippers moving through each point are fairly repetitive and therefore well known as to their level of compliance. Based on this knowledge, each office could create its own selectivity or red–green program, reviewed by headquarters, with an aim toward moving to only random examinations for the more reliable traders and products.

MAGFOR should also explore moving some more routine laboratory analyses to the field for testing as is the process in several countries. Presently all samples taken by the field inspectors are sent to the agency’s central laboratory for analysis. The testing fees range from \$4 to \$80, and results are generally returned within 3 to 6 days. The product must be kept either at the border or at the importer’s premises pending these results. Simple testing in the field could reduce this delay on some products to minutes or hours.

- ◆ Foster a healthy business climate. Fostering a healthy trade facilitation climate requires that the government not only direct its public institutions to facilitate and reduce the costs of the import and export process, it must also create a secure environment that limits smuggling and the introduction of contraband into the economy to minimal levels through effective detection and enforcement policies while respecting the rights of its legitimate traders. Legitimate trade cannot thrive in a climate where a large segment of the competition does not absorb either the same costs or the same requirements.
- ◆ Implement a regional goods transit system. Strong efforts must be made by Nicaraguan authorities to demand that all the countries participating in the Customs Union follow the facilitative measures agreed upon and not institute additions requirements. At a

minimum, a regional transit module must be implemented and the possibility of a regional insurance policy explored. Advancement of the Custom Union should include elimination of either FAUCA, the Customs declaration for Central America, or the transit declaration because both contain almost identical information. Training should also be provided to the drivers (perhaps through the Nicaraguan Technical Institute, which employers fund through a 2 percent tax on payroll) on driver safety, updated mechanicals skills and technology, and new Customs Union requirements so that unscrupulous agents at the border cannot charge for services no longer required. Customs officials could provide the training on Customs Union requirements.

XII. FLOW OF PEOPLE

A. INTRODUCTION

Annual visitors to the country numbered over 525,775 in 2003, up from 468,159 in 1999, a 12 percent rise. According to information obtained from the Nicaraguan Immigration Service, roughly 62 percent of Nicaragua's arrivals enter at the land crossings, 34 percent of travelers pass through airports, and 4 percent arrive by sea. The greatest share of visitors comes from other Central American countries, at 60 percent. Almost two-thirds of these visitors travel from Honduras. North American visitors account for 26 percent of total visitors, Europeans 9 percent, and others make up the remaining 5 percent. The airport has the highest flows with 34 percent of the traffic, while Peñas Blancas and Guasaule mark the other two major entry points with 22 percent and 18 percent, respectively. Las Manos and El Espino handle roughly 10 percent of overall traffic each. Approximately 49 percent of travelers visit for business, 35 percent for tourism, and 17 percent for other reasons.¹⁴³ Revenue from tourism provided \$151 million in 2003, up from \$107 million in 1999, reflecting a 41 percent rise and the second highest export after coffee.

The issue of illegal people flows remains a significant problem. Nicaragua's borders with Honduras and Costa Rica are long and porous. Nicaragua's little developed eastern part of the country provides a frontier for narcotic traffickers to operate. Nicaragua serves as a key origin and transit country for illegal immigration to the United States and Costa Rica. The risk of kidnapping is low and rarely affects foreigners.

Overall, Nicaraguan laws and public and private institutions support flows of trade-related people. However, Nicaragua could do more to modernize its management of highly skilled visitors seeking longer term stays, and it could do much more to address illegitimate flows.

B. LEGAL FRAMEWORK

Generally, the laws and regulations require no undue burdens for those traveling as temporary tourists or on trade-related business.

1. Immigration Operations That Support Trade Facilitation

The law does not require a visa for visitors from the United States, the European Union, Canada, Mexico, or CAFTA countries.

2. Immigration Issues to Address

The legal framework for people flows was last updated in the early 1990s and requires modernization. The law lacks classification for various types of visitors, such as students and specialized working designations. Moreover, the legal framework is especially inadequate with respect to security issues and needs updating to address issues such as human trafficking and terrorism.

¹⁴³ Numbers do not total 100 percent due to rounding.

With regard to regional harmonization, the CA-4 requirements provide a model in the immigration area.¹⁴⁴ These new requirements allow CA-4 members to travel freely without a passport and will soon allow the international traveler to move within the CA-4 with only one immigration review at the point of entry.

C. IMPLEMENTING INSTITUTION

Overall, the major implementing institution, the Immigration Agency, which numbers approximately 500 employees, has a clear mission and is adequately staffed.

1. Immigration Issues That Support Trade Facilitation

Regulations require a visa fee on arrival and an airport tax on departure, but the fees are nominal, \$5 and \$33, respectively. The fee is collected by the airlines.

In prior years, the immigration agency had a reputation as being corrupt. In recent years, however, this image has been changed through reforms and modernization. Most users now see the immigration processes as transparent, predictable, and relatively efficient.

Unlike other Central American countries, Nicaragua has a streamlined system for longer trade-related stays. Procedures are few and efficiently and transparently executed. The \$50 cost is considered reasonable. Times for processing these requests have been reduced from months of bureaucratic hassles and visits to the Immigration Agency to two visits to Immigration and a 3- to 5-day turnaround (one for an interview and initial paperwork and the second to receive a permit). Immigration has further facilitated this process by including immigration officials at the one-stop investment office.

The Immigration Agency has sponsored a public awareness program with USAID that addresses the flow of illegal immigration and trafficking in people. Through the media and promotional materials, the campaign has worked to warn people of the dangers of illegal immigration that include abuse, fraud, and slave labor

2. Immigration Issues That Need to be Addressed

The Immigration Agency's equipment is inadequate. Officials posted at border crossings, ports, and airports lack modern equipment for handling people flows efficiently and securely. For example, passport reading technology is not available at the major airports or border crossings. Computers are in use at the airport; however, the system is rudimentary and handled only by manual inputs to computers. At the land borders, there are no computers for basic processing. Headquarters is not connected electronically to these sites, and the sites are not interconnected electronically. When issues arise, record investigations are done manually.

As a place for origin and transit of illegal migration, Nicaragua's institutions are inadequate for safeguarding its borders and deterring its people who seek to migrate illegally. Nicaragua has started a program, funded in part by USAID, to raise public awareness of the victims of human trafficking, and it includes other ministries, such as Justice and Labor, and the National Civil

¹⁴⁴ The CA-4 is a regional visa valid for El Salvador, Guatemala, Honduras, Nicaragua.

Police. Nicaraguan immigration officials use watch lists from the Interpol, the United Nations, the United States, and other sources to monitor the entry and exit of dangerous persons. However, this procedure must be executed manually, which makes it basically ineffectual.

D. SUPPORTING INSTITUTIONS

The primary supporting institution, the National Civil Police, is not viewed as a strong institution. The Immigration Agency administers the laws, while the police provide the law enforcement function, such as detentions and arrests. The police force is understaffed, ill-equipped, and has a reputation for being corrupt.

Nicaraguan officials have taken efforts to safeguard visitors to the country with the establishment of a specialized unit regarding tourism. Tourism police are trained in tourist security, language, culture, and crime-fighting laws. These police focus on special areas, such as Managua, Granada, and San Juan del Sur.

Infrastructure and services regarding people flows, as elaborated further in this report, are inadequate. Nicaragua effectively has one international airport in Managua, where there are direct flights daily from many cities in the region and North and South America. However, other than a flight between Granada and San Jose, Costa Rica, there are no other international airports currently in operation in Nicaragua. Domestic flights are available to several locations in the interior, the Atlantic coast, and Corn Island in the Caribbean. Intra-country road travel is difficult due to poor infrastructure. Major highways are few, and some of these are in poor shape.

E. SOCIAL DYNAMICS

Trade-related people flows are generally supported at all levels as Nicaragua is relatively open. People flows, particularly in the form of tourism, are widely supported and encouraged at all levels: the Executive Branch, the legislature, private institutions, and the general public. There is support in the business community and government for a business visa to further facilitate business travelers.

F. RECOMMENDATIONS

- ◆ Revise laws to reflect a modern immigration system. Immigration laws need to be modernized to reflect the changing times. Laws that allow certain types of visitors that Nicaragua should encourage (i.e., the highly skilled) should be implemented, and criminal laws targeted at those who abuse the system should be passed and implemented.
- ◆ Increase automation for greater efficiency and security in processing people. Immigration is in particular need of automation of the processing system. Better technology will enhance security and increase efficiency in processing people. The current mostly manual system hinders officials from effectively monitoring entrants, and also makes it difficult to process travelers quickly.

XIII. FINANCIAL CRIMES

A. INTRODUCTION

Integral to any discussion of financial crimes in Nicaragua is the pervasive corruption of the political and judicial systems. On the one hand, Nicaragua has lower levels of ordinary crime, such as theft and robbery, than most of its neighbors. Financial crimes, on the other hand, seem to be flourishing, although a few money-laundering prosecutions have occurred. One of the few convictions is very significant, namely that of former President Alemán.¹⁴⁵ The exceptionality of the Alemán prosecution merely highlights the general lack of financial crime enforcement in Nicaragua. The corrupt and politicized nature of the judiciary, also weakens the ability for prevention, investigation, and prosecution of financial crimes.

B. LEGAL FRAMEWORK

The relevant laws are those on money laundering and the Superintendency of Banks. The first money-laundering law was passed in 1999, namely the Law on Drugs and Narcotics, Money Laundering and Assets proceeding from Illicit Activities (“Law on Drugs and Narcotics,” Law No. 285, published in the *Gaceta Oficial* No. 69 and 70, April 15 and 16, 1999). The other is the Law on the Superintendency of Banks and Other Financial Institutions (Law No. 316, published in the *Gaceta Oficial* No. 196, October 14, 1999). In addition, the general criminal (and drug) code includes some financial crimes provisions.

The Law on Drugs and Narcotics, the money-laundering law, provides for a Commission on Financial Analysis (CAF) to lead the anti-money-laundering efforts. The committee consists of the Superintendent of Banks, the *Fiscalia*, its president, representatives of the Central Bank, public accountants, and two representatives from the National Police: the chief of Drug Police and the chief of Economic Police. The law does not provide for inclusion of the Attorney General. All reports of financial crimes are routed through the committee. The committee, however, has no structure, staff, or budget of its own. Administration of its responsibilities falls to the individual member agencies, which operate from their own budgets.

It took some time from passage of the money-laundering law to its full implementation as regulations were not fully promulgated in 2002. These included administrative instructions outlining internal coordination. In addition, the Superintendency of Banks distributed guidelines and handbooks to banks and other covered entities. They required that banks designate their own compliance officials to cooperate with the Superintendency and to report any transaction over \$10,000.

The Superintendency is currently proposing reforms to the anti-money-laundering system, based on the GAFI/FATF standards and is working with the National Assembly Anti-Drug Commission (equivalent of a U.S. congressional committee in this regard). Two draft laws would reform the institutions that deal with money laundering and also the money-laundering offenses

¹⁴⁵ Besides Alemán, the only other prosecution for money laundering dealing with proceeds other than from narcotics distribution involved one of his associates, Byron Jerez, former head of the Nicaraguan tax collection office.

themselves. These proposals seek greater cooperation among police, government, and regional and international bodies. The proposals would also separate money-laundering laws from drug offenses to clarify that the crime can result from other illegal activities. The proposals would give greater autonomy to the Committee on Financial Analyses by providing staff expertise. Its director would be appointed by the President, with the appointment ratified by the National Assembly.

The need for reform stems from the controversy over the coverage of the money-laundering statute. The *Fiscalia* (prosecutor) and the Attorney General vigorously disagree on the law's interpretation. The *Fiscalia* (prosecutor) takes the position that the money-laundering statute applies only to the proceeds of drug trafficking. Others involved in enforcement of the law, particularly the Attorney General, disagree and contend that a prosecution for money laundering can be based on the proceeds of other illegal transactions. As discussed in the following section, "Implementing Institutions," this is not simply an academic dispute over a matter of legal interpretation but one directly related to the prosecution of former President Alemán, who was convicted for nondrug-related money laundering. Given these political tensions, the prospects for reforms remain uncertain.

C. IMPLEMENTING INSTITUTIONS

1. Commission on Financial Analysis

The CAF is part of the national Anti-Drug Council in the *Ministerio de Gobernacion* (Interior). It is an inter-institutional organization made up of officials who unfortunately do not have adequate time to devote to the issue. The president of the commission is the Attorney General. Due to lack of a budget and staff, it is not actually autonomous.

When a bank reports a suspicious transaction, the bank sends it to the Superintendency, which is required by law to send it to the CAF and the Attorney General. The Attorney General will send it to the economic unit of the National Police for investigation, who do have some technical training in this regard. The police investigate and then pass it back to the Attorney General and the CAF, which makes a recommendation. But without technical experts of its own, the CAF serves more of a bureaucratic function. As a result, many cases die there. The will may be there, but the institutional structure is weak.

2. Superintendency of Banks

The Superintendency of Banks and Other Financial Institutions is an independent regulatory agency created in 1991 with the assistance of USAID and the IDB. The Superintendency is responsible for establishing prudential norms, granting operating licenses, and supervising banks, non-bank finance companies, leasing firms, insurance companies, bonded warehouses, and the domestic stock exchange, "Bolsanic." The law that created it gives it broad enforcement authority, ranging from fines to revocation of operating licenses.

