

A major change of course is needed



In Nicaragua, the fall in income from exports and remittances is already beginning to make itself felt and is having a tangible effect in terms of higher unemployment and increased poverty. In the short term, to limit the impact of the crisis, the government should increase public sector expenditure and thus stimulate economic activity and employment, even though these measures alone do not attack the country's main problems. A major change of direction and a complete overhaul of the current growth model are urgently needed. Agriculture is very backward and must be revived, and a major effort to recapitalise the country's human capital is essential.

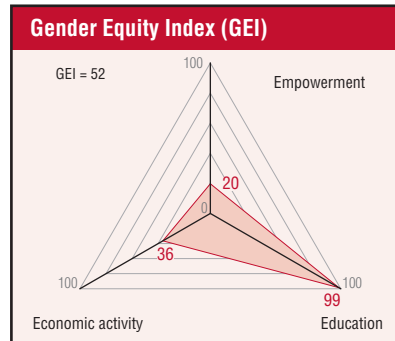
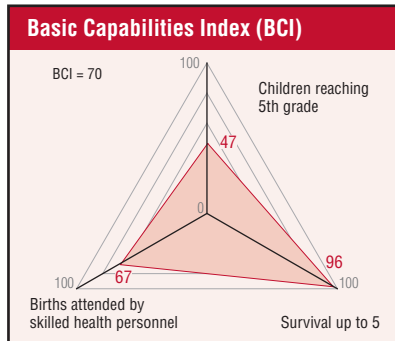
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The current international economic crisis is not only the most serious and severe since the Second World War but also the most synchronised in the sense that although it first began in the developed countries it is now affecting the economies of every region in the world at the same time. In 2009, for the first time in more than 60 years, the world's economy will have negative economic growth. The International Monetary Fund (IMF) has announced negative growth (-1.3%), and the OECD has stated that world trade will contract by 13.2%. The crisis is expected to cause the loss of 50 million jobs worldwide¹, and it is predicted that 200 million people will sink into poverty. The World Bank has announced that more than 400,000 children could die from avoidable causes as a result of the crisis.²

In Nicaragua in the short term, the crisis will probably affect the growth of two crucially important areas of the country's economy, namely exports and family remittances, and it will lead to increased unemployment. Between January 2008 and March 2009, a net total of nearly 20,000 jobs were lost in the export-processing zones alone.

Presumably the impact of the international economic crisis will be reflected in a considerable loss of dynamism in aggregate demand. This in turn will cause a serious slowdown in the rate of growth of production and employment, and there is the inherent risk that the country might slide into recession. Various projections about Nicaragua's economy show that to a greater or lesser extent the main components of aggregated demand will decelerate markedly in 2009.

The reduction in exports of goods and services, in the flows of family remittances and in internal and external credit, added to liquidity problems and increased uncertainty, will probably translate into strong recessive pressures that, with varying degrees of intensity, will affect many sectors of the country's economy. The slowdown in the rate at which aggregate demand is growing could translate



into a GDP growth rate of only 0.5%, but this is the most optimistic scenario, and it is far more likely that there will be negative growth (-1%).

Falling exports and remittances

The production of goods and services for export has been the main driving force behind Nicaragua's economic growth, but on the other hand goods and services for the domestic market have hardly grown at all in the last fifteen years. Moreover, Nicaragua's exports are heavily dependent on the United States. Before 2008 this accounted for 26.7% of the country's GDP, but this market has been severely battered by the crisis and by March 2009 exports had shrunk by nearly 19%.³

In 2008, family remittances amounted to USD 807 million or nearly 13% of GDP, but by May 2009 they had fallen 4%.⁴ Four out of ten families in Nicaragua receive remittances, and 60% of this flow comes from the United States. Remittances provide an essential social cushion in the Nicaraguan economy, and it has been estimated that without them the rate of poverty would increase by four percentage points.

