

**SOCIAL INFRASTRUCTURE INVESTMENT PROGRAM: PHASE IV**

**(NI-0061)**

**EXECUTIVE SUMMARY**

**BORROWER AND  
GUARANTOR:** Republic of Nicaragua

**EXECUTING AGENCY:** Social Emergency Investment Fund (FISE)

**AMOUNT AND SOURCE:** IDB (FSO): US\$50.00 millions  
OPEC: US\$ 4.00 millions  
Local counterpart funding: US\$ 5.56 millions  
Total: US\$ 59.56 millions

**FINANCIAL  
TERMS AND  
CONDITIONS:** Amortization period: 40 years  
Commitment period: 3 years and 3 months  
Disbursement period: 4 years  
Grace period: 10 years  
Interest rate: 1% during the grace  
period and 2 %  
thereafter.  
Inspection and supervision: 1% of the loan amount  
Credit commission: 0.5% of the undisbursed  
balance

**OBJECTIVE:** The main goal of the project, is to improve the living conditions of the poorest people in Nicaragua, on a sustainable basis, by reducing the damaging effect of the destroyed, dilapidated or non-existent basic social infrastructure throughout Nicaragua. It will make a concrete contribution to providing them with the means to improve their lot. Success in doing so will strengthen the incipient national reconciliation and reconstruction efforts.

**DESCRIPTION:** 1. **Investment Projects** (US\$49.04 millions)  
The FISE will finance basic social infrastructure projects to rebuild, expand and repair schools, health facilities, water and sewage systems, social assistance and environmental projects.

2. **Technical Assistance** (US\$1.7 millions)  
Consultancies will be financed to: (i) consolidate pilot projects to develop new municipal planning, management and maintenance regimes based on community participation; (ii) expand and improve FISE's internal procedures and systems; (iii) institute

outreach initiatives to increase community participation and benefits; and (iv) design specific policy measures needed to enhance project viability.

### 3. Social Policy Definition (US\$100,000)

The project will also include policy targets aimed at: (i) establishing criteria to govern any further extensions of the FISE mandate; (ii) improving participation of line ministries in setting FISE procedures, plans and priorities and developing new initiatives; (iii) ensuring the continued use of effective planning tools; (iv) increasing the quality of social services provided via the improved infrastructure; (v) linking expansion of coverage via FISE to the provision of minimum services; (vi) rationalizing disparate public programs that also provide basic social infrastructure to the poor; (vii) heralding in a new maintenance regime for schools and health facilities; and (viii) contributing to the definition of the decentralization model chosen for Nicaragua and enabling the entity responsible for implementing it.

#### JUSTIFICATION:

- a. Nicaragua is still recovering from the internal conflict of the 1980's and despite significant economic and political achievements, poverty still plagues over half the population. Until concrete actions are taken to give these people the means to improve their lot, the success of the incipient national reconciliation and reconstruction efforts will be in doubt.
- b. Understandably, then, Nicaragua's top social priorities are improving equity and reducing poverty.
- c. Over half the population lives below the poverty line and under conditions that can only be improved through the provision of adequate health, education, water supply and sanitation. However, weak institutions and lack of funds severely limit the provision of these services. Furthermore, the impact of services that are being currently provided is diluted by the wretched state or the absence of the infrastructure in which they are provided.
- d. This infrastructure deficit (50% of the education network, 35% of health facilities; 45% of water supply and 80% of sewage) mostly affects the poorest and most vulnerable segments of society such that its reduction would directly improve their living conditions and enhance the

effectiveness of other complementary social investments.

- e. The FISE is the most important weapon in the Government's arsenal for reducing this deficit and assisting the permanent institutions to improve their planning and execution. Even so, this is an important juncture for the FISE. The volume of unmet needs clearly indicates the services it provides will continue to be necessary over the medium term.
- f. The unique and valuable contribution made by the FISE should be preserved over the medium term. Accordingly, the Bank will continue to support its mission during this phase while helping Government to establish parameters for defining its institutional nature in the context of any future extension and/or modification of its mission.

**ENVIRONMENTAL/  
SOCIAL REVIEW:**

The CESI/TRG approved the relevant sections of the Project Report at its meeting (TRG30/97) held on October 31, 1997. It was decided that an EIA was not required. The relevant sections that correspond to this matter are presented in paragraphs 4.8 to 4.20.

**BENEFITS:**

**1. Infrastructure**

Infrastructure investments not only improve the conditions under which the services are provided, but also the access to services (when subprojects provide new or expanded facilities). The project will not only reduce the deficit but will also improve sustainability.

**2. Expedite Definition of Overall Social Policy**

The policy measures to be expedited by the project as well as the assignment of institutional responsibility for its implementation to a specific entity with the corresponding coordinating authority offer important positive externalities. They constitute a driving force for the definition of an overall social policy and the creation of the technical capacity to implement it.

**3. Local Development and Decentralization**

The Project will provide specific support for development of the working relationships between communities, civil society organizations and local governments. In addition, it will take initiatives to advance the decentralization effort by strengthening the managerial capacity of municipal governments and transferring operational responsibilities to them.

**RISKS:**

1. **Coordination of Policy Measures.** Implementation of the policy measures requires actions by agencies over which no single entity currently has the institutional authority or technical capacity to ensure compliance. This implies a risk that FISE projects may be interrupted if the nascent coordinating entity is unable to get other institutions to collaborate. The time needed to provide that entity with the requisite authority and capacity may also delay the component.

2. **General Application of the Policy Matrix.** The IDB is the first of the major international agencies to commit funds to the FISE in support of its 1998-2002 operating program. Although the World Bank and KfW participated in the development of the policy matrix, there is no formal institutional agreement by either agency to adopt similar conditionality in their upcoming operations with the FISE. Given that 45% of the total program will be covered by these agencies a decision by them to not adopt the matrix would send mixed signals to the Government and could undermine the incentive for achieving the policy targets.

3. **INIFOM.** The viability of shifting new responsibilities and authority to the municipal governments to channel community demand, manage the project cycle and coordinate maintenance is intimately dependent upon the corresponding transfer of additional resources to them. However, the new Municipal law (still in process of ratification) does not include such transfers. In addition, each new responsibility will have to be made consistent with the decentralization model yet to be chosen by Nicaragua. Permanent monitoring, support and financial management arrangements will also have to be put in place. The FISE's temporary nature makes it ineligible to assume these functions and the permanent institution with responsibility, INIFOM, is unable to perform them without significant strengthening. There are, however, no specific plans to provide this strengthening. The sustainability of the initiative is therefore clearly at risk. The insistence on presentation of a proposal for developing the permanent institutional capacity to channel funds and supervise municipal governments mitigates but does not eliminate this risk.

4. **Local Development.** The level of organization and training of communities is inadequate to permit them

to participate fairly and effectively in developing projects at the local level. The public institution responsible for local development, MAS, has not developed a comprehensive policy, and the municipal governments which are responsible for implementing community development are wary of it. There is a multiplicity of external programs that operate without coordination and whose coverage is limited. This situation will dilute the impact of FISE's efforts to promote community participation. To partially compensate for this the FISE will develop training programs as a specific menu item aimed at increasing community organization and their capacity to participate effectively in local development initiatives. In addition, the plan for all requests for FISE projects to only be channeled through the municipal governments will not be realized until appropriate checks and balances are in place.

5. **Quality.** By limiting itself to rehabilitating and expanding existing schools and health facilities the FISE maximizes the probability that its investments will be utilized. Although this strategy enhances efficiency, it creates equity concerns by not expanding coverage to those without access to basic social services. The inability of the line ministries to provide greater coverage while maintaining minimum quality levels is at the heart of the problem. Until measures are taken to expand their capacity, the FISE's strategy seems pragmatic and fully justified.

**THE BANK'S  
COUNTRY AND  
SECTOR STRATEGY:**

The primary objective of the Bank's country strategy for Nicaragua (as presented in GN-1931-1 of October 1996) is sustained growth with equity. The key components in achieving it are reduction of the external debt; promotion of the private sector and revitalization of production; poverty reduction and development of human capital; and optimal management of natural resources. In the social sector the Bank's main focus is on poverty alleviation through programs that strengthen the Government's social strategy and support community promotion and participation, the rehabilitation of basic infrastructure and decentralization in the health and education sectors.

**SPECIAL  
CONTRACTUAL  
CONDITIONS:**

The loan contract shall include the following:

**1. Conditions complied with previously**

The conditions complied with prior to the approval of the financing were:

(a) the presentation of a Policy Letter which establishes the context in which the policy component will be executed and its overall targets.