The financial system basically started from scratch in 1991 when the revolution ended and the country moved away from nationalization. For some time, the private banks in the country had little supervision as the Superintendency was in the process of establishing its procedures and

organization. During this period, until the late 1990s, many banks failed due to fraud and corruption.

By 2000, however, the Superintendency became more effective and engaged in its supervisory role, paying more attention to risk management in making decisions, incorporating concerns of exchange rates, credit risks, institutional stability, etc.

The superintendent and vice superintendent are nominated by the President of Nicaragua and confirmed by the National Assembly. Major policy decisions must be approved by a five-member board made up of the Superintendent, the Minister of Economy, the Minister of Finance, the Central Bank President, and a representative of the leading opposition party. Although decisions of the Superintendency may be appealed through the court system, this has never occurred. Fees assessed on supervised institutions fund the Superintendency. In addition, as a result of negotiations with the International Monetary Fund, the government has pledged to ensure that the Superintendency has the resources necessary to perform its duties.

As of 2002, the Superintendency had a staff of 105, of whom 30 are analysts, auditors, and/or inspectors. A number of the auditors were U.S.-trained, and their uniform accounting manual was developed with the assistance of USAID-funded consultants. Banks, finance companies, leasing firms, insurance companies, bonded warehouses, and the stock exchange are required to report consolidated financial data to the Superintendency on a regular schedule.

Currently the Superintendency regulates six banks, three financial entities, four insurance companies, and four bonded warehousemen, and it works with the stock market and supervises brokers. There are no state-owned commercial banks.

The Superintendency recognizes that financial crimes, particularly money laundering and terrorist financing, are matters of particular concern. Without controlling money laundering, it realizes it will be unable to stop organized crime. The level of money laundering, as everywhere, is difficult to measure, but here it is especially difficult due to a weak legal framework.

3. Attorney General and *Fiscalia*

Responsibility for prosecution is divided between the Attorney General and the *Fiscalia* (prosecutor). The Attorney General prosecutes offenses against the state, which includes financial crimes of money laundering, fraud, and embezzlement. The *Fiscalia* prosecutes for offenses against individual victims. Given that some financial crimes can involve the jurisdiction or competence of both offices, both officers may have authority to prosecute a single case.

The office is authorized to have 14 assistant attorneys. Currently it has only four assistant attorneys and one analyst, plus one person for each of the country's five regions. The office, however, is being assisted with funds from donor organizations.

The Attorney General's office works on cases with the United States, dealing directly with U.S. Customs and Immigration. Locally, cooperation exists between the Department of Justice Attorney at the U.S. Embassy and the Nicaraguan Attorney General's office.

The *Fiscalia* reports three convictions for drug-related money laundering from the start of the new system on December 24, 2002. These convictions, reversed on appeal, are pending further appeal. The *Fiscalia* reports that it is investigating 36 other drug-related money-laundering cases.

The *Fiscalia* reports that recently the office created a unit directed at organized crime and corruption. Three prosecutors are supposed to be assigned exclusively to such matters. This office will be responsible for seven types of crimes: money laundering, white-slave trafficking, terrorism, vehicle theft, arms dealing, narcotics trafficking, and illegal immigration.

4. National Police

The law enforcement entity in Nicaragua is the Nicaraguan National Police (NNP). It comprises about 6,000 officers, of which 90 percent are involved in drug investigations. The National Police personnel are reported to be highly motivated and hardworking, but they suffer from inadequate funding, training, and lack of basic equipment, such as vehicles.

Two divisions are involved with money laundering: the Drug Police and the Economic Police. The Drug Police unit has jurisdiction over money and other property seized in connection with drug trafficking. The Economic Police unit handles investigation of various economic crimes, including nondrug-related money laundering. The U.S. Embassy in Managua reports sufficient cooperation from the police.

D. SOCIAL DYNAMICS

The extent of money-laundering activity in Nicaragua is unknown. However, the lack of declaration requirements in terms of the importation/exportation of currency and financial instruments, as well as the facilities available to foreigners for the purchase of real estate, enhance Nicaragua's attractiveness to money launderers. The government of Nicaragua and its police counterparts recognize money laundering as a threat and have solicited assistance in effecting reforms.

The Alemán administration had demonstrated seriousness of purpose and commitment in combating drug trafficking and drug consumption. The new U.S. Drug Enforcement Agency office in Managua has facilitated more effective police interdiction efforts and bilateral cooperation to improve law enforcement efforts.

The Bolaños administration has made a high priority of attacking the corruption prevalent in the prior government. An Office of Public Ethics has been established within the presidency to guide anticorruption policy. The lead agency in investigating and prosecuting cases of corruption is the Office of the Attorney General (*Procuraduria*). In addition to the Attorney General's office, the Office of the Controller General has responsibilities for prosecuting corruption cases. The office, controlled by the two leading political parties, has not succeeded in bringing corruption cases to court.

There have been few serious allegations of corruption against senior officials of the current administration, but Nicaraguan business people and U.S. investors report that corruption remains a concern, especially in the judicial system. Bribery is illegal in Nicaragua but has no specific penalties. Efforts to strengthen the judicial system have occurred, through, for example, the

approval of a "judicial career law," to make the selection and retention of judges merit-based. This was passed in late 2004 and as such its effectiveness is not yet known.¹⁴⁶ President Bolaños's anticorruption campaign has cost him political support within his own party and in the National Assembly, however. As a result, he has been unable to implement meaningful judicial reform or win the nomination of judges free from ties to political parties. The concept of conflict of interest is poorly understood, to the extent that regulators often maintain business interests in companies that they regulate. In addition, it was reported by many interviewees that political connections and nepotism often affect regulatory decisions and business decision-making.

E. RECOMMENDATIONS

- ◆ A bill is currently being considered, but is not yet before the National Assembly, that will clarify the scope of the crime of money laundering by, among others means, specifying that it applies to funds derived from other illegal activities, not just from drug transactions. This bill should be made law.
- ◆ Additional resources should be made available to the agencies responsible for investigating and prosecuting money laundering based on a clearer and more efficient allocation of responsibilities.
- ◆ Current legislation should be amended to clarify relationships between the various bodies involved in financial crimes investigations and prosecutions.

¹⁴⁶ The *Ley de la Carrera Judicial*, No. 501, Article 3. November 30, 2004 (the full text of the law is available at http://www.presidencia.gob.ni/buscador_gaceta/BD/LEYES/2005/LEY%20No.%20501%20CARRERA%20JUDICIAL.pdf).

XIV. FLOW OF MONEY

A. INTRODUCTION

Cross-border goods and services transactions reflect a relatively small yet significant amount of monetary exchange that pays for those goods and services traded—approximately \$2.5 billion in goods and \$562 million in services traded annually in 2003. Of the goods flows, only \$605 million were exported, whereas almost \$1.9 billion were imported. Services were more evenly split: \$213 million exported and \$349 million imported. Remittances also represent a major trade-related financial flow.¹⁴⁷ In 2003, an estimated \$500-600 million (approximately 16 percent of the gross domestic product or GDP) poured into the country, sent by Nicaraguan workers and families abroad.¹⁴⁸ It should be noted that as with other CAFTA members, Nicaragua is challenged by illegal money flows.

Overall, Nicaraguan laws and public and private institutions support these trade-related money flows. Trade finance products are available to all traders. Foreign currency exchange is widely available and easily exchanged for all traders. Credit for export is very difficult due to a high risk premium that reflects serious structural issues, such as a low capital base, little competition in the financial services market, an ineffectual judicial system, and little private production capacity.

B. LEGAL FRAMEWORK

In Nicaragua, the basic legal framework regarding the efficiency and security of financial flows is generally sufficient. The legal framework for credit to assist import and export, however, is wholly inadequate. Interest rates are high, due to multiple factors, but two prominent reasons are out-dated banking laws and a judicial system suffering from corruption.

1. Legal Issues That Support Trade Facilitation

Domestic private banks operate throughout the country. However, no foreign banks operate in Nicaragua.

The Trade Finance Guidelines by the International Chamber of Commerce (ICC) are generally applied, and the laws are in conformity with the Uniform Customs and Practice for Documentary Credits.

The legal structure for trade-related finance allows for payment through wire transfers, foreign checks, commercial letters of credit, standby letters of credit, documentary collections, and open accounts.

Importers and exporters do not find the legal framework for exchanging payments to be overly cumbersome or complicated.

¹⁴⁷ See <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=SV,NI>.

¹⁴⁸ Economic Intelligence Unit (EIU) Reports – Nicaragua Country Profile 2003-2004.

The legal framework for currency exchange also provides for suitable flexibility for traders. Nicaragua's official currency is the *cordoba*. Under the law, traders have the freedom to exchange currency at financial institutions and nonbank institutions alike.

There are no restrictions on repatriation of profits by foreign businesspeople.

Laws addressing illegitimate financial flows are in place. Nicaragua has enacted and implemented a law criminalizing the laundering of proceeds of crime, although conflicting interpretations of the law have recently led to reform efforts.

2. Trade Facilitation Issues to Address

Credit beyond the short term can be difficult for traders to access because of a weak banking legal framework and corruption in the legal system. As a result of the scarcity of credit, businesses (particularly SMEs) will struggle to grow.

C. IMPLEMENTING INSTITUTIONS

1. Banks

Nicaragua has a small banking sector with just six banks. The banking system consists of six commercial banks and three finance companies, which are the primary source of credit for the public and private sectors. This is the smallest system in Central America. Five banks are private and one is public. Approximately 70 percent of the deposits are in U.S. dollars.

a. Bank Operations That Support Trade Facilitation

Almost all the banks provide some form of trade financing. The banks maintain correspondent relations with U.S. banks and other international banks. Trade financing offerings include basic letters of credit and foreign exchange. Other institutions such as the National Investment Finance Company (FNI in Spanish) and the Central American Bank for Economic Integration (BCIE in Spanish), have created special programs for export financing through the local banks.

FNI has received \$30 million from the IDB to improve SME export credit focused on medium- and long-term time frames through local banks. The program only recently commenced, and little has been committed (\$500,000 to cattle, poultry, and farm machinery). FNI has had problems with credit in the past due to what it perceives as producers' management inadequacy. FNI has funded shrimp farms that have failed, whereas foreigners' shrimp farms have thrived. A melon project failed due to management's inability to meet SPS standards and other problems. Yet onions have proven successful as the company's competent management built in quality, brand, and reliable service.

The U.S. Export-Import Bank provides short- and medium-term guarantees for sales to the private sector, and Nicaragua participates in the U.S. Department of Agriculture's programs for import credit guarantees of U.S.-origin agricultural products.

b. Bank Issues to Address

Although financial institutions offer trade short-term finance payment methods, like letters of credit, to domestic importers and exporters, qualifying for credit beyond short-term payment is extremely difficult for small and medium-sized traders.

There are few alternative facilities in place to assist would-be traders (i.e., export finance lines of credit). High interest rates that lead to poor credit access are due to a number of reasons, including those cited previously in the legal framework section. In addition to the legal inadequacies, interest rates are high because of insufficient credit information (i.e., no credit bureau), poorly managed private sector companies, inadequate bank competition, and low capitalization. That said, recent policy reforms have lowered risk premiums, including the HIPC (Highly Indebted Poor Countries) program and Nicaragua's involvement in the Millennium Challenge Account.

New methods to expand credit are essential. There is a proposal, supported by President Bolaños, that FNI provide first-floor financing. FNI is a second-floor bank that services nine financial intermediaries. FNI manages a series of funds from international donors, including projects for nontraditional exports, small business support, renovation of coffee plantations, and assistance to the livestock sector.

2. Central Bank

The Central Bank of Nicaragua manages the exchange rate policy and regulation. Central Bank operations that support trade facilitation include the following:

- ◆ The institution has sufficient capacity to administer the exchange rate function.
- ◆ Currency exchange occurs at numerous institutions, including banks, currency exchanges, and hotels.
- ◆ Currency exchange operates at rates that are highly competitive, and fees for wiring money abroad are less than 10 percent of the amount of money to be wired.

Although not a formally (U.S.) dollarized economy, the dollar is widely tradable in the market and is accepted by merchants large and small in the exchange of goods and services. Dollars are accepted in almost all transactions. In fact, the public holds more than 70 percent of bank deposits in U.S. Dollar-denominated accounts.

3. Financial Crimes Unit

The main implementing institution for money laundering, the Financial Crimes Enforcement unit, is working to attack money laundering. It is early in the development of this capacity, but it appears that the institution is working hard on this critical issue.

The other institutions that address illegitimate financial flows—banks, regulators, and prosecutors—generally appear to be cooperating.

D. SUPPORTING INSTITUTIONS

The national supporting institutions that facilitate trade-related finance are relatively weak. Nicaragua has no government-sponsored export credit agency. The Banker's Association is not viewed as an effective instrument for advocacy in Nicaragua. As noted, Nicaraguans do benefit from the BCIE. One of BCIE's programs involves awarding credits to traders for circulating and fixed capital. BCIE targets economically viable projects and exporting companies to upgrade regional export capacity.