Unemployment and poverty

According to the ECLAC, the unemployment rate increased from 7.5% in 2008 to between 7.8% and 8.1% in 2009, and the informal market expanded. This rise means that up to 1.8 million people have been added to the 1.6 million who were already unemployed.⁵

This, in turn is reflected in the fact that there is less employment and it is of worse quality. The loss of formal employment means that more and more people are losing the benefits of social security protection, which affects not just the main recipients but also their dependants.

It is difficult for people who lose their jobs in the formal sector to find another in the same part of the economy, as this sector is shrinking at an alarming rate. The poor cannot afford the luxury of remaining unemployed, so they will probably drift into employment or sub-employment in the informal sector. But this sector has to absorb not only these new unemployed but also most of the young people who join the economically active population, so it will become saturated and income per person will fall. Poverty and extreme poverty levels are already very high and they will increase still further, so the social fabric will deteriorate even more.

In Nicaragua, income is very unevenly distributed (Gini rating: 0.56). Population groups in the lowest reaches of the income distribution scale benefit less in phases of economic growth and they tend to suffer more from any adverse shock that occurs. People in the poorer sectors of the population do not have savings or assets to fall back on to alleviate the impact of economic hardship and carry them through difficult times, and the crisis could rapidly push many of them below the extreme poverty line or even into indigence.

In all likelihood, as unemployment increases various ways of generating income will emerge in the informal economy. These will take the form of small-scale and family undertakings as a survival strategy, and more people will seek ways to become self-employed. These strategies could make for a considerable increase in unpaid work by members

1 See: ILO *World Employment Trends, 2009*. Available at: <www.ilo.org/wcmsp5/groups/public/—dgreports/—dcomm/documents/publication/wcms_103599.pdf>.

2 See: <www.gara.net/paperezkoa/20090322/128371/es/EL-BM-compara-profundidad-crisis-actual-Gran-Depresion>.

3 See: <impreso.elnuevodiario.com.ni/2008/10/14/economia/87227>.

4 See: <www.remesasydesarrollo.org/estadisticas/remesas-familiares-hacia-nicaragua-siguen-cayendo-por-recesion-economica>.

5 See: <mpreso.elnuevodiario.com.ni/2008/12/19/economia/91815>.

of the family, and the main weight of this will fall on women and children. But employment in small-scale and family undertakings will in turn become saturated so per capita income in households that depend on these jobs will fall even more, in a scenario in which the levels of poverty associated with this kind of employment are already very high.

To make matters worse, in 2007-2008 food prices increased sharply and this had a cruel impact on the poor, as it severely restricted their access to food and aggravated their situation. In the twelve months up to December 2007, the price of food index jumped by 24.9%, and up to December 2008 it rose by another 22.5%.

This worsening food access situation has not only affected the urban poor, some 93.8% of whom (according to the FAO) are net purchasers of food, but has also impacted on the rural poor, of whom 73% are also net buyers. The worsening economic straits in which many households find themselves could hamper their access to food even more, and exacerbate the problem of hunger in a country in which 22% of the population are already undernourished.

Women are affected more

Women as a population group are particularly vulnerable to the effects of the crisis. According to the National Institute of Information about Development (INIDE), some 71% of working-age women in rural areas and 58% in urban areas are not in the workforce and therefore do not have their own sources of income. In many cases, low household income means that women are overloaded with work at home, trying to produce the goods that the family can no longer afford in the market.

Of Nicaraguans who are employed, some 86.5% work in services (35.8%), trade (32.3%) and manufacturing (18.4%), and these sectors are vulnerable to the adverse effects of the crisis in terms of unemployment or jobs becoming precarious. In fact, job losses in the export-processing zones have impacted more on women than on men.