(b) the designation of the permanent entity to be assigned the responsibility for coordinating the policy component and the institutional arrangement to manage the function until that entity is in place (Par. 2.21)

**2. Prior Conditions to the First Disbursement for first half of the Financing.**

- a) Present an agreement pursuant to which the Borrower transfers to the FISE on a non-reimbursable basis the loan and counterpart resources for the execution of the project. (Par. 2.29)
- b) Present inter-institutional agreements with INIFOM, MED, MINSA, INAA, MARENA, INATEC and FONIF to cover the extended period of the FISE's mandate until 2002; (Par. 3.9)
- c) Present the list of FISE staff to be financed with Bank resources (Par. 3.3);
- d) Present evidence that the operating regulations are in-force (Par. 3.10).
- e) Compliance with the conditions related to the second phase of the policy matrixes presented in paragraph 2.22 of this document.

**3. Twelve Month Conditions**

The following conditions are part of the policy matrix and will have to be met within 12 months of contract ratification (Par. 2.23).

- a) Agreement on the terms of reference for a consultancy to propose criteria to govern future extensions of the FISE's mandate.
- b) Present a plan to improve FISE agreements with other public entities to increase their participation in setting FISE targets and collaboration in the development of new initiatives and procedures until the Social Policy is operational.
- c) Contract a consultancy to prepare a plan to strengthen INIFOM.
- d) Operationalize the entity responsible for coordinating the policy component.

**4. Conditions prior to the Second Half of Financing**

- a) In order to commit the second half of the financing it will be necessary to comply with the conditions presented in paragraph 2.24 of this document which relate to the third phase of the policy matrix.

**5. Special Conditions during Execution**

- a) Any significant modification of the operating regulations for the project will have to first be agreed with the Bank, as will any significant change in the operating manuals. (Par. 3.13)
- b) The impact indicators will be updated to reflect the adjustments agreed on with the Bank, within the first 12 months of loan ratification (Par. 3.19).
- c) No project resources may be managed by the municipal governments on behalf of the FISE until the Borrower has agreed with the Bank on the corresponding institutional arrangements (Par. 1.46).
- d) Conditions relating to phase IV of the policy matrix (Par. 2.25).
- e) Present a copy of the co-financing agreement signed with OPEC (Par. 2.27).
- f) The maximum amount that may be advanced using the Advance of Funds modality has been established at the equivalent of 10% of the total value of the financing (Par. 3.17).
- g) Consult with the Bank prior to any change in the staff members who form part of the list agreed prior to the first disbursement.

Additionally, the loan contract shall contain the standard conditions prior to first disbursement for this type of operation and shall include other standard conditions related to, inter alia, auditing, reports, inspection, maintenance, evaluation, and the procurement of goods and services.

**POVERTY  
TARGETING:**

The program is consistent with the high priority that the Eighth Replenishment assigns to poverty reduction. It is geographically targeted to reach poor beneficiaries and it has been determined that a significant majority of the beneficiaries of the operation are poor. (Par. 1.26-1.31)

**PROCUREMENT:**

International competitive bidding will be required for consulting services in excess of US\$200,000; goods and services in excess of US\$250,000 and works in excess of US\$1,000,000 (Par. 3.15-3.16). The application of the ex-post review of procurement is recommended for this operation (Par. 3.16).

## I. BACKGROUND

### A. Reflections of Poverty

- 1.1 Nicaragua continues to be one of the poorest countries in Latin America. The annual GDP per capita for 1997 is estimated at US\$468 (still well below the US\$850 achieved during the 1970's), approximately half the population lives below the poverty line and 20% in conditions of extreme poverty or indigence. The majority of Nicaraguans live in rural areas (78%) and they are the hardest hit by poverty (75% live below the poverty line compared with 32% in urban areas). The rural population also has the lowest access to education and health services which is a contributing factor to the high incidence of waterborne diseases that have the greatest impact on maternal and child health.
- 1.2 Health and education indicators are among the lowest for the region. Infant mortality is 50.3 for each 1,000 live births mostly due to preventable diseases and the lack of adequate water and sewage services. The index for death through childbirth (160 per 100,000 births) is the highest for the region. With regard to education, 25% of the population is illiterate and a full 78% of those who enter primary school drop out. The situation is critical and with a population growth rate of 2.9% it is threatening to get worse.
- 1.3 The Government's capacity to combat this situation remains limited due to ongoing budgetary constraints and the persistent weakness of public institutions. In the face of growing social demands it has therefore been necessary to continue to rely on emergency delivery arrangements operating side-by side with permanent ones.

### B. The Social Sector

#### 1. Alternate Delivery Mechanisms

- 1.4 The current delivery mechanisms to combat poverty have their origin with the advent of the democratic government in 1990. The emergency situation facing the social sector at that time demanded that the Government focus its efforts on the poorest and most vulnerable groups, that it do so quickly and at the lowest cost possible. However, the permanent institutions (primarily the line ministries) were unable to provide a rapid response. They were facing severe budget constraints, did not have the systems and methodologies to focus their efforts on target populations and were stymied by bureaucratic procedures and institutional weaknesses. Emergency measures were called for so the Government decided to temporarily transfer specific functions to a series of special programs freed of operational and financial constraints. The special programs were supposed to provide a short term safety net while the line ministries pursued long term solutions to develop Nicaragua's human capital.



- 1.5 The Government operates five major special programs: (i) MAS (Ministry of Social Action) provides basic social services and infrastructure to poor communities through its Integrated Basic Services Program; (ii) the National Program for Rural Development - PNDR finances social and economic investments in rural areas; (iii) the Nicaraguan Institute for Municipal Development - INIFOM finances training and basic economic and social infrastructure for municipal governments; (iv) the Nicaragua Fund for Children and Families FONIF benefits women and children in rural areas; and (v) the largest, FISE, finances small projects to repair the destroyed and abandoned social infrastructure throughout the country.
- 1.6 The strategy worked. Overall, the special programs did a good job of assuming the short term functions of the permanent institutions and providing temporary relief for the most vulnerable and poor. However, the line ministries have made little progress in overcoming their constraints and the emergency programs have not only retained their short term functions, but have had to evolve to also assume long term ones. The result has been: overlapping functional responsibilities, institutional rivalries and duplication of effort all of which is exacerbated by the absence of a comprehensive social policy to provide a context and forum for coordination.

## 2. The Social Policy

- 1.7 At the request of the current Government, the World Bank and the IDB have been assisting the Ministry of Social Action (MAS) to formulate a comprehensive social policy for Nicaragua, adjust its institutional framework and develop the technical capacity to implement it. The IDB initiative has been channeled through INDES with the support of the Norwegian Fund for Innovation in Social Programs (NFISP) and is focused mainly on developing the institutional capacity to implement the policy. Despite these efforts, the Government has only produced a very general framework of the policy and it has still to be made operational. In addition, the technical capacity to implement the policy has not yet been formed.
- 1.8 The main focus of the framework is on keeping pace with the unmet needs of the growing population while gradually reducing poverty and its structural causes. This is a massive challenge since ongoing budgetary limitations imply it will be a major success just to prevent resource allocations from falling in real terms in the immediate future.
- 1.9 Once the social policy has been formulated, it will have to be made operational, the corresponding institutional changes effected and the implementing capacity developed. Until then, the Government is relying on each individual line ministry and special program to apply its own programming criteria within the context provided by the general framework. Although pragmatic, this strategy does not allow for directly reducing duplicated effort and inter-

institutional rivalry that arise from the unclear assignment of responsibilities, and the missing context for coordination of activities.

### 3. Stop-Gap Measure

- 1.10 Since the FISE's operations are meant to closely complement the efforts of the line ministries, the viability of the proposed project is directly affected by the lack of coordination. In order to overcome this, the Government and the Bank have agreed to expedite the definition of specific policy measures without which the infrastructure would probably be underutilized and poorly maintained.
- 1.11 The mechanism chosen for doing so is the attached policy matrix (See Annex I) which outlines the policy targets included in the project. Given their importance, it has also been decided to build-in an incentive for their implementation by linking policy advances to the release of Bank resources for FISE operations.
- 1.12 It is noteworthy that the matrix was developed in close collaboration with the other major donor agencies and the Government authorities. With the exception of OPEC, there is not, however, a commitment by any of these agencies to include similar conditionality in their upcoming operations with the FISE. The basis for including each of the specific policy targets is presented below.
- 1.13 FISE Role: The Government has assigned long term duties to FISE, but it continues as a temporary entity dependent on periodic extensions of its charter. . While its goals were still short term in nature it was relatively easy to determine the need to extend the FISE, however, with the advent of long term objectives new criteria now have to be developed to govern future extensions. The Bank will work with the Government to define the FISE's long term functions especially in light of the anticipated strengthening of its counterparts that will result from the Modernization of the State (RAP) program.
- 1.14 Weak Coordination: FISE develops procedures, plans expenditures and sets priorities without adequate participation by client institutions. In addition, FISE's initiatives to promote community participation and municipal development have yet to be formally recognized by the institutions with legal responsibility. Accordingly, the proposed program will improve existing agreements between FISE and line ministries
- 1.15 Targeting: Nicaragua does not have a single, generally accepted methodology for targeting investments to the poor and the MAS is seeking to have all sector institutions use only one. Although the Bank supports the rationalization of targeting tools, any change in the one traditionally used for FISE operations would have to be carefully analyzed to ensure there is no loss of efficiency or

equity. Accordingly, the Government has confirmed that the Poverty Map developed by the donor agencies with FISE will continue to be used for the proposed operation and the introduction of a new one will have to first be accepted by the Bank.