E. SOCIAL DYNAMICS

The lack of access to trade finance credit is a serious issue in Nicaragua. It receives a good deal of attention at all levels. The government, banks, small exporters, and potential traders are all interested and focused on the need for change. Although the solutions are difficult, the dynamics point in the right direction through positive and consistent engagement of the principles of modern banking.

The issue of money laundering, too, is one that receives attention at many levels. The government has been working to improve its capacity to deal with the problem through the passage of legislation and the establishment of the appropriate institutions and processes. The private sector, in turn, has been responsive to implementing its responsibilities, such as know-your-customer regulations.

F. RECOMMENDATION

- ◆ Improve access to credit for small and medium-sized importers and exporters. A more vibrant trade system will provide small and medium-sized traders with the ability to finance their export and import activities. The current system requires them to self-finance their activities, which in turn imposes a significant cost on their respective product or service. This added cost makes their product less competitive in export markets and the domestic market, as well. Trade and financial institutions must develop strategies to effectively provide credit to reliable firms. These strategies could include (a) establishing associations among producers for pooling resources and risks, (b) establishing a guarantee fund that provides credit to a group of exporters for fewer guarantees than currently demanded, and (c) increase producers' knowledge of bank instruments. Legal and institutional reforms regarding microfinance, guarantees, trusts, and arbitration are critical, and strengthening SMEs through training and technical assistance is also fundamental.

XV. SUPPORTING INFRASTRUCTURE

A. INTRODUCTION

Infrastructure is an important component of a well-developed trading community. Without it, the ability for a region to participate in the world of international trade would be nonexistent. Easily understood as a functional requirement for trade, implementation of a highly efficient, user-friendly infrastructure system, offering cost-effective and reliable services, can be viewed as a competitive advantage. In the broader context, there is a direct link between economic growth and infrastructure quality. Implementation and administration of a quality infrastructure system reduces costs, expands market reach, and induces demand for increased services. Within the context of CAFTA and its participating countries, regional competitiveness is an emerging key theme, with infrastructure playing an important role.

This section discusses Nicaragua's trade infrastructure, which typically includes transportation components, such as roadways, airports, seaports, railroads, and border crossings. In addition, supporting infrastructure, such as electrical power generation, transmission and distribution, and telecommunications and IT are necessary components of an efficient trading environment, and are consequently included as part of this overall assessment. To the extent possible, this assessment provides a description of the nation's trade infrastructure inventory and responsible administrating entities; evaluates its overall condition, capacity, and utilization; describes proposed improvement projects; and provides recommendations as appropriate. This assessment relates key findings to the common theme of competitiveness, which encapsulates three key components: service quality, reliability, and cost.

Overall, Nicaragua's stock of trade infrastructure places Nicaragua at a competitive disadvantage in the arena of international trade. There are broad differences in infrastructure quality, with regard to both installed capacity and overall administration. The lack of specific infrastructure components forces Nicaragua to rely heavily on the infrastructure and services of its neighboring nations in order to participate in international trade. This fact imposes uncompetitive costs on Nicaragua's system users resulting in an overall lack of demand for some of the nation's existing infrastructure components. Exhibit 2 presents a summary assessment of key findings of individual components.

Exhibit 2. Summary Infrastructure Assessment Findings

Infrastructure Component	Overall Assessment	Key Positives	Key Negatives
Roadways	Less Competitive	<ul style="list-style-type: none"> Ongoing implementation of roadway capacity improvements Sound capital planning initiatives Recent projects exhibit implementation of sound geometric design principles 	<ul style="list-style-type: none"> Dense traffic conditions within city limits Undercapacity overpasses and bridge structures Lack of authority to enforce maintenance of right-of-way Incomplete network upgrades located along the northern part of the country Prevalence of user abuse System security and safety

Infrastructure Component	Overall Assessment	Key Positives	Key Negatives
Seaports	Less Competitive	<ul style="list-style-type: none"> Established autonomy for implementing institution Advanced containerized cargo handling capability at Pacific coast facility (however, of small scale) Recent private sector interest in developing services to Caribbean coast facility at Rama 	<ul style="list-style-type: none"> Lack of capacity established along Caribbean coast Lack of effective marketing for established Pacific coast facility Inconsistent quality of roadway access facilities to Pacific coast facility Lack of demand, no critical mass
Airports	Competitive	<ul style="list-style-type: none"> Established autonomy for implementing institution Ongoing implementation of Capital Improvement Plan, capacity building Segregation of domestic and international traffic through two discrete terminals 	<ul style="list-style-type: none"> Current air cargo constraints, particularly for refrigerated cargo Limited landside access capability for vehicular traffic Lack of fuel storage facilities at Caribbean coast airports Poor overland access to Caribbean coast airports
Railroads	Unavailable	<ul style="list-style-type: none"> Former right-of-ways may be reestablished 	<ul style="list-style-type: none"> No railway service provided
Border Crossings	Less Competitive	<ul style="list-style-type: none"> Dedicated facilities 	<ul style="list-style-type: none"> Lack of complete pavement systems
Electricity	Less Competitive	<ul style="list-style-type: none"> Multiple power generation sources Private sector participation—power generation, distribution 	<ul style="list-style-type: none"> High dependence on fossil fuel generation facilities High technical and non-technical distribution losses High electricity cost per capita
Telecom and IT	Less Competitive	<ul style="list-style-type: none"> Open and competitive market Advanced technology 	<ul style="list-style-type: none"> Low tele-density Potential for monopolistic private sector involvement
Assessment Scale			
Highly Competitive		Deployed systems exhibit high quality in both fixed assets and operations, are uniformly deployed nationally, and have significant opportunities for growth.	
Competitive		Deployed systems adequately meet market demands, may exhibit potential inconsistencies nationally, and have opportunities to maintain service levels over time through thoughtful capital planning and implementation.	
Less Competitive		Deployed systems currently suffer from problems inhibiting efficient trade.	
Developing		Systems have only recently been deployed providing very limited existing service capabilities and consequently are immeasurable.	
Unavailable		Systems are not deployed.	

Observations and interview results indicate that Nicaragua’s existing infrastructure is ineffective at facilitating trade. The country suffers from incomplete systems, resulting in significant service gaps and high operating costs. Nicaragua will require comprehensive strategic planning assistance to identify the appropriate direction for change, followed by technical expertise and funding assistance to implement a seamless trade infrastructure system that would be attractive for significant private sector investment in the nation. Specifically, Nicaragua should focus its efforts on the following areas:

- ♦ **Roadways.** Although ambitious upgrades are currently planned, Nicaragua’s existing roadway infrastructure suffers from inconsistent network quality and incomplete linkages to key destinations. The focus of contemplated upgrades involves development of rural roads, otherwise known as “productive” roads, serving the agricultural industry. However, many of these projects are not funded. The nation requires significant roadway

improvements to provide seamless, unimpeded access to its neighboring borders. In addition, efforts should focus on linking the nation's major consumption/production zones to the Caribbean coast. Currently, the nation's overall international trading competitiveness suffers from poor roadway access to key international gateways. Transportation costs are comparatively high for Nicaragua, making it an unfavorable location for potential shippers.

- ◆ **Seaports.** Seaports along Nicaragua's Caribbean coast are inadequate, placing the nation at a competitive disadvantage. The majority of the region's exports are bound for eastern U.S. and European markets, necessitating access to Caribbean coast port facilities. Nicaraguan traders, however, are forced to utilize port facilities located in either Costa Rica or Honduras, at substantial added costs. Along the Pacific coast, Nicaragua's port facilities are quite good; however, they realize significant underutilization due to an overall lack of demand, resulting from both a low level of installed capacity and the comparatively high Caribbean coast transportation costs. To facilitate trade, attract substantial business interest to the region and improve the nation's competitiveness, Nicaragua requires a cost-effective solution to meet the transportation requirements for shippers exporting through the Caribbean coast. While many believe that building an Atlantic port is the solution, this alternative should be carefully studied and weighed against other transportation improvement needs, such as targeted roadway improvement projects and/or regional intermodal railroad development. Significant technical assistance in strategic transportation infrastructure planning will be required to identify an effective solution for this competitive disadvantage.
- ◆ **Airports.** Nicaragua is in the midst of an expansive international passenger terminal and a future air cargo terminal capital improvement program. Full program implementation will double the existing passenger-handling capacity at the nation's primary international airport. Although the expansion program includes future air cargo capacity building, no projects are currently funded. Air cargo handling efficiency is a current issue that has been raised by facility users, particularly in the area of refrigerated storage capacity. Near-term initiatives should focus on improving the nation's air cargo handling capacity, with emphasis on refrigerated cargo facilities.
- ◆ **Railroads.** Currently, Nicaragua has no rail network within the country. As noted previously, Nicaragua requires a cost-effective transportation solution to serve exporters requiring access to Caribbean coast gateways. Development of a regional intermodal rail strategy may be a viable alternative, provided that an effective rail corridor can be identified and development costs are justified. Technical assistance will be required to evaluate the potential feasibility of a regional rail strategy as an alternative to roadway development.
- ◆ **Border Crossings.** Nicaragua's border crossing facilities lack consistency in installed infrastructure at key international junctions. For example, one border crossing lacked such critical elements as pavement systems, requiring heavy truck traffic to traverse the facility along compacted dirt roads. Common to other Central American countries, regional initiatives include removal of border crossing facilities, and consequently, little to no investment is currently contemplated for Nicaragua's borders. However, it is

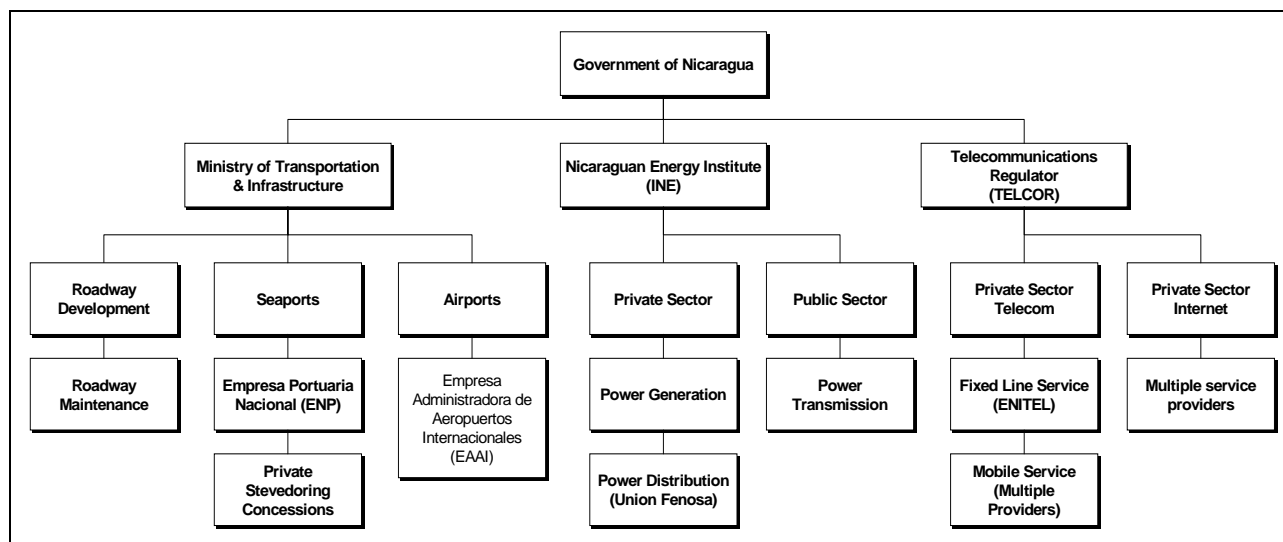
important to invest in minimum facilities to reliably meet the demands of transportation service providers.

- ♦ **Electricity.** Nicaragua suffers from comparatively high electricity costs, further placing the nation at a competitive disadvantage. The nation's power generation capacity is highly dependent on fossil fuel thermal generating plants, resulting in highly variable input costs. Current fuel prices are a leading cause of the nation's high energy costs. Promotion of new generation facilities, based on renewable energy sources such as hydroelectric power, is recommended. Nicaragua's energy sector also suffers from significant cost impacts resulting from technical and non-technical distribution losses, currently estimated at between 32 to 34 percent. Regulatory boundaries restrict the amount of these losses that may be allocated to end users, inhibiting the distribution service provider's ability and willingness to invest in system upgrades. Detailed system analysis is required to fully segment and allocate distribution losses, identify solutions, and implement improvements. Technical assistance will be required to fully understand the requirements of the nation's electricity sector.
- ♦ **Telecommunications.** In the near future, Nicaragua will enjoy an open and competitive telecommunications market, providing opportunities for reliable service and deployment of modern technology. Currently, the nation's wireless technology sector is a fully open and competitive market. By January 1, 2005, exclusivity guarantees for the nation's only existing fixed-line service provider, the former state-owned telecommunications company (Enitel), were set to expire, opening the door for full competition throughout the telecommunications sector. Although considered an open market, it is important to note that three out of four of the existing telephone service providers are currently owned by a single parent company, representing a sizeable market share. Common to developing countries, further densification of telecommunications access is required but is anticipated to occur naturally as service becomes more affordable. Additionally, the region requires assistance in developing a harmonized plan for recovering termination costs for regional international calls.