Measures to contain the effects of the crisis

What is mainly needed to contain the adverse effects of the international economic crisis is to counter the slowdown in aggregate demand or total expenditure oriented to the acquisition of goods and services at the domestic level. When it comes to putting a brake on trends leading towards recession, the instrument that governments most frequently have recourse to is to increase money and credit in the economy to stimulate consumer spending and investment and to attenuate liquidity problems. This policy would mean that the central bank could (1) lower the official reserve limit (the legally stipulated level of reserves), (2) re-purchase bank bonds that have been placed on the open market, or (3) lower the discount rate for credit lines for the financial system.

In any case it will be essential to make credit more easily available to support banks that could eventually run into liquidity problems – due for example to the withdrawal of their foreign sources of finance – or to enable banks to provide assistance for enterprises with liquidity problems. In an extreme case, the central bank could even assist banks with solvency problems to recapitalise. In no way would this be privileged treatment for the financial sector, it would mean underpinning the financial system because instability in that sector could have extremely severe repercussions in the economy as a whole. Bear in mind that the current world crisis began with a “simple crisis” in the financial sector.

Up until now the most important measure the Government has taken was to obtain a contingent credit line with the Central American Economic Integration Bank (BCIE), and this will be utilised if some Nicaraguan banks eventually find themselves in financial difficulty.

Another aspect of the problem is that the banks would find it hard to expand their credit operations aggressively in a context of such weak and uncertain prospects in the various sectors of the economy. In fact, bank credit tends to be pro-cyclical, that is to say it tends to behave restrictively when the economic situation is deteriorating, which causes the downside to worsen even more.

The logical course of action to put a brake on the shrinkage in aggregated demand caused by falling private consumption and investment would be to increase public expenditure. This is part of aggregate demand, just as private spending is, and as such it would serve to stimulate economic activity and employment. But if the opposite course is taken, if public spending is reduced instead of increased, the recession will get worse. In other words, reducing public expenditure is pro-cyclical.

The most effective option to counteract this dramatic slowdown in demand would be to implement a public investment package sufficiently extensive to compensate for the shortfall in growth in the other components of aggregate demand. This is what governments all over the world are doing.

What is needed is an aggressive programme of public investment in basic infrastructure that matures rapidly, such as the repair and maintenance of roads and improvements to the road network, the expansion and improvement of the potable water distribution and sanitation systems, the expansion of the energy supply grid, and the maintenance, repair and construction of new classrooms, housing, etc. In addition there should be a programme to improve productivity in small and medium economic units, in rural as well as urban areas. This wide-front approach would yield various benefits as it would not only help to counteract or at least attenuate the impact of the crisis, but it would also stimulate the creation of new assets and capabilities that would

make a contribution to the future development of the country. These investments would constitute prerequisites and provide basic foundations for the development process.

It is also essential to take all possible steps to protect current levels of expenditure in the basic priority area of human capital, which means especially in education, health care services and access to essential medicines and nutrition, and to expand expenditure on social protection, which ought to function as a cushion against the worst effects of poverty when there are adverse fluctuations in the economy.

Long term measures

However, it is not enough merely to tackle the negative impacts of the crisis in the short term. It is vital to initiate a change in the direction the country is going, to decisively overcome the extreme backwardness and state of abandonment that agriculture⁶ and rural areas have fallen into, and to re-orient today's growth model and invest on an unprecedented scale in human capital and basic infrastructure. We propose a major national effort to achieve, within a strict time frame, a series of basic goals:

- To eradicate adult illiteracy. By the proposed deadline 100% of the population over 15 years old should be literate.
- To achieve universal pre-primary education coverage, raising net enrolment among children aged 3 to 5 to 100%.
- To achieve a net primary school enrolment rate of 100%.
- For at least 80% of children who enrol in the first grade of primary education to complete the whole basic education cycle.
- To achieve a net secondary education enrolment rate of 75%.
- To achieve a significant improvement in the quality and relevance of education at all levels.
- To raise average schooling in the country to 9 years within the set deadline. ■

⁶ Agriculture accounts for 21% of the gross added value produced by the various sectors of Nicaragua's economy, it employs around 30% of the country's employed workforce, and it generates more employment than any other single sector.