- 1.16 Complementary Activities: The impact of building new infrastructure depends on ensuring the minimum quality levels are maintained in the new surroundings. Accordingly it has been agreed that the assignment of FISE resources will be made conditional upon the maintenance of, at least, minimum quality standards in the infrastructure it improves. The World Bank is financing a study to determine the quality level of services provided in FISE-built infrastructure. Once its results are available they will be used to define specific measures to improve the quality of services.
- 1.17 Coverage: To ensure the use of the infrastructure it builds, the FISE only finances the rehabilitation and expansion of existing schools and health facilities. This is an operationally simple way to make sure FISE investments are used, however, it is not consistent with the line ministries' desires to expand coverage. In recognition of the need to avoid underutilized infrastructure it has been agreed to maintain the FISE's strategy until the financial capacity of the line ministries changes.
- 1.18 Duplication: There are several other institutions besides the FISE that also provide basic social infrastructure to the poor. These include, among others, the Ministry of Social Action, the Agrarian Reform Institute (INRA), the PNDR as well as the line ministries. In order to reduce duplicated effort and institutional rivalry it has been agreed to implement an action plan to rationalize these initiatives.
- 1.19 Maintenance: The line ministries do not have sufficient funds to maintain the infrastructure built by FISE (which invests about US\$23.0 million a year in schools and health posts, but estimates that FISE-built infrastructure worth US\$8.0 million falls into disrepair annually for lack of maintenance). In response, the FISE, with support by the Bank, has developed a pilot initiative whereby the communities and municipal authorities will take responsibility for maintenance, although the line ministries would still have to meet at least part of the cost. For the first time this year, as a result of the pilot, the line ministries assigned a line item in their budget earmarked specially for maintenance. It has been agreed that the Government will take the steps necessary to implement the new maintenance scheme nationally. In addition, continued access to FISE investments will be made dependent on increased budgetary allocations by the line ministries in accordance with schedules to be agreed with the FISE.

- 1.20 Decentralization: The policy for decentralization has yet to be finalized and the institution responsible for it, INIFOM, does not have the institutional capacity to coordinate its implementation. Nevertheless, INIFOM has sought the assistance of the FISE to spearhead a long term process of strengthening the management capacity of the municipal governments to carry out municipal planning in consultation with communities, assume responsibility for parts of the FISE project cycle and coordinate maintenance of FISE infrastructure. Unless INIFOM is strengthened it will not be able to assume the role of supervising the activities of the Municipal Governments in these new areas. Accordingly, the Government, with the financial and technical support of the Danish International Development Aid Program, is implementing an institutional strengthening program to provide INIFOM with the means to assume these functions. It is noteworthy that the permanent function of effecting the financial transfers to the Municipal Governments has been assigned to the FISE. In addition, the proposed initiative requires the collaboration of the line ministries which have yet to adopt INIFOM's decentralization model.
- 1.21 Coordinating Entity: The MAS would normally be responsible for coordinating the policy measures included in this project. However, as a result of the RAP, the normative functions of the MAS are in the process of being transferred to a new social secretariat that will report directly to the President of the Republic. The secretariat will come into existence in the first quarter of 1998 and will be made operational by mid-year. Since this is a transition period for the entity responsible for policy coordination it has been agreed that its functions with regard to this project will be handled by the Social Secretariat until the new entity is in place. It is considered important to wait until that time to define the policy measures to: (i) establish the criteria for future extensions of the FISE and, (ii) to improve coordination with its counterparts.

#### 4. The FISE

- 1.22 The FISE was created in 1990, as an autonomous and temporary public entity reporting directly to the President of the Republic. Its purpose was to compensate for the impact of the adjustment programs on the poorest groups by grant financing of small, make-work projects to repair the destroyed and dilapidated social infrastructure throughout the country. Indeed, weak, under-funded and hobbled by Government procedures, the line ministries could not perform this function so it was necessary to create the FISE as a special entity exempt from salary and procurement norms that used targeting and evaluation methods capable of attracting external donor support.
- 1.23 The FISE complements the operations of the line ministries by rehabilitating existing schools and small health installations; and building new water and sewage systems. Initially, it was authorized to operate until 1995. However, due to the persistence

of the emergency situation that brought it into existence and its successful execution record the FISE was extended, first to 1997 and then to 2002.

- 1.24 The FISE is the largest and most efficient institution for investments in social infrastructure. With annual disbursements of US\$30 to 35 million it accounts for 20% of all public investment and 62% of social investment. Its well trained staff uses targeting and evaluation criteria that ensure high efficiency levels and guarantee funds reach target groups. It is also practically the only institution that retained its key technical staff despite the recent change of government.
- 1.25 Its unique institutional capacity has enabled the FISE to develop into the most important source of specialized management services and technical assistance in the public sector. It fills-in for weaker entities by either directly assuming the deficient function or assisting the agency to do a better job themselves.
- 1.26 These features, though laudable, make it an anomaly in the sector. The generalized weakness of its counterparts has obliged the FISE to go beyond its core functions of project evaluation and financing, to also help allocate resources, program expenditures, develop procedures and methodologies, promote and formulate projects and ensure their sustainability. The FISE was supposed to temporarily complement not indefinitely supplant the permanent institutions, however, there is no schedule for it to stop shoring up these institutions. Accordingly, the debate on the permanence and role of the FISE remains open.

##### 5. The Future Role of the FISE

- 1.27 The Bank has supported the FISE continuously since its inception. The last Bank operation included specific measures to determine whether the FISE should continue beyond 1997. Further extension of the FISE had to be based on the adjustment of its mission and structure to be compatible with Nicaragua's social policy and the Public Administration Reform Program (RAP) (also financed by the Bank). The follow up of this matter was established as a pre-condition for further Bank support.
- 1.28 In 1996, the Government decided FISE would continue as a temporary institution retaining the exemptions that ensure its effectiveness. The extraneous activities to its core functions are supposed to be reduced gradually as its counterparts grow stronger. The key departure from its traditional role was to ask the FISE to begin transferring management of the project cycle to those municipal governments able to assume it (only about 20 out of a total of 145, at this time) and develop procedures for local management of promotion, planning, execution and maintenance. Based on these precepts, the Government then presented a request to the Bank to support a further stage of FISE operations.

### C. Lessons Learnt

- 1.29 To date, the IDB has financed about 30% of FISE's operations through two loans (US\$56.5 million in total) and two technical cooperations (for a total of US\$4.3 million). The previous Bank operation was approved in 1994 for US\$40 million. It will be fully committed by December of this year and the last disbursement is projected for the third quarter of 1998. Other donor institutions (principally the IBRD and the KfW) have also participated in financing the FISE and total resource mobilization has reached about US\$224 million. The mid-term review of the previous phase was completed in April of this year in conjunction with the World Bank and KfW. The most salient conclusions of this review and the ex-post study of the first FISE/IDB operation prepared by EVO last year, were taken into account in preparing the following findings.

#### 1. Targeting

- 1.30 The FISE targets beneficiaries using a Poverty Map based on a Living Standards Measurement Survey (LSMS) which was updated as part of the previous Bank operation. It is a geographic targeting tool that divides municipalities into categories of: extreme, high and medium poverty based on the poverty gap 1/. This has proved to be a very effective tool which helped the FISE to channel 87% of the resources of the previous operation to extreme and high poverty areas and a full 72% to rural areas.
- 1.31 It is important, however, to look beyond the municipal level in considering the success of efforts to reach needy groups equitably. Requests for FISE funds can be presented by the municipal governments, any other public entity with which it has signed cooperation agreements and any legally constituted group that represents beneficiary communities. In receiving these requests the FISE depends on a first-come-first-served modality that puts the remoter and less well represented communities at a disadvantage. As a means of correcting this, the FISE has instituted promotion techniques to increase their participation and is developing a methodology to formalize equitable community participation at the municipal level (Microplanning).
- 1.32 The procedure currently used by FISE for collecting about half its requests that correspond to about half the value of its projects is to participate in open meetings chaired by the municipal authorities at which community groups, NGO's and/or local representatives of the line ministries present project ideas. There have been cases in which FISE promoters have suspended meetings at which communities are not adequately represented, however, there is no systematic procedure to ensure equitable

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1/ This methodology uses levels of expenditures as a proxy for measuring poverty. It often vies with one based on unsatisfied basic needs which is considered more vulnerable to inaccuracies in the case of Nicaragua.

representation of communities. The rest of the requests for projects originate directly from line ministries (44%) and NGOs account for 7% (although they got 30% of the number of projects) . Since communities are able to present requests directly to the FISE they have an alternative if the line ministries or municipal authorities are not willing to sponsor their projects. This is important since there is still wide variance in the degree of access of individual communities to municipal authorities and line ministries.