B. LEGAL FRAMEWORK

Transportation infrastructure planning, coordination, supervision, implementation, and maintenance are the responsibility of Nicaragua's Ministry of Transportation. This ministry is responsible for implementing the nation's primary transportation infrastructure, including roadways, airports, and seaports. However, the ministry provides only direct implementation of the nation's roadway networks, providing only regulatory authority over the nation's airport and seaport infrastructures, which operate as decentralized government authorities. Electricity is administered by INE, and telecommunications is administered by TELCOR, both national regulatory bodies. Exhibit 3 provides an organizational chart outlining the institutional relationships.

Exhibit 3. Nicaragua Infrastructure Organizational Chart



Roadway network development and maintenance are the responsibilities of the Ministry of Transportation and Infrastructure. Development projects are funded either through approval of funds from the central government or through donor agencies.

Nicaragua's airport infrastructure is administered and operated by the *Empresa Administradora de Aeropuertos Internacionales* (EAAI). The EAAI operates as an independent authority, enjoying semi-autonomy in execution of its duties; however, it is regulated by the Ministry of Transportation and Infrastructure. The EAAI consists of an independent board of directors representing public and private concerns. Although the EAAI enjoys autonomous status, its annual operating budgets and investment plans are subject to approval by the nation's central government.

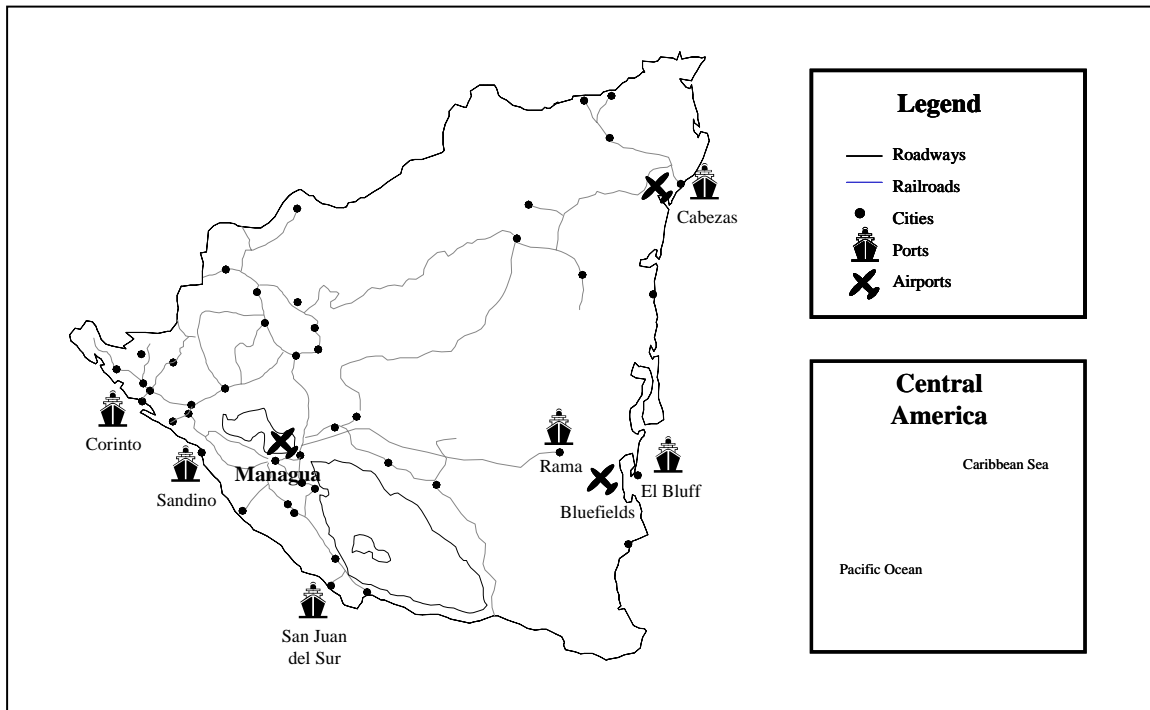
Electrical power generation, transmission, and distribution services are regulated by INE, a government regulatory body. INE is authorized to approve tariff rates proposed by distribution companies within certain guidelines limiting allocation of costs associated with technical and non-technical distribution losses. Power generation and distribution are, in large measure, implemented through the private sector. The government provides power transmission.

Internet and telecommunications service is regulated by TELCOR, a government regulatory body. TELCOR is authorized to license telecommunications and Internet service providers.

C. IMPLEMENTING INSTITUTIONS

The following sections provide an overview of each of Nicaragua's major trade infrastructure components. The discussion provides a brief description of the major facilities and overall operations and provides recommendations for improvement as appropriate. Exhibit 4 provides a regional map of Nicaragua.

Exhibit 4. Nicaragua Country Map (N.T.S.)



1. Roadway Networks

Nicaragua's roadway infrastructure is administered through the Ministry of Transportation and Infrastructure, responsible for both roadway development and maintenance. The ministry has recently developed a comprehensive roadway improvement plan, focused primarily on improvements to the Pan America Highway corridor as identified through SIECA, as well as development of rural roads serving agricultural production regions. Ongoing projects include a major roadway improvement project from Managua to El Rama, the nation's inland river port, serving the Caribbean Sea.

Overall, Nicaragua's roadway infrastructure involves two-lane asphalt paved corridors, with little to no bypass corridors around major population centers. Consequently, there are traffic congestion issues within major population centers, particularly within the city of Managua. Roadway conditions vary significantly throughout the country, with multiple instances of incomplete, unpaved roadways along major transportation corridors. A prime example involves access points to Honduras, located along the northern border. In these cases, there are reports of multiple stretches of incomplete pavement systems, forcing truck traffic to slow to a near crawl, impacting both traffic flow and cargo security. The nation has little capacity and reliability of access to the Caribbean coast, hurting the nation's overall competitiveness. Significant upgrades will be required to facilitate trade for Nicaragua.

To facilitate trade, Nicaragua's roadway network will require overall improvements to overcome competitiveness issues. Key improvements and recommendations include the following:

- ◆ Identify key transportation corridors, and implement improvements to reduce transportation costs. As noted, Nicaragua's roadway infrastructure suffers from an incomplete network to provide seamless transportation along the full length of key corridors. For example, little seamless capacity is provided linking the nation's Pacific coast to its Caribbean coast. In addition, capacity constraints exist along key corridors linking the nation's production/consumption zones with its neighboring country's key international gateways. As a result, the costs associated with landside transportation are comparatively high, seriously impacting the nation's overall transportation competitiveness. Although targeted improvements are required, the nation will require assistance in developing a prioritized development plan to realize a seamless transportation environment.
- ◆ Build technical expertise with regard to roadway planning, construction, and maintenance. Nicaragua's implementing institution requires technical assistance to realize a high-quality transportation network. This has been identified by the Ministry of Transportation and Infrastructure as a key issue that must be addressed going forward. Interviews indicate that the nation lacks overall transportation expertise to execute key transportation projects. Technical assistance will be required to enable Nicaragua to realize its currently planned roadway development strategy. This includes planning, analysis, design, and construction.
- ◆ Implement bridge and overpass upgrades and improvements along principal freight corridors. Common to the region, many of Nicaragua's existing highway bridges are under capacity with regard to existing highway loads. Many of these bridges were designed and constructed with loading limits of approximately 25 tonnes. Today, load limits are typically over 40 tonnes. Although funding to improve the entire portfolio of Nicaragua's bridges would be difficult to acquire, targeted improvements along major freight corridors is highly recommended. Improvements would enable the nation to realize the benefits of high-capacity truckloads, reducing both traffic congestion and labor costs.

2. Seaports

Nicaragua currently operates a total of six seaport facilities with one primary facility, Puerto Corinto, located on the Pacific coast. Puerto Corinto is characterized as a multipurpose facility, handling general cargo, containers, and liquid and dry bulk cargoes. Nicaragua's port facilities operate under an independent operating port authority utilizing private sector participation in stevedoring only. The *Empresa Portuaria Nacional* (EPN), an independent port authority, responding to a board of directors, implements all port operations. The board of directors is composed of both private and public sector representatives and enjoys a fair amount of autonomy in implementing its operations.

Exhibit 5 breaks down key infrastructure elements at each Nicaraguan seaport facility.

Exhibit 5. Seaport Comparison Matrix

Port Facility	Corinto	Sandino	San Juan Del Sur	Cabezas	El Bluff	El Rama
Location	Pacific	Pacific	Pacific	Caribbean	Caribbean	Caribbean
Operation	Independent Public Port Authority operating multiple facilities					
Main Wharf	370 meter marginal wharf (240 meters dedicated for containers); dedicated dry bulk facility	150 meter marginal; 2 offshore mooring platforms	70 meter launch wharf; offshore anchorage	687 meter timber finger pier	160 meter marginal wharf	93 meter floating barge
Water Depth (in meters)	Varies (12.7 to 13.4)	< 4	10 at anchorage	4 – 7	4	4
Number of Berths	4 – 5	3	1	N/A	2	1
Cargoes Handled	<ul style="list-style-type: none"> • Containers • General cargo • Liquid bulk • Dry bulk 	<ul style="list-style-type: none"> • Liquid bulk • Dry bulk • Neo bulk 	<ul style="list-style-type: none"> • Cruise 	<ul style="list-style-type: none"> • Cabotage • Fishing 	<ul style="list-style-type: none"> • Cabotage 	<ul style="list-style-type: none"> • General cargo • Cabotage
Dedicated Wharf Equipment	<ul style="list-style-type: none"> • Container gantry crane • Dry bulk evacuator • Conveyance system 	<ul style="list-style-type: none"> • Liquid bulk conveyance • Dry bulk evacuator 	N/A	N/A	N/A	N/A
Container Yard Layout	Top pick	N/A	N/A	N/A	N/A	N/A
Expansion Potential	Low	Low	Low	Low	Low	Low
Comments	Good facility, but requires marketing assistance and capacity building	Low capacity facility with limited opportunity for growth	Dedicated facility serving a key market niche	Facility not usable for international trade	Facility not usable for international trade	Private sector interest in carrier service from Rama
Overall Assessment	Competitive	Less competitive	Competitive for market served	Less competitive	Less competitive	Less competitive

Source: *Empresa Portuaria Nacional*, www.epn.com.ni.

Puerto Corinto's support backlands include two dry bulk distribution facilities, privately leased liquid bulk storage facilities, dedicated container storage areas, four covered storage warehouses, and open storage facilities for neo bulk, automobiles, and other cargo. Currently, one warehouse is leased to Customs for inspection services. All facilities are secured through facility-wide perimeter fencing and accessed via one of two manned gate facilities.

To facilitate trade, Nicaragua's seaport system would benefit from the following key improvements and recommendations:

- ♦ Establish a clear strategic plan for business development at Puerto Corinto. Puerto Corinto is Nicaragua's primary port facility; however, it sees very little use. Although there are a number of reasons for the lack of demand, including transportation cost considerations to the Caribbean coast, the facility does require assistance in developing marketing objectives. The facility has the ability to provide good service, but it does lack sufficient capacity to attract large-scale carriers. Technical assistance will be required to

develop a comprehensive strategic plan that identifies market opportunities, growth impediments, infrastructure requirements, and solutions.

- ◆ Provide landside access improvements to Puerto Corinto. The nation's primary Pacific coast facility suffers from inadequate landside access. Specifically, the facility's primary access road requires repairs and upgrades to meet minimum load-bearing requirements and accommodate both current traffic volumes and any increase in truck traffic. The roadway will require capacity upgrades at overpass facilities. In addition, the roadway transits the town of Corinto, mixing local vehicular and pedestrian traffic with the potential for heavy truck traffic. Upgrades to the roadways should include consideration of vehicle separation to reduce traffic density while improving overall facility safety.
- ◆ Work with the private sector in funding Caribbean coast port infrastructure projects. Nicaragua's port infrastructure suffers significantly from the lack of terminal capacity along the nation's Caribbean coast. In general, Nicaragua has no substantial Caribbean access, requiring exporters to utilize port facilities located at its neighboring countries (Puerto Limon, Costa Rica, and Puerto Cortez, Honduras). This lack of infrastructure adds significant land transportation costs to export loads, detrimentally impacting the nation's competitiveness. That said, the EPN is currently considering investment in its El Rama facility, located approximately 90 kilometers up-river from the Caribbean Sea. El Rama is a very small facility with capacity to accommodate a small, targeted niche market. There is private sector interest in developing carrier service from El Rama to the United States; however, this contemplated service is only focused on capturing existing business currently using neighboring port facilities rather than on developing new business opportunities. The venture has some merit, however, and will require the EPN to invest in El Rama to build capacity. It is recommended that the funding for expansion of existing Caribbean coast facilities utilize private funding to minimize risks to the nation.
- ◆ Work with existing national transportation implementing institutions to identify cost-effective solutions to Caribbean coast access points. As noted previously, Nicaragua suffers from little seaport capacity along its Caribbean coast. To improve competitiveness, efforts should focus on lowering Caribbean coast transportation costs. A predominant concept involves development of an "Atlantic port." Commercial traders as well as government implementing institutions have identified this concept as the most preferred solution. However, this solution must be weighed against alternative transportation improvement projects, such as further development of the nation's roadway network or possibly an intermodal rail strategy, to identify the preferred solution. Technical assistance in regional strategic transportation planning will be required to evaluate alternatives and identify the most cost-effective solution to this important problem.

3. Airports

Airport infrastructure is implemented by the EAAI, a decentralized government authority enjoying semi-autonomy in executing its duties. The EAAI currently operates one qualified international passenger/cargo airport, Managua International Airport, and three national airports located at Bluefields, Puerto Cabezas, and Corn Island. Bluefields and Puerto Cabezas are capable of accommodating international cargo shipments. Plans are being contemplated to

expand the nation's international passenger capacity along the Caribbean coast. For discussion purposes, Managua International Airport is the nation's key air transportation gateway and is the focus of this section.

Managua International Airport is located within the city limits of Managua, having little opportunities for significant expansion. However, the EAAI is currently in the midst of implementing significant capital improvement projects aimed at improving overall passenger handling operations. The international passenger terminal, currently consisting of 4 gates, is expanding to 7 gates, essentially doubling its existing passenger handling capacity, while providing sufficient operating room to accommodate planned international traffic for the next 15 or more years. New construction exhibits incorporation of modern best practices.

Managua International Airport is also equipped with a small national terminal, which is wholly segregated from the nation's international facility. A single runway (2,442 meters by 45 meters) serves the two terminals. The runway is planned for an 800-meter extension project to commence in 2005.

To facilitate trade, Nicaragua's airport infrastructure will require targeted improvements. Key improvements and recommendations include the following:

- ◆ Realize full execution of Managua International Airport's master development plan. As noted, Managua International Airport is in the midst of a significant capital improvement program. Although not all targeted improvements are currently funded, it is important that the overall plan realize full completion. This is of particular importance in the air cargo area. Many facility users consider the existing air cargo facilities small and inefficient. The EAAI's master plan includes developing two new 3,500 to 5,000 square meter air cargo facilities. This, however, is not currently funded in the capital program.
- ◆ Focus on landside access improvements. Managua International Airport has very limited landside vehicle access and parking facilities. Today, the terminal suffers from capacity constraints during peak passenger arrival and departure periods. Although plans include developing a new parking garage in the distant future, it is believed that the terminal will suffer from poor traffic conditions following completion of the ongoing international terminal expansion and increased passenger traffic. Assistance should be provided to help the EAAI realize a seamless landside access environment to facilitate passenger traffic to and from the airport.
- ◆ Develop aircraft fuel storage facilities at the nation's primary Caribbean coast airport facilities. Nicaragua's existing Caribbean coast airport facilities are at a competitive disadvantage due to a lack of aircraft refueling capability. Consequently, the facilities provide little service capability to meet the requirements of large air carriers. This lack of fueling capability can be linked to the nation's lack of sufficient Caribbean coast port facilities and limited overland transportation capability. Efforts should be made to improve the service characteristics of the nation's Caribbean coast airports to serve major carriers.

4. Railways

Railway service is currently unavailable within Nicaragua, having been dismantled in 1994 after falling into disrepair. However, many of Nicaragua's railroad corridor right-of-ways still exist. Considering the economics of rail transportation, any future rail service initiatives must involve a Central American regional approach to realize the potential benefits of rail service. Considering the existing transit distances to the predominant Caribbean coast ports, Nicaragua's lack of competitive transportation access to the Caribbean coast might well be solved through development of a regional rail concept, which should be evaluated as a potential option.

To facilitate trade, Nicaragua would benefit from an evaluation of rail service alternatives. The following action item is recommended for consideration:

- ◆ Recognize the economic benefits of rail service through length-of-haul and consolidated cargo characteristics. Rail services realize economic value across long distances, typically 500 miles or more. Nicaragua's primary consumption zone is geographically located from existing Caribbean port facilities at distances that may approximate economically optimal rail service conditions. Consequently, implementation of any rail service would require a regional planning approach. Nicaragua should work with its neighboring countries and the United States to develop a regional intermodal rail strategic plan to realize the potential benefits afforded to rail service.

5. Border Crossings

Nicaragua provides fixed administration and vehicle inspection facilities at all its international border crossings. These facilities are designed to house Customs, Immigration, and Agriculture officials while providing vehicle and pedestrian travel ways. Nicaragua's facilities are described as incomplete with regard to installed infrastructure. The assessment team sampled one facility for inspection. The subject border crossing facility lacked key infrastructure components to reliably facilitate trade. For example, the facility lacked pavement systems, requiring heavy truck traffic to transit the facility along dirt roads. During periods of inclement weather, vehicle transit reliability is further degraded. As noted earlier, regional initiatives include removal of border crossing facilities, and consequently, little to no investment has been or is currently contemplated for Nicaragua's borders.

Although the future intent is to remove formalized border crossings, near-term improvements are required to facilitate trade. The following improvement is recommended in the interim:

- ◆ Improve overall facility conditions through completion of pavement systems. Although not all facilities were inspected, it was noted that the nation's border crossings suffer from incomplete development, particularly in the area of pavement systems. It is recommended that funding be identified to provide a facility that does not inhibit traffic flow.

6. Electricity

Nicaragua's electricity sector is a key detriment affecting the nation's competitiveness. The network suffers from high costs associated with production as well as significant technical and

non-technical losses in distribution. Nicaragua's electrical power generation, transmission, and distribution implementing institutions are a mix of private and public entities. According to interviews performed during the assessment, power generation consists primarily of fossil fuel thermal generation plants, encompassing approximately 83 to 85 percent of the nation's power generation capacity. A mix of geothermal and hydroelectric makes up the balance of the nation's generation capacity. Nicaragua's heavy reliance on fossil fuel generation facilities is a competitive disadvantage due to both high market prices for fuel and seasonal variability. The government of Nicaragua, through a state-owned transmission company, provides power transmission services. Distribution is provided through private sector concession contracts. Union Fenosa, a private sector concessionaire, administers approximately 94 percent of the existing distribution network.

To facilitate trade, Nicaragua will require significant assistance in developing a competitive electricity system. The following key improvements are recommended:

- ♦ Pursue and develop low-cost power generation capacity. Nicaragua is highly dependent on fossil fuel power generation plants. Consequently, the costs associated with power generation are comparatively high for the region. These costs are pronounced when factored as a percentage of average incomes for the majority of the population. Going forward, Nicaragua should focus on developing power generation facilities that are based on renewable energy sources as available. Technical assistance in analysis and implementation is required to realize these potential future cost savings.
- ♦ Reduce distribution losses to acceptable levels. Although Nicaragua has included the private sector in implementing its power distribution sector, the nation suffers from significant technical and non-technical losses, approximately 32 to 34 percent currently.¹⁴⁹ Among administrative costs, these losses are a result of both system inefficiency and illegal wire tapping. The private distribution company is unable to recover the full costs associated with these losses. Cost recovery from distribution losses is regulated by INE and represents a fraction of the overall cost structure. Currently, the distribution company is operating at an annual loss. These financial losses impede the firm's ability and potential willingness to invest in distribution infrastructure improvements to reduce technical losses. Technical assistance will be required to help identify the full breakdown of non-technical and technical losses. Following identification, a formalized strategic loss reduction plan can be formulated and implemented.
- ♦ Vigorously support ongoing regional transmission capacity upgrades. An important regional project, supported by the IDB, involves inter-country connectivity and improvement of transmission capability within the region. On an annual basis, Nicaragua periodically requires importation of electricity to meet its peak operating requirements. However, and more important, Nicaragua lacks transmission capacity to tap into lower cost sources of electricity, necessitating dependence on its fossil fuel power generation capacity. Nicaragua would benefit greatly from increased access to lower cost electricity generated within the borders of its neighboring countries. Consequently, continued support in this area is highly recommended.

¹⁴⁹ Data provided by interviewees in the course of the assessment.

7. Telecommunications and the Internet

Fixed-line telecommunications is currently provided by Enitel, the nation's former publicly owned telecommunications service provider. Enitel's service exclusivity clauses will expire by January 2005, opening the door for competition within the fixed-line telephony sector. The nation's wireless telecommunications system now operates within an open and competitive market place. Although both the fixed-line and the wireless system will operate in a fully open competitive market, it is important to note that the majority of services will be owned and operated by a single parent company maintaining a monopolistic environment. According to interviewees, current tele-density is very low for the region and is estimated at approximately 3 percent for fixed-line services.

It is important to note that the region has yet to come to terms with a harmonized plan for recovering international termination costs for calls between Central American countries. Currently, providers initiating calls retain all revenues. This practice creates inequities in recovering costs depending on the ratio of outgoing to incoming calls placed between the Central American countries. It is perceived that CAFTA implementation will put significant pressures on the telecommunications industry to resolve this issue. Consequently, it is highly recommended that support be provided to identify and evaluate solutions to harmonize the international telecommunications industry.

D. SUPPORTING INSTITUTIONS

- ♦ **Trucking Companies.** Private trucking companies operate throughout the country with limited capacity provided at seaport and inland distribution terminals. Trucking companies provide drayage and inland distribution services for all international trade. The quantity and quality of trucking companies available within Nicaragua is considered below par for high-quality services, inhibiting the nation's ability to facilitate trade.
- ♦ **Airlines.** Managua International Airport is served by several major airlines currently providing service to accommodate over 800,000 annual passengers.¹⁵⁰ The facility serves as an international destination with national transit opportunities for local airline service providers. Major carriers also provide air cargo service. Air service is considered adequate and scalable to facilitate trade; however, landside vehicle access is considered inadequate during peak operating hours now as well as for the longer term.
- ♦ **Ocean Carriers.** Nicaragua serves a limited number of international ocean carriers calling on regular intervals. This is a result of limited capacity and lack of demand for services stemming from high-cost landside transportation costs. Consequently, there are limited opportunities to serve local shippers and receivers, limiting market responsiveness to increase services. Nicaragua's port facilities will require assistance in developing a strategic marketing and infrastructure development plan to identify the scope of business that may be afforded to international ocean carriers.
- ♦ **Railways.** Railway service is unavailable within Nicaragua. Considering the economics of rail transportation, any future rail service initiatives must involve a Central American

¹⁵⁰ See, www.eaai.com.ni/.

regional approach to realize the potential benefits of rail service. Nicaragua's need for a cost-effective solution to access the Caribbean coast may be solved by a regional rail service alternative. Technical assistance in evaluating alternatives, including rail, will be required to fully understand the potential.

- ◆ **Electricity.** Power distribution from private sector generating plants is provided through a number of private generation companies, with a large percentage of the power generated from fossil fuel thermal systems. Supporting institutions include government-run transmission and private distribution companies. International transmission capacity is inadequate to accommodate future demands. Consequently, either upgrades of international transmission capacity or capacity building of local power generation plants would be required under implementation of CAFTA.
- ◆ **Telecommunications and the Internet.** Landline and wireless telecommunications and Internet services will be fully provided through private sector concessions in an open market and competitive environment. This environment provides users with a number of technologies and reliable services from which to choose.

E. RECOMMENDATIONS

- ◆ Nicaragua's overall trade infrastructure system provides less than competitive service to facilitate trade. Nicaragua will require assistance in developing a prioritized improvement schedule to improve its overall position.
- ◆ Completion of key corridors within Nicaragua's roadway network is needed to provide seamless connections between production/consumption zones and international gateways. Targeted improvements include developing a Caribbean coast access strategy to reduce transportation costs and to improve the nation's trading competitiveness in terms of cost.
- ◆ Nicaragua's seaport facilities are woefully inadequate to serve customers demanding service to the Caribbean coast. Although alternative transportation opportunities should be studied to understand potential cost savings, the fact remains that Nicaragua does not have a competitive port located along its Caribbean coast. To mitigate risk, Nicaragua should engage the private sector in developing a potential Caribbean coast seaport facility.
- ◆ Nicaragua's Pacific coast facilities are underutilized and will require technical assistance in developing a strategic marketing plan. The facility is in good condition and of reasonable capacity to accommodate a significant growth opportunity in international trade. However, no concerted efforts have been made to capture potential market opportunities. Technical assistance in developing a marketing plan will be required.
- ◆ Nicaragua's international airport facility will require acceleration of its master development plan to meet the needs of the international air cargo community. The international passenger terminal is currently in the midst of a major expansion program, forcing development of the air cargo facilities to be retained as a future project. However, existing capacity and efficiency constraints are hurting the nation's competitive position. Technical assistance in prioritization and funding will be required to realize these improvements.

- ◆ Nicaragua's rail network is non-operational. The country's overland access network and geographic position with neighboring international gateways may provide opportunities to develop a cost-effective solution that is based on rail transportation. Technical support on a regional planning level is required to fully understand the potential benefits of rail transportation for both the country and the region.
- ◆ With respect to electricity, Nicaragua is highly dependent on high-cost fossil fuel thermal power generation facilities. In addition, the nation's distribution network experiences unacceptable technical and non-technical losses further escalating the cost of electricity. The nation requires assistance in identifying alternatives for power generation and technical assistance in identifying the mix of distribution losses and identifying solutions.
- ◆ Nicaragua's telecommunications sector, common to all Central American nations, is at risk of significant price increases for local calls and inequities associated with regional international calls. Technical support and focus groups are required to develop a regional plan to harmonize recovery of termination costs.