## 2. Microplanning

- 1.33 A new model for municipal planning is being developed by the FISE which has at its core explicit dependence on the municipal authorities to replace the first-come-first-served strategy with one based on community participation in project identification that gives priority to the poorest areas within the municipality. The model is still in the pilot phase. The initiative was launched in eight municipalities and five have completed the first phase. The project will extend it to 30 more municipalities. (See Chapter IV for details).
- 1.34 Until the Microplanning modality is in place the FISE will continue to promote community participation on an ad hoc basis using its existing promotion procedures. Since Municipal authorities still do not have adequate incentives and tools to treat fairly with the communities, the FISE will continue to act as a broker between them. In addition, the two alternative windows to municipal sponsorship will be retained until the provisions for equitable community participation are fully operational.

## 3. Sectoral Allocations

- 1.35 For planning purposes the FISE sets sectoral financing goals that reflect both the priorities of each ministry and historical demand. To preserve compatibility between this practice and their goal of being responsive to beneficiary demand the FISE does not hold inflexibly to its allocations. Allocations under the previous phase are shown in the following table.

**ALLOCATION OF RESOURCES UNDER LAST OPERATION**  
(as of October 1997)

	No. of Projects	Amount Committed (US\$000)	Percentage
<b>I. Infrastructure</b>			
Primary Schools	248	15,460	47.2%
Secondary Schools	22	2,890	8.8
Vocational Ed. Centers	4	225	0.7
Health Posts	55	1,832	5.6
Health Centers	5	937	2.9
Water Systems	15	3,100	9.5
Sewage Systems	15	3,500	10.7
Child Care Centers	3	207	0.6
Old Age Homes	6	406	1.2
<b>II. Social Assistance</b>			
Community Organization	574	640	2.0
Educational Equipment	358	1,680	5.1
Health Equipment	89	155	0.5
Preventive Health	4	70	0.2
Latrines	41	1,540	4.7
<b>III. Administration</b>			
Salaries	77	1,172	3.6
<b>Total</b>		<b>32.720</b>	<b>100.0</b>

**4. Demand Responsiveness**

- 1.36 For the FISE to realize its goal of being a demand-driven source of sustainable infrastructure projects for the poor its project cycle has to be more flexible to the heterogenous demands of communities. In full recognition of this, the FISE is taking steps to widen its menu based on data collected on project types that are frequently requested but are not eligible in its limited menu (currently 26 categories). It is also developing new procedures to better reach culturally diverse groups (principally in the Atlantic Region).
- 1.37 Under the prior phase, the FISE was to have developed new procedures and methodologies for working with communities whose differences from the mainstream culture hamper their ability to benefit from FISE operations. This refers mainly to the Atlantic Coast Region which presents stark differences from the rest of the



country. It is inhabited by indigenous people and creoles, is physically isolated from the rest of the country, languages other than Spanish predominate and it has a unique political structure. Unfortunately, the efforts made were insufficient to develop the special procedures and they will have to be redoubled under the proposed operation. The development of new ground rules for working through NGO's will contribute to better results. Even so, FISE was able to significantly increase the volume of resources allocated to this area such that over the last two years it has received almost twice the amount allocated via the poverty map.

## 5. Local Development

- 1.38 There is growing evidence that beneficiary participation in decision-making and project management not only contributes significantly to the sustainability of investments, but also improves beneficiary satisfaction (the match between their perceived needs and what is actually provided).
- 1.39 The effectiveness of community participation is intimately linked to the degree of organization, training and management capacity of the given community. However, the current situation is one in which many communities still require significant assistance to organize themselves, acquire management skills and adopt a proactive attitude toward participating at the local level. In addition, the representative structures are often not democratically based. It is important to promote local development as a way of creating systems and structures that will remain after specific projects are completed and to transform communities from mere beneficiaries of Government welfare to generators of their own welfare.
- 1.40 The MAS has yet to develop an overall policy that provides an operational context for local development; and the centralized public institutions (primarily the line ministries) have not instituted individual policies on the matter.
- 1.41 The municipal governments are responsible for promoting community organization and participation, however, they are not empowered to orient the activities of centralized public institutions (principally the line ministries) along these lines. Several distinct models for local development exist simultaneously and the failure to include municipal governments in their development has resulted in wariness on the part of these governments that tend to see the process of local development as a threat to their influence.
- 1.42 There is a multiplicity of non-public entities and individuals active in local development, however, they do so in an ad hoc fashion without the benefit of an overarching policy to coordinate their activities and establish norms; and they do not cover all parts of the country. These include: women's groups, credit organizations, occupational associations, unions, cooperatives,

religious groups, other NGO's, and hundreds of individual facilitators trained through externally financed programs. These entities are the closest to the target communities and often constitute the only form of organization and managerial capacity at that level. 2/

- 1.43 Although it is not involved in policy formulation or rationalizing local development models, the FISE will contribute to a solution by developing new menu items to finance specialized services to organize, train community groups and disseminate information.

#### 6. Project Formulation

- 1.44 The FISE is not responsible for establishing norms and standards or for preparing projects. Nevertheless, it has collaborated closely with the line ministries to develop specifications; improve evaluation methodologies; and has even had to assist in project preparation by hiring private firms on behalf of municipalities. This has increased the quality and number of projects but has also increased FISE operating costs. The experience with MED has been very positive, however, MINSA and INAA have not made optimal use of the help available from the FISE (planned technical assistance has not been taken-up).

#### 7. Project Evaluation and Supervision

- 1.45 Slippage was noted in processing times (average time to move from request to starting construction is now 300 days) and administrative costs are currently up from the target of 10% of disbursements to 11.5%. The project will finance improvements in FISE's internal procedures and methodologies that will assist in reversing this trend. In addition, the quality of collaboration with the line ministries will be enhanced through the policy component.
- 1.46 The quality of designs, plans, specifications materials and workmanship were found to be generally good. This aspect has improved over time due largely to outsourcing project formulation and improved coordination with line ministries. Quality is also considered to have increased due to permitting contractors to use their own labor rather than require hiring local people. Even so, the quality of supervision was found to be variable and improvements were agreed on. FISE already uses private supervisors for 60% of its projects to make up for inadequate supervision by line ministries and municipalities.

#### 8. Impact

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2/ A Bank-commissioned study on the status of local development in Nicaragua was the basis for this section and is included in the technical files of this project.

- 1.47 The FISE has approved financing of US\$157.0 million for over 6,100 projects; contracted 117 construction firms and 1,011 independent contractors; increased the demand for financial services from private banks and insurance companies; and hired several NGO's. Although employment creation is no longer an explicit goal, but an externality of its operations, the FISE estimates it has generated over 230,000 months of temporary employment. The purpose of the FISE is not to build schools and health posts but to improve living conditions. Accordingly, as part of the prior phase the FISE is in the process of developing systems to estimate the impact on the welfare of beneficiaries. In addition, the World Bank is promoting and evaluation of FISE's projects to assess the extent to which the range and/or quality of services to the poor was increased. It will also gauge any increase in utilization rates.

#### 9. Maintenance

- 1.48 As noted above, there is a serious problem with the sustainability of FISE investments. Although the FISE is not directly responsible for maintenance, if a high percentage of its projects are not maintained it will not have achieved its goal of improving living conditions on a sustainable basis. Given the weakness of the line ministries which are responsible for maintenance, the previous operation included a pilot whereby the FISE coordinated and co-financed a maintenance fund (US\$885,000) limited to primary schools and health posts. The main idea is to assist communities and municipal authorities to prepare and co-finance maintenance projects in conjunction with line ministries and the FISE. If successful, the pilot will establish the basis for a new national maintenance regime.
- 1.49 The first phase of the pilot has been tested in 31 municipalities of the total of 145 in Nicaragua. As part of this phase the municipal governments were trained to assist communities to form ad hoc groups responsible for identifying needs, preparing requests, providing matching funds, managing money and reporting. After consolidating the communities' requests, the municipal authorities seek clearance from the line ministries and then request matching funds from the FISE which manages the contribution from the line ministries. The municipal governments transfer the funds to community groups and monitor their use. The process is clumsy, but as a first step is still a significant improvement over relying on unpredictable, ad hoc measures or simple neglect by the line ministries.
- 1.50 Although a few municipalities have opted not to participate due to lack of resources, the results have been encouraging since participating municipalities and communities mobilized about 37% of the total requirement and line ministries contributed another 7%. The pilot got off to a late start and is still in its initial phase, as such, only 14% of the Bank contribution (US\$613,500) has been used to date. Nevertheless, a rapid acceleration is expected next year. The line ministries will be required to continue

assigning resources to maintenance, however, expansion of the scheme to cover the whole country will imply levels of financing the feasibility of which has yet to be proved. Independently of the new regime, it has been agreed that continued access to FISE investments will be conditional on increased budget allocations (they should reach US\$1.5million in 1998) by the line Ministries according to schedules to be agreed with the FISE.