ATTACHMENT 1: COMPILATION OF RECOMMENDATIONS

COMPANY

No.	Type	Recommendation	Priority	Duration
1.	Legal reform	<p>Update the Commercial Code.</p> <ul style="list-style-type: none"> ▪ Assessment of parts of the Commercial Code to be reformed. ▪ Approval of specialized law such as the law on stock market, the law on trust, the law on simplification of business start-up administrative procedures. ▪ Draft a modern law on companies that includes corporate governance principles, protection of minority shareholders and the treatment of exceptional cases when the legal personality of a company can be disregarded private-public working groups about these laws and workshops. 	High	Near term
2.	Institutional strengthening	<p>Modernize the Commercial Registry</p> <ul style="list-style-type: none"> ▪ Update Public Registry bill and grant supervision for the Registry's activities to a central government body. ▪ Monitor and complement the World Bank project on Registry's modernization ▪ Collaborate on automation of the registration processes and to acquire better equipment and better Registries' facilities. <p>Monitor and cooperate with the Interamerican Development Bank project on one-stop-shop for investors.</p>	Medium	Long term
3.	Institutional strengthening	<p>Conduct an in-depth analysis of SME sector to identify how to remove obstacles to increased growth and to promote more involvement in the formal sector:</p> <ul style="list-style-type: none"> ▪ Design economic incentives to promote the formalization and growth of SMEs. Focus resources on SME sectors with the greatest potential for progress. ▪ Design special programs for SMEs financing. ▪ Set up a donors' conference on SMEs to design regional policies. 	Medium	Near term
4.	Assessment	<p>Undertake a tax assessment on Nicaragua:</p> <ul style="list-style-type: none"> ▪ Identify discrepancies on taxes. ▪ Determine cost-benefit of taxes. ▪ Draft changes in laws and institution to make the tax system efficient. 	Medium	Near term

No.	Type	Recommendation	Priority	Duration
5.	Institutional strengthening	Integrate of the Central American stock market: <ul style="list-style-type: none"> ▪ Draft harmonized model of regulatory and procedural standards for stock market transactions ▪ Devise a strategic plan for full integration. 	Medium	Long term

CONTRACTS

No.	Type	Recommendation	Priority	Duration
1.	Institutional Strengthening/ Legislative	Reform the judicial system: <ul style="list-style-type: none"> ▪ Working groups and workshops on changes in the electoral system in general to make it more democratic and around justices and judges selection ▪ Update the judicial career law and allocate selection of the judges to a separate and independent body. 	High	Near and long term
2.	Institutional Strengthening and Training	Reform the legal profession: <ul style="list-style-type: none"> ▪ Draft law on legal practice and include admissibility requirements for lawyers such as bar exam. ▪ Create independent supervisory and disciplinary body for lawyers (i.e. a <i>colegio de abogados</i>). ▪ Conduct continuing legal education seminars for legal professionals (notaries, lawyers, judges, court clerks) on same topics. 	High	Near and long term
3.	Legal Education	Improve knowledge of legal professionals and law students to support the international business community more effectively. <ul style="list-style-type: none"> ▪ Develop/revise law school curricula to include international standards in business transactions, economic analysis of law, international principles and conventions on contracts (UNIDROIT and INCOTERMS) and enhance training on importance of rule of law, basic legal principles, foreign jurisprudence and doctrine such as “substance over form” and economic analysis of law. ▪ Conduct workshops for common citizens about basic legal principals. 	Medium	Long term
4.	Institutional Strengthening	Improve use of arbitration as an alternative means for settling contract disputes. (See Commercial Dispute Resolution recommendations)	High	Long term

No.	Type	Recommendation	Priority	Duration
5.	Legal reform	<p>Enhance the legal framework regarding contracts:</p> <ul style="list-style-type: none"> ▪ Through a public/private partnership and consensus, draft a new civil and commercial procedure code where oral procedures are provided, in addition , draft laws on leasing, factoring, electronic contracts and electronic signatures. ▪ Set up a working group on possibility Nicaragua signing the Interamerican Convention on Legal Regime of Powers to be used abroad. 	Medium	Long term

Real Property

No.	Type	Recommendation	Priority	Duration
1.	Institutional Reform/legal reform	<p>Regularize private property.</p> <ul style="list-style-type: none"> ▪ Identify the discrepancies among all the real property regulations and harmonize them ▪ Draft a guideline that sets the priorities as per geographic zones and economic sector interests to pay landowners of expropriated but not compensated property whose lands have been reassigned to other people ▪ Reduce the administrative steps to regularize property through regulatory reform. 	High	Long term
2.	Institutional strengthening	<p>Reform the Real Property Registry to improve services, reduce costs, and increase confidence in information.</p> <ul style="list-style-type: none"> ▪ Monitor and complement the on going reforms on the Real Property Registry ▪ Approval of the Public Registry Law is essential. ▪ Collaboration with the Registry's automation process. ▪ Develop and institutionalize a training program for Registry staff on best practices for Registry operations. 	High	Long term
3.	Institutional Development	<p>Update the national cadastre</p> <ul style="list-style-type: none"> ▪ Start a national cadastre map and integrate it with the Real Property Registry. ▪ Approve the Cadastre Law. ▪ Integrate the existing municipal cadastre data into a unified national multi-purpose cadastre 	High	Long term
4.	Legal reform	<p>Change zoning regulations</p> <ul style="list-style-type: none"> ▪ Draft a law on territory order ▪ Empower institutions to enforce the law. ▪ Introduce strategic planning techniques to the public officers relevant to the territory plan and zoning through training. 	Medium	Long term

No.	Type	Recommendation	Priority	Duration
5.	Legal reform/ Housing	<p>Reduce the housing deficit</p> <ul style="list-style-type: none"> ▪ Asses the housing deficit ▪ Draft a specialized legal framework to offer incentives for building for low-income dwellers. 	Medium	Long term

COLLATERAL

No.	Type	Recommendation	Priority	Duration
1.	Legal Reform	<p>There is need for new legislation in Nicaragua in the area of secured transactions, electronic commerce and bankruptcy. A uniform commercial code that incorporates generally accepted principles and best practices for the region would be a useful tool to guide reform in Nicaragua. In addition, the ability to achieve quick and inexpensive realization of Nicaraguan security interests will only be able to be attained with reform and modernization of the substantive and procedural laws regarding the registries.</p>	High	Long term
2.	Regional coordination and legal reform	<p>USAID and other significant donors should work with the Nicaraguan public and private sectors and stakeholders with a view to coordinating their efforts with the adoption and implementation of the Organization of American States' (OAS) Model Law on Secured Transactions for the region.</p> <ul style="list-style-type: none"> ▪ Efforts leading to the adoption of a new law and regulation(s) should include a comparison between current Nicaraguan laws and developments in other countries of the region and throughout the Americas, including the principles embodied in the OAS Model Law. ▪ A regional electronic commercial registry should be developed, and a work plan for the operation of individual in-country registries should be established. ▪ The legal framework for electronic commerce and electronic signatures should be brought up to current international standards 	High	Long term
3.	Training	<p>Training on the scope and operation of the new legal system should also be provided to judicial and administrative officials to facilitate implementation of modernized laws and systems. Such training should include: information pertaining to the new collateral structure; interconnection between the new secured transactions framework and other areas of the law; financing options available to local companies and foreign investors; and registry operations</p>	Medium	Long term

COMMERCIAL DISPUTE RESOLUTION

No.	Type	Recommendation	Priority	Duration
1.	Legal Reform	The Legislative Assembly should adopt the currently pending bill that will reform arbitration and mediation by putting those procedures under the direction of private parties and organizations.	High	Near term
2.	Public education	Before and after adoption of such a bill, business and other private organizations should educate members of the business sector on the advantages of arbitration and mediation, especially in the context of Nicaragua's dysfunctional judiciary.	High	Long term
3.	Institutional reform	After passage of reform legislation, establishment of the mechanics for the use of arbitration, such as an arbitration center and arbitration and mediation training for lawyers and others, should be undertaken by the public and private sectors	High	Long term
4.	Judicial reform	Political corruption pervades the judicial system. An initial step to rectify this would be to pass a 'judicial career law.' Such a law is currently being considered; however, in its current form it would do little to reform the judicial system. Technical assistance should be given to ensure that this law is more than simply a sham.	High	Short term

BANKRUPTCY

No.	Type	Recommendation	Priority	Duration
1.	Legal reform	<p>In effect, Nicaragua has no functioning insolvency laws. Hence, the country is lacking an essential component that, if effectively designed and implemented, could enhance confidence in the economy.</p> <ul style="list-style-type: none"> ▪ Nicaragua should consider modernizing its bankruptcy law and harmonizing it with that of its trading partners in the region and beyond, also taking into consideration the World Bank's principles and guidelines for effective insolvency regulation, as well as the concepts contained in UNCITRAL's Draft Legislative Guide on Insolvency Law and other regional and international models. ▪ This reform needs to be consistent and integrated with the country's broader legal commercial framework. Insolvency reform is often ineffective unless accompanied by parallel reform in other related areas of the law, in particular, insolvency and bankruptcy principles need to be consistent with a model uniform regional secured transactions law. 	High	Long term
2.	Capacity building – Public sector	<p>In order for the system to be effective, judges and supporting institutions (<i>e.g.</i>, receivers) should receive support and training on the meaning and consequence of sound and effective asset management, as well as greater powers to detect and reverse fraudulent activities.</p>	Medium	Long term
3.	Capacity building – private sector	<p>Additional training (in the form of seminars, discussions or roundtables organized by chambers and/or sectoral associations) should also be tailored to the needs of the private sector so that more companies and entrepreneurs are educated on the advantages of reorganization and rehabilitation of enterprises to promote a more fluid and transparent business environment.</p>	Medium	Long term

COMPETITION POLICY

No.	Type	Recommendation	Priority	Duration
1.	Legal Reform	The substantive provisions of the July 2004 draft of the competition law are very sound and have strong regional symmetries. While a merger notification system and compulsory review of mergers may not be necessary, consideration may be given to a general provision allowing the competition authority to investigate and block anticompetitive mergers.	High	Within three months (if the bill is submitted to the National Assembly in November)
2.	Legal Reform	Regarding the proposed agency structure in the July 2004 draft law, drafters should decide whether to circulate current draft as written (that provides for an independent agency), or to prepare alternative/additional draft that gives the Dirección General de Competencia y Transparencia de los Mercados (DGCTM) additional enforcement powers and creates a specialized decision-making body. In doing so, the Panamanian and Costa Rican models may prove useful. Consideration should also be given to the Nicaraguan experience with similar administrative and judicial models, including Superintendency of Pensions, Income Tax Court, etc.	High	Within three months (if the bill is submitted to the National Assembly in November)
3.	Legal Reform advocacy	DGCTM has made important progress in building support for the current draft with influential groups such as the Consejo Superior Empresa Privada de Nicaragua (COSEP). However, certain members of the business community and consumer groups have not seen the current draft. The draft should be disseminated more widely for comments, including to important stakeholders such as: the Liga de Defensa al Consumidor Nicaraguense (LIDECONIC), Cámara de Industrias de Nicaragua (CADIN), and CACONIC. Dissemination should be supported by adequate follow-up; and DGCTM should engage in affirmative outreach with recipients of the draft (including phone calls, meetings, etc.). DGCTM may also wish to consider obtaining signatures of groups that have been consulted, for submission to the Legislative Assembly, as evidence that certain groups/sectors have been consulted.	High	Within three months (if the bill is submitted to the National Assembly in November)
4.	Legal Reform	With a view towards regional convergence/harmonization, consider carefully the competition laws of Mexico and Panama; and consult with the drafting committees in El Salvador, Honduras and Guatemala.	High	Near term
5.	Legal Reform	Consult with sectoral regulators (TELCOR, INAA, INE) to clearly delineate responsibilities and ensure consistency among laws.	High	Near term

No.	Type	Recommendation	Priority	Duration
6.	Legislative Advocacy	Prepare an advocacy brochure for the Deputies who will vote on the Bill, explaining in clear, basic language the principle purposes of a competition law in the Nicaraguan context, drawing on examples from previous studies (e.g., FIAS studies on dairy and fisheries, DGCTM studies on beer and potatoes, etc.). Disseminate and conduct intensive follow-up with the Deputies. Invite members of the Legislative Assembly to attend an educational meeting about the proposed law.	Medium	Near term
7.	International cooperation	Donors and relevant government officials (outside of DGCTM, including, for example, la Comisión Presidencial de Competitividad) should meet with the Minister of Trade to discuss the role of a competition law in trade liberalization/integration to better inform the draft.	High	Near term
8.	Public education	<ul style="list-style-type: none"> ▪ Develop a series of seminars to promote private sector support, focusing on recent experiences, for example, in the telecommunications sector, regional initiatives, etc. ▪ Develop a series of seminars to educate the Legislative Assembly about a competition law. The DGCTM may wish to prepare a short advocacy document, as explained above. 	Medium	Near term
9.	Institutional strengthening	After passage of the law: <ul style="list-style-type: none"> ▪ Develop a policy strategy to make the law operational, including institutional arrangements (e.g., staffing and training). ▪ Develop regional training programs for staff (Medium term) and with universities and bar associations (medium to Long term). ▪ Develop an enforcement strategy that focuses on investigating anticompetitive conduct in sectors that are important to consumers and that address Nicaraguan market failures. (Medium term) 	High	Long term
10.	Public Advocacy	Continue advocacy initiatives, including reviews of government policies and regulation affecting competition, and preparing studies on key sectors. (on-going). Promote a competition culture through public communication including: preparing communication/media materials; enhancing the capacity of media in publication of competition-related issues through dialogue/workshop with journalists; engaging in dialogue/workshops with related law enforcement officers, other government regulators, and the business and academic communities. (on-going)	High	Long term