- 1.51 To make the new regime operational it will be necessary to identify the permanent institutions that will handle financial transfers and control. The temporary nature of the FISE makes it ineligible for these responsibilities. It has been suggested that the FISE assume them until the permanent entities have been identified, however, it should be noted that for the FISE to function as a second tier financial institution, (transferring funds to municipal governments on behalf of the communities) requires institutional adjustments that have yet to be defined. Until the corresponding institutional arrangements have been effected and agreed with the Bank no project funds could be managed by municipal governments.
- 1.52 This brief experience with primary schools and health posts has been instrumental in designing more comprehensive maintenance schemes for the other FISE projects. Already, it has shown the benefits to be derived from training municipal governments and organizing community groups. The new project will also provide training to community groups and municipal authorities in the maintenance of more complex projects.

D. Coordination with Other Bank Programs

- 1.53 The Bank is simultaneously executing or preparing other operations in Nicaragua that will have a bearing on the FISE project. The ongoing ones include; a rural development program (PNDR) that works with municipal governments to support agricultural development; a social benefit program for providing rural women and children with food, training and shelter (FONIF); support for the formulation of the social policy (MAS); expansion of the water supply network (INAA); and reform of the public sector institutions (RAP). The ones still being prepared are: expansion of PNDR to make it nationwide; a secondary school education project (MED); a health sector project, (MINSA); and a housing program.
- 1.54 FONIF The FONIF program provides the materials, food and services and the FISE provides the complementary infrastructure. Maintenance is the responsibility of the community groups organized by FONIF. FISE infrastructure investments would be requested directly by FONIF rather than by the beneficiaries. It is expected that about 12% of the total FISE program for 1998-2002 would be devoted to social assistance projects like FONIF. The microplanning methodology being refined by the FISE would require that the FONIF sub projects form part of municipal plans based on community expressions of demand. This will require modification of

the inter-institutional agreement between FISE and FONIF once the microplanning scheme is in place.

- 1.55 PNDR The PNDR is also known as the productive FISE. It promotes productive activities in rural areas by financing the rehabilitation of rural roads, the construction of slaughter houses, technical assistance, and environmental projects. Besides the possibility of some overlap between these activities and those of the FISE, the PNDR also uses a delivery strategy that focusses on active community participation in conjunction with officials at the municipal level. Even so, they have different selection criteria, evaluation methodologies, contracting and execution procedures and supervision norms.
- 1.56 The Bank does not have an agreement with the FISE to finance any projects that could overlap with PNDR and will not do so without one. The FISE is convinced that there are priority social projects that are not covered by the PNDR and has indicated its intention to develop a methodology that ensures there is no overlap. The Bank will review FISE's proposal in the context of the overall policy target to rationalize public delivery programs to eliminate duplication of solutions already offered by the FISE. Care will also be taken to ensure consistency between the decentralization models adopted by the FISE and PNDR programs. <sup>3/</sup> In this sense, rationalization of the FISE and PNDR programs will be required as a condition for disbursement of the second half of the financing.
- 1.57 INAA. The FISE decision to finance larger water and sewage projects in rural areas will necessitate close collaboration with the ongoing IDB project with INAA. Not only will care have to be taken to avoid paying twice for developing designs and specifications, but also to find a way to easily allocate projects to either program. The rationale for FISE's decision is the slow progress being made by INAA in meeting the pressing need to expand these water and sewage networks to improve the health and well-being of the target population.
- 1.58 The policy component includes the improvement of collaboration between FISE and INAA, as well as an action plan to rationalize public programs offering the same solutions as the FISE. Satisfactory advance in both will be required for eligibility for disbursement of the second half of the financing.
- 1.59 RAP. The RAP calls for the reduction of bureaucratic procedures, smaller operating budgets, greater efficiency and clarity in running the public sector. With regard to the FISE and its institutional counterparts it will eliminate the direct execution

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<sup>3/</sup> A detailed analysis of the current status of municipal governments and the incipient decentralization policy in Nicaragua was produced by the Bank in November 1997 and a copy is included in the technical files.

function of MAS; and modify the Municipal law to delegate more responsibilities to local governments.

- 1.60 The policy measures in the new FISE operation would support the RAP by expediting the decision on the MAS in order to provide a credible entity to coordinate the social policy measures. The microplanning model, transfer of project cycle management and the maintenance fund all support decentralization to the municipal level. However, no single decentralization model has yet been decided on, there is no schedule for providing the municipalities with the corresponding increase in resources and the normative entity, INIFOM, is desperately weak. To the extent that parallel efficiency measures at MED, MINSA and INAA generate additional funds to provide services, they will enhance project viability.
- 1.61 MED. The upcoming education project will be limited to upgrading secondary education. The MED has a functioning works department to build those schools (about 10% of the total) that are not eligible for FISE financing. It will be necessary to ensure a pragmatic way of dividing the schools between the two projects.
- 1.62 MINSA. The health project will extend the RAP reforms and improve and expand health infrastructure. If the decision is taken to include health posts and centers in the MINSA project, then a way of dividing the projects between each agency will have to be decided on. Like MED, MINSA also has a works department for projects that are not eligible through the FISE.
- 1.63 Housing Ministry. The upcoming housing project may benefit from coordination with the FISE project if it is designed to include small water and sewage systems, street paving, drainage, waste disposal, etc, that could viably be executed by private companies.

## II. OBJECTIVES AND DESCRIPTION

### A. Objectives

- 2.1 The main objective of the project, is to improve the living conditions of the poorest people in Nicaragua, on a sustainable basis, by reducing the damaging effect of the destroyed, dilapidated or non-existent basic social infrastructure throughout Nicaragua. It will make a concrete contribution to providing them with the means to improve their lot. Success in doing so will strengthen the incipient national reconciliation and reconstruction efforts.

### B. Project Strategy

#### 1. Supporting a Program

- 2.2 The FISE has projected an operating program with a total cost of US\$140.0 million for its next phase: 1998 - 2002. The IDB and OPEC would be the first agencies to approve co-financing operations for this program. Only by confirming further support at this time, will the FISE be able to continue its operations seamlessly from the current phase to the new one.

#### 2. Co-financing

- 2.3 OPEC will cofinance the Bank's contribution with US\$4 million that would be subject to the same conditions governing the IDB financing. The World Bank and KfW intend to approve other operations later next year for US\$48 and US\$15 million, respectively. The remaining US\$23 million is expected to be provided by a variety of bi-lateral agencies.

#### 3. Building on the Past

- 2.4 The lessons from the prior two phases supported by the Bank will be used to streamline its project cycle procedures widen the menu and improve its treatment of environmental, gender and indigenous issues and to achieve greater participation by civil society in its operations. In addition, in explicit acknowledgment of FISE's technical assistance capacity, it will help weak permanent institutions to design and implement innovative models for advancing realization of the fledgling decentralization and local development policies.

#### 4. Financing FISE Itself

- 2.5 The FISE is the single most important weapon in the Government's arsenal for reducing the infrastructure deficit and assisting the permanent institutions to improve their planning and execution. Even so, this is an important juncture for the FISE. The volume of unmet needs and continued weakness of its counterparts clearly indicate it will continue to be necessary over the medium term.

However, making it a permanent public entity at this time would probably result in its decline due to the consequent removal of its exceptions to public sector salary and procurement rules and the inevitable change in the nature of external support.

- 2.6 The FISE is only as good as the people who run it. In this sense, the source of financing is as important as the level of salaries for keeping competent motivated and objective staff. The withdrawal of Bank financing at a time that coincides with severe budget constraints and the wholesale replacement of public officials in other agencies, would destabilize the FISE. Consequently, to ensure Nicaragua continues to benefit from the unique and valuable contribution made by the FISE, it is recommended that the Bank maintain its accustomed financing of professional salaries.
- 2.7 Since the inception of the FISE the Bank has financed its core staff (including the directors of each functional department). Under the previous Bank operation the number rose to 77 of its total professional staff of 119. The Government already covers 50% of total staff cost which includes all of the support staff and part of the professional team. During this phase, however, Bank financing for its staff will be, at least partially, replaced by other sources more consistent with its growing permanence. The Bank's financing will be reduced gradually from the current level of 41% of FISE's total annual wage bill to 33% in the last year of project execution. This corresponds to a reduction from 77 positions to about 62. Although mild, this initiative sends a clear message as to the Bank's position with regard to continued financing of the recurrent costs of an important but increasingly permanent FISE. The technical files contain the table showing the annual schedule for reducing Bank financing.

## 5. Complementary Policy Initiatives

- 2.8 The comprehensive social policy and the institutional capacity to implement it are not yet in place. As such without certain key policy advances, project viability could be jeopardized. Accordingly, the Government and the Bank have agreed to expedite the definition of those aspects that have a direct bearing on the viability of FISE's operations.

## C. Project Description

- 2.9 The bulk of project resources will go to financing small infrastructure projects, but it will also tap into the FISE's unique ability to act as the principal think tank and technical assistance arm of the sector. The project comprises three main components: (i) Investments in Infrastructure Projects; (ii) Technical Assistance; and (iii) Policy Measures.



1. Infrastructure Projects US\$46 million

- 2.10 The FISE will finance basic social infrastructure projects to rebuild, expand and repair schools, health facilities, water and sewage systems, social assistance and environmental projects. The procedures and criteria for these investments have been improved and tested over the years and are considered adequate to govern the proposed project. Additions to the list of items financed under the previous stage require prior agreement between FISE and IDB on the selection criteria and evaluation methodologies for new items.
- 2.11 Geographic allocation of resources will be governed by the recently updated Poverty Map which indicates over half the resources of the 1998-2002 program will be allocated to municipalities classified as extremely poor and at least 70% to rural areas. These percentages will be treated as targets for the commitment of project resources. In addition, the project will introduce new menu items to increase equitable community participation, increase outreach to indigenous groups, advance gender equity and protect the environment.
- 2.12 The specific activities to be financed under this component include: (i) Education: Infrastructure and furniture for pre-schools, primary schools, secondary institutes and vocational centers. Projects for mini-classroom libraries, other teaching materials, training and school orchards will be focussed primarily on rural areas and the poorest municipalities; (ii) Health: Infrastructure, furniture, equipment and basic materials for health posts and centers, as well as, latrine projects, management and disposal of solid waste (using animal traction) and basic health prevention training. There will also be special training in household hygiene aimed primarily at rural and marginal urban areas; (iii) Water and Sewage: The networks in rural areas with concentrated populations and in marginal urban areas will be improved and expanded; and a special effort will be made to increase the incidence of projects in rural areas with disperse populations. These projects would include training to ensure proper operation and maintenance. In addition, when required, they may also include components for latrines, basic household hygiene and small projects to protect watersheds; and, (iv) Social Projects: These activities would be focussed on the most vulnerable groups and would include infrastructure, furnishings, equipment and basic materials for child care centers, old-age shelters and homes for the elderly, training to create family gardens (for sustenance) directed primarily to the poorest municipalities and areas with the highest incidence of infant malnutrition.
- 2.13 As a global program that seeks to be responsive to demand, FISE does not make rigid sector allocations. Nevertheless, for planning purposes it has made the following indicative assignments for its overall program based on past demand and the global objectives of the respective ministries: 33% to education; 20% to health; 19% to water and sewage; 12% to social assistance; 8% to municipal projects (drainage, streets, access roads, markets, slaughterhouses, bridges, solid waste disposal etc.); and 8% to

environmental projects (watershed protection, training, reforestation etc). The IDB and OPEC project will not finance municipal or environmental projects until agreement has been reached on the evaluation methodology and areas of possible duplication with other institutions have been resolved. The IDB will finance the training associated with the menu maintenance projects, but not the projects themselves.

## 2. Technical Assistance (US\$1.8 million)

- 2.14 Consultancies will be financed to: (i) consolidate pilot projects to develop new municipal planning, management and maintenance regimes based on community participation; (ii) expand and improve FISE's internal procedures and systems; (iii) institute outreach initiatives to increase community participation and benefits; and (iv) design specific policy measures needed to enhance project viability. The global amount allocated to each area is presented in the cost table. 4/
- 2.15 Municipal Development. This subcomponent supports the decentralization process whereby increasingly more functional responsibilities will be transferred to the municipal level. INIFOM would access the services of the FISE via an interagency agreement to develop the procedures and technical capacity necessary for competent municipal governments to prepare investment plans, manage the project cycle and coordinate maintenance.
- 2.16 The subcomponent would consolidate ongoing pilot projects and includes: (i) training of 24 municipal governments in municipal planning so they eventually channel all community demand directly to the FISE; (ii) training 30 municipal governments to formulate simple projects and manage the project cycle; and (iii) training all 145 municipal governments to coordinate maintenance projects. The funds will cover transport costs and perdiems of the FISE and other participants in the pilots as well as the contracting of private consulting services. To achieve these goals it will be necessary to work through NGO's as a way of reaching more municipalities rather than relying only on the FISE's internal capacity.
- 2.17 Outreach Initiatives. Consultancies will be financed to develop new menu items to organize communities to better participate in development programs; improve attention to the Atlantic Region; and advance gender equity; incorporate social projects in the menu. This will also entail working more through NGO's.
- 2.18 Project Cycle Improvements. Consultancies will be financed to develop the procedures and methodologies to better incorporate environmental concerns in FISE's operation and implement the system

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4/ A gant chart showing the implementation schedule and preliminary budget for each area of assistance is in the technical files of this project.

of indicators for monitoring the impact on beneficiaries. In addition, the planning promotion, evaluation, contracting, supervision, finance and administrative departments will all receive assistance to upgrade their systems and procedures.

- 2.19 Policy Implementation. The following policy measures will require consultancies to prepare specific action plans: (i) propose criteria to govern future extensions of FISE's mandates; (ii) rationalize public delivery of social infrastructure; and, (iii) define the institutional changes required to adopt a new national maintenance regime based on the Maintenance Fund Pilot.

### 3. Policy Measures

- 2.20 The policy component is comprised of five inter-related and sequential parts: (i) Conditions complied with prior to Board presentation (these are listed in Annex I and are reflected in the Policy Letter and the Minutes of Negotiation); (ii) Conditions that have to be in place before the operation gets underway and therefore will be complied with prior to the first disbursement (once these are met, commitment of the first 50% of the Bank's resources will be able to start); (iii) Policy definitions that rightly should be developed with the entity that coordinates social policy, however, since that entity will only become operational in mid 1998, the period for agreeing on the definitions has been set at 12 months after the loan is ratified; (iv) Conditions that must be met for the FISE to be eligible to start committing Bank resources beyond the first 50% (by this juncture most of the policy decisions will have been implemented); and (v) Implementation of the remaining policy measures. Continued commitments will depend on quarterly verification that prior commitments are being maintained (see paragraph 3.21 for details on the monitoring arrangements).

#### Conditions Previously Complied with

- 2.21 Both of the conditions for presentation of the operation to the Board have been complied with. The first was the presentation of a Policy Letter describing the overall context in which the policy measures will be executed and the specific agreements reached with the Bank for this project. The specific conditions are presented in the corresponding column of the matrix in Annex I. The other condition was the designation of a competent entity to be responsible for coordinating the policy component. It was agreed that the Social Cabinet will handle this function until a new entity is created to assume it. These agreements were recorded in the Minutes of Negotiation. The Policy Letter is attached to the Minutes of Negotiation which are filed in the Technical Annexes.

#### Prior Conditions to First Disbursement

- 2.22 It is important to ensure policy definition is underway at the outset of the project. To this end the following targets would be

set as conditions to the first disbursement. Compliance with these conditions permits commitment of the first half of the Bank's resources to begin.

- a) Demonstrate that the agreement to continue targeting FISE operations with the Bank via the Poverty Map is being maintained.
- b) Present, based on guidelines agreed between FISE and the World Bank, the terms of reference for the 1998 impact evaluation (FISE/LSMS 98) regarding the quality of the services delivered and the sustainability of the investments.
- c) Demonstrate maintenance of policy decisions to limit expansion of health and education networks to budgetary availability of line ministries and to limit new Bank financed FISE operation to rehabilitation and expansion of existing health and education networks.
- d) Contract consultancy to prepare action plan to rationalize public investment in basic social infrastructure.
- e) Contract consultancy to determine institutional adjustments needed to adopt new maintenance initiatives.
- f) Present a four year schedule agreed between MED, MINSA, MIFIN and FISE to increase ministries' budgetary allocation for maintenance of FISE-financed primary health and education infrastructure.