INTERNATIONAL TRADE

No.	Type	Recommendation	Priority	Duration
1.	Customs service reform	An efficient, well-staffed, honest and transparent Customs Service is absolutely essential to ensuring free trade. Efforts should concentrate on continuing to expedite the clearance process (including improved risk management systems and targeting methodology), further reducing opportunities for corruption, helping deter smuggling, drug trafficking and terrorism, and generally promoting a healthy trading environment.	High	Long term
2.	Capacity building	Continued training at the <i>Dirección General de Aduanas</i> (DGA) is required. Areas identified as a priority by DGA include: <ul style="list-style-type: none"> ▪ training on better internal procedures to apply risk management criteria and create profiles; ▪ methodologies to detect fraud and undervaluation; and ▪ computer and technological training. 	Medium	Long term
3.	Private sector training	There is insufficient training in the private sector on commercial and customs issues, including classification and valuation of goods. With greater training, producers will be able to increase their productivity levels to compete under a free trade regime. To facilitate this further, businesses will need enhanced investment and modern technology to adapt to the new requirements of CAFTA and improve productivity and competitiveness in their areas of activity.	High	Long term
4.	Financial reform	It is essential to facilitate access to credit (both to local and foreign companies and investors) by modernizing and harmonizing laws relating to the provision of collateral on a regional basis and creating a centralized registry of debtors and collateral. A related key factor will be the modernization of the country's legal framework on electronic documents and electronic signatures. (<i>see Collateral Report.</i>)	High	Long term
5.	Regional integration	It is necessary to encourage regional solutions to problems with respect to trade facilitation, investment and customs area. Technical assistance should be provided to establish a regional customs school, and to promote regional dispute resolution systems (<i>see Commercial Dispute Resolution Report</i>), among others.	High	Long term

FLOW OF GOODS AND SERVICES

No.	Type	Recommendation	Priority	Duration
1.	Regional Harmonization	<p>Promote regional standardization and strategies for the Customs Union through the following:</p> <ul style="list-style-type: none"> ▪ Develop a regional CACM center for risk assessment to develop a regional selectivity system, compliance measurement program, audit verification approach, joint investigations and verification of country of origin processing. ▪ Create a coordinated information center for all data relating to Customs Union procedures, easily accessible by the trade and with required advance notification time lines. ▪ Develop Regional operational procedures and a manual to promote standardization within CACM. ▪ Standardize and streamline import and export registration and permit processing within CACM. ▪ Develop a Regional Laboratory for the complex analysis that local laboratories cannot accomplish 	<p>Medium</p> <p>Medium</p> <p>High</p> <p>High</p> <p>High</p>	<p>6-18 months</p> <p>3-6 months</p> <p>6-18 months 18-24 months</p> <p>6-12 months</p>
2.	Customs	<p>Assist Customs in advancing its modernization efforts to facilitate and control by the following actions:</p> <ul style="list-style-type: none"> ▪ Provide additional training and a training curriculum to increase capacity of those officers specialized in the area of and promote sector specialization: <ul style="list-style-type: none"> ○ Customs Classification and Valuation ○ Commercial fraud detection techniques ▪ Incorporate existing risk assessment procedures into a comprehensive risk management program to include advanced IT capabilities/support, strategic sector analysis, and well developed post audit procedure. ▪ Provide access to Customs of the revenue currently generated by service fees and develop and promote WTO compliant User/Service Fee for Customs declaration processing to augment budget and to create a fund for: <ul style="list-style-type: none"> ○ payment of salaries ○ purchase of equipment and tools ○ modernization of Custom and upgrading of facilities 	<p>High</p> <p>High</p> <p>High</p>	<p>6-12 months</p> <p>18-24 months</p> <p>6-18 months</p>

No.	Type	Recommendation	Priority	Duration
3.	Customs (continued)	Identify and provide funding for additional tools for Customs examination sites and to upgrade current small Laboratory facility <ul style="list-style-type: none"> ▪ Modern tools for personnel dedicated to examination of cargo ▪ Resource materials and software for laboratory ▪ Updated equipment for laboratory ▪ Floor scales to weigh incoming and outgoing cargo ▪ Major equipment such as container scanners for a less intrusive but more productive approach to detection of weapons, drugs and contraband and to improve border protection ▪ Cameras for goods warehouse, commercial cargo lots to prevent access to or pilferage of goods under Customs control 	Medium	18-24 months
4.	Customs (continued)	Compliance and Criminal Prosecution <ul style="list-style-type: none"> ▪ Support the reform of the Judicial System to further the prosecution of Customs criminal offenders ▪ Strengthen Broker penalties and provide Customs greater ability to discipline those brokers that assist and promote non-compliance within the trade community ▪ Review minor penalties and refrain from charging penalties for clerical errors unless there is reason to believe that reasonable care is not exercised. ▪ Promote, support and reward compliance by providing benefits such as expedited processing and release to compliant traders. 	High High Medium High	12-24 months 6-12 months 3-6 months 3-12 months

No.	Type	Recommendation	Priority	Duration
5.	Regional Harmonization/ Procedural Simplification	<p>Reduce and harmonize the documents and costs of trade within Central America through the following actions:</p> <ul style="list-style-type: none"> ▪ Combine the FAUCA (Customs Form for Central American Goods) with the Central American Transit Document. ▪ Establish a regional Central American transit control program either through integration of the national Customs Transit processing systems or creation of a simple automated program that controls the movement from entrance into the CU or initiation of the transit within Central America to destination. The latter could be accomplished through promotion of the “best practice” national system to the regional level. ▪ Establish a regional strategy to combat undervaluation of products entering Central America from the Panama Canal Zone. ▪ Establish an effective regional information system to notify trade of impending changes caused by furtherance of the Customs Union. Sufficient time must be allowed to the transport, import and export sectors to modify their operations prior to implementation of the changes.. ▪ Strengthen the ability of regional institutions to enforce compliance with Customs Union procedures by all its members and eliminate adoption of additional national procedures that impede facilitation process. Use regional organizations such as the pro-committees and the regional organization of the various national Chambers and associations to further this agenda. 	<p>High</p> <p>High</p> <p>High</p> <p>High</p> <p>High</p>	<p>3-6 months</p> <p>6-12 months</p> <p>6-9 months</p> <p>6-9 Months</p> <p>6-12 months</p>
6.	Regional Harmonization/ Procedural Simplification	<ul style="list-style-type: none"> ▪ Establish regional laboratories for testing of the more complex specialty items such as pesticides and genetically modified products to reduce costs of equipping and training personnel from each country. ▪ Develop an IPR training program on the detection of IPR infringing articles for Registry, National Police and Customs personnel sponsored by the IPR international organizations. ▪ Promote EDIFACT as the standard language to be used by the business and public sector in designing programs dealing with international trade so systems can communicate with current and potential international partners 	<p>Medium</p> <p>Medium</p> <p>High</p>	<p>18-24 months.</p> <p>12-18-months</p> <p>12-18 months</p>

No.	Type	Recommendation	Priority	Duration
7.	Institutional Reform	<ul style="list-style-type: none"> Integrate the National Police administration's concerns for security and control in the formulation of facilitative Customs Union procedures so that control and security concerns are balanced with speed of movement. This would eliminate the increase in road stops that usually occur when the border is more open. 	High	6-12 months
8.	National Procedural Simplification	<p>Decrease time and costs to traders by simplifying import/ export processing through the following steps:</p> <ul style="list-style-type: none"> Provide donor support to the project of the Presidential Committee on Competitiveness to reduce transaction costs through procedural simplification. This approach is a comprehensive strategy to review the entire process and includes trade involvement. Effort must involve public employees at the working level to provide commitment to effective implementation. Reengineer Customs Free Zone processing operations to significantly decrease Customs intervention in process and place more reliance on risk management and post audit techniques. This would include benchmarking of time and costs of Customs processing and oversight, identification of "best practice" within industry, and its adaptation to Nicaragua. Goal is reduction of Customs costs and delays by 50%. This effort has been started by the President's Committee on Competitiveness and should be supported by the donor community. Result could be "best practice" and adopted by other Central American Customs administrations. 	High	3 -6 months
			High	6-12 months
9.	Institutional Reform	<ul style="list-style-type: none"> Establish a program to promote innovation within the regulatory agencies that implement international trade procedural requirements. This would include monetary or other incentives to recognize and reward employees who devise more efficient procedures 	Medium	6-12 months
		<ul style="list-style-type: none"> Reevaluate CETREX - Stop integration of all other agency forms into CETREX until their requirement has been evaluated. When this re-engineering has been completed, continue with automation of process. Eliminate requirement to file low value shipment through CETREX. 	High	6-12 months
		<ul style="list-style-type: none"> Reduce MAGFOR release times at the border through the implementation of risk management principles and the establishment of laboratory analysis on less complex items in the field. 	Medium	6-12 months
		<ul style="list-style-type: none"> Reassign National Police to Peñas Blancas border so that time for selection to examine is reduced from 2 hours to 15 minutes. 	Medium	3-6 months
		<ul style="list-style-type: none"> Eliminate the issuance of penalties for minor clerical errors by Customs. 	Medium	6-12 months

No.	Type	Recommendation	Priority	Duration
10.	Technical Capacity Building	Improve technical capabilities of public agencies/private supporting institutions through the following actions:		
		<ul style="list-style-type: none"> ▪ Provide Internet access to MINSA regulatory staff to allow them to research the USDA website and reduce time now required for registration of imported pharmaceuticals. 	Medium	6-12 months
		<ul style="list-style-type: none"> ▪ Research effectiveness of using electronic sensors at the critical blind spots on the border. 	Medium	6-12 months
		<ul style="list-style-type: none"> ▪ Establish through the Nicaraguan Technical Institute a school for commercial truck drivers to include safe driving practices, vehicle maintenance and revised Customs Union border procedures. 	High	6-12 months

FLOW OF PEOPLE

No.	Type	Recommendation	Priority	Duration
1.	Legal reform	Pass regulations creating a “business” visa or visa category that promotes Medium term and Long term stays for potential investors and highly-skilled persons	Medium	Near term
2.	Institutional strengthening	Modernize immigration technology systems for processing of files and improving security function. (i.e., electronic passport readers at borders)	High	Near term

FINANCIAL CRIMES

No.	Type	Recommendation	Priority	Duration
1.	Legal reform	Currently there is a bill currently being considered but not yet before the National Assembly which will clarify the scope of the crime of money-laundering by, among others means, specifying that it applies to funds derived from other illegal activities, not just from drug transactions. This bill should be made law.	High	Medium term
2.	Institutional reform	As part of the legal reform efforts and/or other regulatory changes, the Attorney General and the Prosecutor should establish a working framework through which they would better coordinate their efforts to prosecute money-laundering.	High	Long term
3.	Institutional assistance	Additional resources should be made available to the agencies responsible for investigating and prosecuting money-laundering based on a clearer and more efficient allocation of responsibilities.	Medium	Long term

FLOW OF MONEY

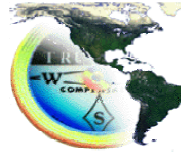
No.	Type	Recommendation	Priority	Duration
1.	Training/ education campaign	Work with SMEs exporters and those with export potential (and relevant associations) on essentials for gaining trade finance.	Medium	Long term
2.	Institutional strengthening	Develop alternative financing options for SMEs exporters and those with export potential (and relevant associations) to expand access to credit (i.e., cooperatives).	High	Near term

INFRASTRUCTURE

No.	Type	Recommendation	Priority	Duration
1.	East Coast Exportation Solutions	Identify, evaluate and implement a cost effective solution to meet Nicaragua's east coast exportation requirements <ul style="list-style-type: none"> ▪ Quantify and classify existing transportation costs ▪ Compare / Contrast effectiveness of solutions (i.e. roadway improvement, railroad development, port development) ▪ Conduct cost-benefit analysis and weigh new-build options against low-cost policy improvements to improve nation's overall competitive position as a Caribbean gateway. 	High	Near term
2.	Roadway Network Development	Realize much needed funding for roadway improvement projects through deployment of a user fee system <ul style="list-style-type: none"> ▪ Eliminate bureaucracy in allocating funds ▪ Enable implementing institution to fully implement its network improvement plan ▪ Build consistency and reliability in the network improvement program to attract business 	High	Near term