#### First year conditions

- 2.23 It is important to wait until after the third quarter of 1998, when the new Social Secretariat will be operational, to establish the criteria for future extensions of the FISE and improve coordination with its counterparts. In addition, the definition of the plan to strengthen INIFOM will be handled by the Danish International Development Assistance Program and, as such, does not rely exclusively on the Government. For these reasons compliance with the following conditions would not be required before twelve months following ratification of the loan contract.

- a) Agreement on the terms of reference for a consultancy to propose criteria to govern future extensions of the FISE's mandate.
- b) Present a plan to adjust FISE agreements with other public entities to improve their participation in setting FISE targets and collaboration in the development of new initiatives and procedures, including adjustments to reflect advances arising from the RAP.
- c) Contract a consultancy to prepare a plan to strengthen INIFOM.
- d) Operationalize the entity responsible for coordinating the policy component.

#### Conditions for Commitment of second half of financing

- 2.24 In order to ensure that the policy initiatives are implemented in time to benefit the investment component, it has been decided to make eligibility for FISE to start committing the second half of

the Bank financing conditional on compliance with the following policy targets. A special administration mission will review the status of compliance with policy targets in order to determine whether the second half of the financing is eligible for disbursement.

- a) Complete the consultancy to develop criteria to govern future extensions of FISE's mandate and agree on criteria.
- b) Implement the first stage of a plan to improve coordination in FISE agreements with other entities until the social policy is operational.
- c) Maintain agreement to continue targeting FISE operations with the Bank via Poverty Map, as well as agreement to consult with the Bank prior to effect changes in the map.
- d) Based on the FISE/LSMS98 results agree with the Bank on the specific measures need to be implemented to improve the quality of the services delivered and the sustainability of FISE investments.
- e) Maintain policy decisions with regard to limiting expansion of health and education networks to budgetary availability and to limit new Bank financed FISE operation to rehabilitation and expansion of existing health and education networks.
- f) Implement plan to rationalize public programs offering basic social infrastructure and training.
- g) Implement institutional changes needed to adopt new maintenance initiatives; and demonstrate compliance with the schedule agreed between MED, MINSA, MIFIN and FISE to increase ministries' budgetary allocations for maintenance of FISE-financed primary health and education infrastructure.
- h) Implement first stage of action plan to strengthen INIFOM.
- i) Demonstrate that the entity is operating in accordance with the terms agreed with the Bank.

#### Ongoing compliance

2.25 Following eligibility for committing the second half of the Bank financing, the remaining policy measures will be implemented and ongoing compliance with these and each of the earlier agreements will be verified on a quarterly basis. Continued compliance will permit commitments to reach 100% of the Bank financing. Bank acceptance of the Borrower's quarterly submissions on each policy agreement will be necessary to avoid the interruption of ongoing commitment and disbursement of Bank resources.

- a) Demonstrate that the criteria governing future extensions of the FISE are being maintained.
- b) Implement second stage of plan to improve coordination between FISE and other sector institutions.
- c) Demonstrate that the agreement to continue targeting FISE operations using the Poverty Map
- d) Implement the measures agreed with the Bank to improve the quality of the services delivered and the sustainability of FISE investments.

- e) Demonstrate that the policy decisions to limit expansion of health and education networks to budgetary availability of the line ministries and to limit new Bank financed FISE operations to rehabilitation and expansion of existing health and education networks are maintained.
- f) Implement and maintain institutional changes needed to adopt the new maintenance regime and demonstrate compliance with schedule to increase ministries' budgetary allocations for maintenance of FISE-financed health and education infrastructure.
- g) Implement second stage of plan to strengthen INIFOM.
- h) Demonstrate that the coordinating entity for the policy component is operating in accordance with the terms previously agreed with the Bank.

D. Cost and Financing

1. Bank Financing

- 2.26 The Bank would finance up to US\$50.0 million of the total cost of the project, to be applied as shown in the following cost and financing table. The Government has opted to capitalize interest payments during the disbursement period. The financial terms and conditions of the Bank financing are as follows:

Amortization Period	40 years
Commitment Period	three years and three months
Disbursement Period	four years
Grace Period	10 years, and first payment 6 months after final disbursement
Interest Rate	1% during the grace period & 2% during the rest of amortization
Inspection and Supervision	1% of the loan amount
Credit Commission	0.5% of the undisbursed balance
Capital Fund	Fund for Special Operations

2. Co-financing

- 2.27 OPEC has already approved a loan for US\$4.0 million and intends to formalize the agreement with Nicaragua in early 1998. The OPEC resources will be applied to the financing of investment projects, part of the technical assistance component and 10% will go to cover administrative costs. The loan contract for the IDB financing will include the stipulation that: (i) the Government's agreement with OPEC should include the same policy conditions as those applied to the Bank financing; (ii) the allocation of OPEC resources should be as shown in the cost and financing table of the Bank loan; and (iii) the Bank should be consulted on the aspects of the agreement

that affect the subsequent Administration Agreement between the Bank and OPEC prior to formalizing the loan between Nicaragua and OPEC.

### 3. Local Counterpart

- 2.28 Given that Nicaragua is classified as a "D" country and the vast majority of the Bank resources will go to benefitting people who live below the poverty line, the minimum local counterpart contribution is 10%. The items to be financed with these funds are presented in the cost and financing table. It is anticipated that about US\$ 1.65 million will be provided from budgetary resources and another US\$ 4.0 million will come from the PL-480 program with USAID. It is noteworthy that the contributions of beneficiaries may also be included as part of the local counterpart contribution once an agreement has been reached with the Bank on the accounting procedure to be used.
- 2.29 As a prior condition to the first disbursement of the IDB and OPEC loans, the Borrower will present an agreement pursuant to which the Borrower will transfer loan and counterpart funds to the FISE on a non-reimbursable basis.

**COST AND FINANCING TABLE**

CATEGORIES	IDB <u>5/</u>	LOCAL <u>6/</u>	SUBTOTAL	OPEC	TOTAL	%
Administration	4,420	1,650	6,070	400	6,470	10.9
Projects	41,830	3,910	45,740	3,300	49,040	82.3
Technical Assistance	1,500	0	1,500		1,800	3.0
1. Municipal development	675					
2. Project cycle improvements	530			300		
3. Outreach initiatives	195					
4. Policy implementation	100					
Interest	1,750	0	1,750	0	1,750	2.9
Inspection & Supervision	500	0	500	0	500	0.9
Total	50,000	5,560	55,560	4,000	59,560	100.0
%	90.0	10.0	100.0			

5/ Bank financing of administration costs would include: salaries, equipment, field visits, seminars and travel.

6/ This may include contributions by beneficiaries

### III. EXECUTION

#### A. Borrower

- 3.1 The borrower would be the Republic of Nicaragua. In addition to being responsible for ensuring compliance with the conditions agreed to in the loan contract, it will also be responsible for (i) formalizing the co-financing agreement with OPEC; (ii) providing the local counterpart resources; (iii) agreeing to transfer the loan and local counterpart resources to the FISE; and, (iv) repayment of the loans. The agreement between the Borrower and the FISE will be a prior condition to the first disbursement of the IDB and OPEC loans.

#### B. Executing Agency

- 3.2 The executing agency for the project would be the FISE. It has a total staff of 166 of which 119 are professionals and the rest are support staff. It operates out of a single office in the capital city, Managua, and makes systematic visits to the beneficiary communities to promote projects, assist in their formulation and participate in their supervision. Its total annual operating cost is about US\$4 million half of which is covered with Government resources and the rest comes from the various external financing agencies.
- 3.3 In order to guarantee the high technical capacity of its staff and ensure its institutional stability and objectivity, the Bank will finance the salaries of a select group of FISE's professional staff. The precise list of individuals comprising the group will be agreed with the Bank prior to the first disbursement subsequent changes in any of these staff members will require prior Bank approval.
- 3.4 The FISE has successfully executed two prior loan operations with the Bank and its internal procedures and methodologies are considered to be adequate for the project. It has internal and independent control mechanisms that ensure compliance with the operating regulations. Its staff is highly qualified and their relative longevity on the job will enable the proposed operation to benefit from experience and training provided under the previous phases.
- 3.5 This competence not only refers to the actual analysis, contracting and co-supervision of small infrastructure projects, but also to all the steps from the planning phase to subsequent maintenance. The FISE has evolved far beyond its initial emergency focus on reduction of the deficit in physical infrastructure through make-work projects. Its superior staffing and institutional agility gave it unique competence that led to an increasingly wider set of duties ranging from assisting in setting sector policies to developing new management procedures and supporting greater



community participation. In effect, by continuously filling vacuums left by weaker institutions, it has become the de facto think tank and technical assistance arm of the sector.