No.	Type	Recommendation	Priority	Duration
3.	Electricity Generation / Transmission / Distribution	<p>Reduce the cost of electricity to end users while improving overall system reliability</p> <ul style="list-style-type: none"> ▪ Reduce dependence on oil-fired thermal power plants through development of hydroelectric or geothermal systems ▪ Allocate appropriate maintenance funds to improve distribution network reliability. ▪ Reduce technical losses by making targeted system upgrades ▪ Empower implementing institution to take action against unauthorized tapping of electrical network system, further reducing distribution losses and reducing costs 	High	Medium term
4.	Telecommunications Fixed-line density improvements	<p>Improve density of nation's fixed-line telecommunications equipment (currently <3 lines per 100 people)</p> <ul style="list-style-type: none"> ▪ Actively promote elimination of existing "exclusivity" clauses to build private sector interest in investment (Exclusivity clauses will be eliminated over the next 12 months) ▪ Promote private sector investment in telecommunications infrastructure development, not bandwidth rental on existing systems to build market share ▪ Continue to promote private sector investment to build overall competition. (Currently, all telecommunications sectors are dominated by a single parent company.) 	Medium	Medium term
5.	Seaport Facilities (Pacific Coast)	<p>Improve utilization and promote business growth at existing Pacific Coast seaport facility</p> <ul style="list-style-type: none"> ▪ Port Corinto requires an actionable marketing plan in order to build business and realize its full potential ▪ Landside access facilities must be improved to allow for appropriate vehicle queuing as well as high load limits ▪ Rail access and linkage with a regional system (potentially tied to Canal <i>Seco</i>), has a high potential for improving the Port's attractiveness ▪ Port Corinto should be considered as a potential option to the La Union (El Salvador) development, marketing and regional cooperative are key areas for success 	High	Near term

No.	Type	Recommendation	Priority	Duration
6.	Seaport Facilities (Atlantic Coast)	Avoid full-scale development of Atlantic Coast port facility prior to detailed understanding of business demand and costs <ul style="list-style-type: none"> ▪ Develop Atlantic marine facilities only in conjunction with execution of Long term contracts with private-sector partner ▪ Seek private-sector direct investment to validate business demands ▪ Avoid development of robust facilities, but rather maintain high degree of flexibility in design 	Medium	Medium term
7.	Airport Facilities	Continue execution of existing capital improvement program <ul style="list-style-type: none"> ▪ Existing program will more than double capacity of existing Managua International Airport ▪ Consider further analysis of vehicle entry/exit/parking facilities to ensure free-flow of traffic now and in the future ▪ Consider development of additional refrigerated air-cargo storage facilities in the Near term ▪ Continue to deploy technology-based security devices to maintain and augment overall facility security 	High	Near term
8.	Railroad	Evaluate benefits associated with redevelopment of nation's existing rail corridors <ul style="list-style-type: none"> ▪ Seek optimal length-of-haul opportunities through partnering with international neighbors 	Low	Long term



ATTACHMENT 2: ROUNDTABLE PACKAGE

Preparación para el CAFTA y la Armonización Regional Comercio, Derecho Comercial y Estrategia para el Fortalecimiento Institucional Mesa Redonda

25 del agosto de 2004

Intercontinental Metrocentro • Managua, Nicaragua

Temario

1:30 – 2:00 **Registro**

2:00 – 2:30 **Palabras de bienvenida**

- Presentación del temario: Mark Belcher, Booz Allen Hamilton
- Dr. Mario Arana, Ministro, MIFIC
- James Vermillion, Mission Director, USAID/Nicaragua

2:30 – 3:00 **Sesión I: Presentación de las conclusiones del diagnóstico sobre el comercio y el Derecho Comercial**

- Perspectiva de un Experto Nicaragüense: Francisco Somarriba, Professor
- Conclusiones referentes al Derecho Comercial: Omar Garcia Bolivar, BG Consulting
- Conclusiones referentes a las aduanas y el comercio: Joanne Cornelison, Booz Allen

3:00 – 3:15 **Café**

3:15 – 4:30 **Sesión II: Discusión en grupos**

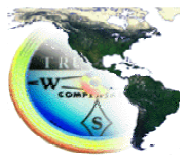
- **Reduciendo los Costos de las Transacciones de Importación/Exportación**
- **Promocionando Sistemas Sanos de Crédito**
- **Implicaciones para los PyMEs**
- Priorizando Iniciativas Regionales para Beneficiar Comercio Internacional

4:30 – 5:00 **Presentación de los resultados de la discusión grupal**

5:00 – 5:30 **Comentarios finales y clausura**

- Jim Stein, Director, Office for Trade and Economic Analysis, USAID/G-CAP

5:30 – 7:00 **Cóctel**



Breakout Discussion Topics

Reducing Import/Export Transaction Costs

- What procedures need to be simplified and expedited? Are all documentation verifications and authorizations really necessary?
- What are the priority factors that contribute to the transport sector costs? What changes need to occur to reduce these costs?
- Where do the major delays occur in the transportation process and what can be done to eliminate them?

Fostering Healthy Credit Systems

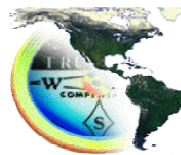
- What are the major challenges to improving the credit system so that it will attract substantially increased levels of commercial finance?
- What are some solutions to overcome these challenges?
- What are the impediments to implementing these solutions?

Implications for SMEs

- What are the priority legal/regulatory, policy, and other challenges that SMEs in general will face as CAFTA is implemented? What specific challenges will SMEs in priority economic growth sectors face?
- How can the private sector and civil society complement government efforts to improve the environment for SME export growth?
- What are the implications for increased participation of the informal sector in the formal economy? How to attract SMEs in the informal sector into the formal?

Prioritizing Regional Initiatives to Benefit International Trade

- What are Nicaragua's priorities and why are they important?
- How can Nicaragua take a leadership role at the regional level to promote these priorities?



Roundtable Conclusions/Recommendations

Group 1 -- Reducing Import/Export Transaction Costs

Transaction costs in Nicaragua are high. Numerous steps can be taken to solve this problem:

1. Businesses must improve themselves through greater training for those involved in the transport of goods so as to make them more efficient and cost effective. In addition, equipment used in the movement of goods should be modernized, such as Nicaragua's trucking fleet. Modernizing the trucking fleet and updating other modes of shipping would also help reduce the impact of the high fuel costs in the country.
2. Greater efforts should be made to improve regional transport safety and security. At present, only Costa Rica and Nicaragua enjoy relatively secure movement of goods. Relatedly, insurance policies for goods in transport should be regionalized which would reduce costs.
3. With respect to Central American transit shipments, two forms that are currently used, the Customs declaration and the transit document, should be consolidated since they contain almost identical information.
4. Transaction costs for sending goods outside Central America are particularly high for Nicaragua as businesses must use the infrastructure of other countries, such as the Honduran Atlantic port. One solution would be to build an Atlantic port in Nicaragua as arguably there is enough volume and a growing diversity of commodities that would make such an effort cost effective. In any case, however, infrastructure improvements cannot result solely from public funds and will require private involvement and investment.
5. Laws must be promoted and passed for the full automation and modernization of customs systems. Currently, there is a project in National Assembly that would work to make the transfer of information involved with customs more efficient, but more can be done to modernize systems.
6. Central American countries should work toward projecting a stronger regional image – goods could be sold under a joint Central American origin tag. In addition, there should be a greater sharing of business intelligence across the region and work should continue to bolster the customs union.
7. Infrastructure capacity improvements, particularly the roads and ports in Nicaragua, but also throughout the region, should be undertaken. This is an area where Nicaragua is particularly weak and that is made more significant as most north-south goods must transit through the country.
8. EDIFACT, a standardized language used in automated trade functions both by public agencies and private enterprise, should be used throughout the region so that systems, such as Customs, can communicate with each other. At present all have different operating systems, making it difficult to transmit to each other.

Group 2 -- Fostering Healthy Credit Systems

Access to credit is necessary to the development of the Nicaraguan productive sector. At present, however, credit is limited to a small group of private businesses, i.e. large and wealthy companies; micro, small and medium enterprises have limited access. This is particularly problematic as SMEs in Nicaragua represent a significant portion of the economy. Various problems and possible solutions exist:

1. There is no coherent strategy for improving access to credit at rates where it is affordable for SMEs. The “microfancieras,” or credit unions that specialize in lending to SMEs, are ‘patching holes’ at best, and have no integrated plan. There is no state development bank to help create an integrated plan and improve access, which is a mistake of public policy. A mechanism in this regard should be created, i.e. a development bank for SMEs that is a cooperative effort between the public and private sectors. Steps must be taken to ensure that such a bank operates with the highest levels of integrity.
2. The kinds of usable guarantees allowed is limited. Predominantly, secured lending is based on a mortgage, the ‘classic’ collateral. Even then, however, consumers are at a disadvantage as lending institutions will often perform their own evaluation of the property, find that it is of lower worth than its actual value, and decrease the amount of the loan. Consumers are left little recourse against this.
3. When it finally reaches SMEs, the money made available from international development loans for business development has higher interest rates that many businesses can afford, and there is a lack of control of this process. For example, if the money reached the country at 6% interest, this quickly becomes 12% because of transaction costs, and may reach as high as 21% because of commissions and other additional costs.
4. The legal framework surrounding lending is inadequate. Reform is needed in various areas, in particular with respect to property ownership and the guarantees system. With respect to the latter, the law should allow for greater possibilities of collateral, such as inventories and bank administered contracts that would create greater legal certainty.

Group 3 – Implications for SMEs

Micro, Small and Medium enterprises face numerous challenges, including:

1. Delayed or lack of access to technological advances relevant to business;
2. Difficulty in gaining access to credit. While some progress has been made through “microfinancieras”/credit unions, opportunities remain rare and rates remain high;
3. Lack of clear definitions and policies within the government for microenterprises as something separate from SMEs, without which both groups will face added and unnecessary challenges. In addition, more specific policies are needed from and for SMEs themselves as the needs of various sectors are different, e.g. industrial businesses versus agricultural;
4. Underutilized International development funds from sources such as the Interamerican Development Bank;
5. Uneven and incomplete efforts to create business clusters. Presently, similar businesses are too dispersed and not able to work together to improve their position jointly.
6. Difficulty in achieving higher standards of production quality as a result of limits on resources. Participants stated a concern that this challenge will only increase as a result of CAFTA;

7. Imperfect information on the number of SMEs currently in Nicaragua;
8. Inadequate laws regarding property ownership. Currently, many SMEs, in particular in the farming sector, don't have legal certainty with respect to their property, limiting their possibilities;
9. Limited or ineffectual legislation to support SMEs;
10. Little incentive for the informal business sector, which represents 90% of Nicaraguan production, to formalize because of the high cost of doing so because of, for example, taxes. Relatedly, there is a lack of fiscal equity as large companies are not required to pay a just share; and
11. High production costs for SMEs as a result of limited access to technology as well as credit. As a result, they are not as competitive.

Number steps and reforms can be taken to address these challenges:

1. Microenterprises should be separated from SMEs in terms of government actions and policies in order best meet their unique needs and to encourage growth;
2. A tax law must be passed which is in general more equitable, but in particular relatively less harsh on SMEs and which gives them greater incentives to formalize;
3. A new survey, updating the study of 2000, should be completed to determine the number SMEs currently existing and trends thereof. This will allow policymakers to better target their efforts;
4. As many middle men as possible should be removed from the processing of international loans so that rates remain affordable. One means to achieve this would be to create a national development bank;
5. Incentive programs should be created to promote business growth, competition, and technological innovation;
6. Business clustering should be encouraged. This will increase the possibility of formalization and legal recognition, as well as increase access to many benefits such a technological advances and credit;
7. National quality standards must be bolstered and regional standards must be taken into account. One means to achieve this is through training of businesses so they know the standards they should meet, as well as through encouraging clustering which will help businesses be better able to regulate themselves in this regard;
8. Law should be reformed in order to improve intellectual property rights and protections so that there is greater incentive for development; and
9. SMES must create a clearer self-vision as a sector, in particular to have a clearer plan in light of CAFTA.

Group 4 - Prioritizing Regional Initiatives to Benefit International Trade

1. The well-known and significant problems of the judicial system must be dealt with. Without the functioning rule of law, Nicaragua will struggle to improve its position with respect to international trade.
2. Nicaragua currently operates under a system of laws many of which are obsolete. Substantial legal reform is needed in various areas, including, for example, the commercial and

civil codes, labor laws, laws regarding contracting and secured transactions, as well as laws to continue development of the regional customs union. With respect to the customs union, Nicaragua has been regional leader and should continue to be so. In addition, wholesale adoption of new laws in other areas is needed. These include, for example, laws on international trade and alternative dispute resolution. In this latter area, Nicaragua has the opportunity to be a regional leader as it can learn from its neighbors' mistakes to create a better functioning system that could then be taken to the regional level.

3. Nicaragua must clean its image abroad. Too many continue to believe that is a dangerous country when in fact it is the safest in the region. Simultaneously, while working to rehabilitate its image, both the public and private sectors must work to build trust so that investors, both domestic and international, feel secure doing business in the country. Currently, Nicaragua ranks very low with respect to investor trust.

4. Nicaragua and the region must embrace integration through specialization. In this way the countries of the region will complement, instead of compete against, each other.

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