- 3.6 This is an important juncture for the FISE in that this supporting role has been explicitly recognized and it is now being called on to provide specialized services in the context of the decentralization effort. Based on the intimate working relationships developed with local governments and civil society representatives over the last six years, the FISE is in a singular position to develop the functional links between the two and increase the management capacity of local governments. Once the systems have been perfected, the supporting institutional modifications have been made and the target batch of municipal governments has been trained, the FISE's involvement will come to an end. It should be noted, however, that the FISE will retain the responsibility for financial transfers and control which implies a more long term involvement.
- 3.7 It is probable that this sort of limited targeted assistance could become an increasingly important part of FISE's repertoire. It hints at interesting possibilities for packaging the services offered by the FISE in a form that permits calculating their cost. This would be a very useful step should the Government decide to introduce an element of competition, whereby the FISE's capacity to provide a specific service would be compared with proposals from other public or private entities.

#### **1. The Coordinating Entity for Policy Targets**

- 3.8 The entity responsible for coordinating compliance with the policy measures included in this project will convene the different actors affected by the conditionality to orient them in the activities that will have to be carried out to define the specific policy measures. It will also be required to support the consultancies to be executed in this regard and will have to formulate proposals for the Government's position on the outcomes of the consultancies and action plans. The FISE will contract the four consultancies and effect payments as recommended by the Policy Coordinating Entity. Once the action plans have been approved, the entity will coordinate the initiatives called for therein and will prepare documentary evidence of compliance according to the schedule agreed with the Bank. In carrying out these functions, the entity will have to constantly relate the measures to the emerging social policy. Furthermore, unless they are one and the same, the coordinating entity for the policy component will also have to remain in close coordination with the entity in charge of developing the overall social policy and developing the technical capacity to implement it.

## 2. Agreements with Clients

- 3.9 The FISE works with the line ministries through formal agreements that establish the parameters of the collaboration between each of them and the FISE that are necessary to process requests for projects and execute them. The validity of the current set of agreements with MED, MINSA, INAA, INATEC, FONIF and MARENA will expire at the end of this year. It will therefore be necessary to renew these agreements to cover the period of the second extension of its mandate until the end of 2002. Given the importance of these agreements for executing the project, their renewal will be required as a prior condition to the first disbursement of the Bank financing.

## 3. Operating Regulations

- 3.10 Being a global operation, the use of project resources will be governed by operating regulations that are similar to those currently in-force for the second phase of FISE's operations. The most salient aspects of the regulations are: (i) procedures for targeting the poorest areas via the use of the Poverty Map; (ii) methodologies for evaluation; and (iii) procedures for contracting, supervision and financial management and control. The presentation of evidence that the operating regulations are in-force for the new operation will be a condition prior to the first disbursement.
- 3.11 The specifications for the schools and health projects have recently been updated by the line ministries. This will require increases of 20% to 50% in the parameters for dimensioning projects. The FISE also plans to request an increase in the maximum size of a single project from US\$400,000 to US\$1.0 million to accommodate water and sewage projects that have had to be split into phases to get around the lower ceiling. In addition, health centers in remote parts of the Atlantic Region have to be more self-sufficient and therefore can cost up to US\$800,000.
- 3.12 The IDB has not agreed on a methodologies for financing municipal and environmental projects so no project funds could be used for these purposes until explicit agreement is reached for their inclusion. The FISE has indicated that these projects are necessary to fill the gap left by other programs that are unable to offer poor communities the solutions they need. Care will have to be taken to ensure there is no overlap and that respective niches are operationally clear and simple. With regard to environmental projects, they are most often offshoots of water projects and with the increase in total project size may no longer be justified as separate initiatives. In addition, the FISE will collaborate with MARENA to ensure there is no overlap.
- 3.13 The FISE is constantly improving and updating its systems and procedures, and will continue to do so with the support of the new operation. In addition, the new project will introduce new activities (e.g. Micro-planning, delegation of parts of the project

cycle to municipal governments, management of the Maintenance Fund, environmental procedures, incorporation of gender issues, development of new methodologies for the Atlantic Region and community organization) that will imply modification of the FISE's manuals and probably also of the operating regulations. The loan contract will stipulate that any modification of the operating regulations will have to first be agreed with the Bank as will any significant change in the operating manuals.

- 3.14 There will be several consultancies that have a diversity of purposes ranging from training municipal governments and organizing communities to introducing new activities and procedures into the FISE's operations. Indicative budgets have been developed for each of them, however, it will probably be necessary to effect significant adjustments in the allocation of resources between them. Accordingly, it has been agreed that the FISE may make the necessary adjustments within the four large categories to which each study pertains and present the change at the same time they present the terms of reference for the Bank's non-objection. Transfers between the four large categories will also require prior Bank approval.

#### 4. Procurement

- 3.15 The procurement of goods, contracting services and professional services will be conducted in accordance with the Bank's standard procedures. International public bidding will be used for procurements whose value exceeds: US\$200,000 for professional services; US\$250,000 for goods; and US\$1.0 million for works. The experience of the prior phases has shown that these limits are consistent with the dimensions required to attract international competition for each type of acquisition. The procedures for lower amounts are compatible with Bank procedures and will be conducted in accordance with local law which requires the FISE to use public competitive bidding for amounts above US\$ 150,000 and permits private competition for amounts above US\$50,000.
- 3.16 There has been a steady reduction of the percentage of contracts let via direct contracting such that it fell below 12% during the current phase of FISE operations. This seems to be an equilibrium level for direct contracting, therefore, the loan contract for the new operation will limit it to that level. Based on the Bank's experience with the FISE over the last few years, it is recommended that the ex-post review of procurement be applied for this project.

#### 5. Disbursement

- 3.17 The loan resources will be requested by the FISE and disbursed directly to the special project account. It is important that the Government continue the current procedure whereby the special account in which the resources of the financing are deposited is held in a commercial bank. This ensures that the flow of funds to

the project is expedited. The advance of funds modality will be used and in light of the impeccable experience in terms of timely and accurate financial management, it is recommended that the FISE be authorized to request advances whose total value at any one point can be as high as 10% of the total value of the Bank financing.

## 6. The Execution Schedule

- 3.18 A detailed gant chart, supported by explanatory tables and action plans, has been prepared for all the activities contemplated in the project and is included in the Technical Annexes. It will be updated as the various consultancies are completed and they produce more precise implementation schedules for the individual activities. The execution schedule resulting from this exercise indicates that the commitment period should be 39 months and the disbursement period should be 48 months. The approximate schedule of commitment and disbursement of funds is as follows:

(Percentages)

	1998	1999	2000	2001
<b>Commitments</b>	35	40	20	5
<b>Disbursements</b>	3	33	33	31

## 7. Supervision

- 3.19 The logical framework included as Annex II to the Loan Proposal will be updated jointly by the Country Office team, the FISE and the Coordinating Entity for the Policy Component before the loans become eligible for the first disbursement. This exercise will provide clear guidelines for project start-up and is especially important in view of the goals to widen FISE's menu, introduce new operating procedures and link policy measures to its investment program.
- 3.20 The performance and impact indicators for the current phase will also be applied to the new project which will include funds to continue the collection of data. The previous Bank operation included consultancies to assist the FISE to develop impact indicators for beneficiaries but they have not yet been implemented and an extension until May of 1998 has been requested. Although they will be in place prior to commencement of the new project, it will still be necessary to continuously improve the indicators. Already, it is clear that they will have to include information that permits the identification of projects that are repeats from earlier years that are so decayed they had been presented again for another reconstruction. In addition, it is necessary to include information to monitor the gradual connection of individual homes to water and sewage systems since current indicators end when the mains have been completed. It is recommended that the loan

contract establish the requirement that the impact indicators be updated to reflect these and other adjustments to be agreed on with the Bank within the first year from the date of signature of the loan contracts.

- 3.21 The policy measures constitute a new aspect of the Bank's operations with the FISE and as such will require special consulting services to monitor progress and develop opinions on the advances reported. Given the special nature of these aspects and their importance for release of the second half of the loan resources, it is recommended that a special administration mission review the status of compliance at that point. Following the declaration of eligibility to start committing the second half of the Bank financing ongoing compliance with policy measures will be required to permit commitments to reach 100%. As such, the content of the quarterly progress reports would be essentially the same as those currently prepared by the FISE with the exception that they will have to include a new section presenting the status of each of the policy measures agreed with the Bank. The financial statements would be presented in accordance with standard Bank policy.

#### 8. Reporting

- 3.22 Complementary initiatives to assess the impact of FISE's operations, sponsored by the IDB and the World Bank will produce useful indicators of the impact of investments on beneficiaries and changes in the quality of services provided. The pilots relating to community participation, transfer of parts of the project cycle and the maintenance regime all will be developed via consultancies that will produce individual reports on the outcome of each activity. The policy component will likewise be covered not only by periodic progress reports, but also by the final report which will summarize all project activities and the attainment of targets. For these reasons a separate ex-post report is not recommended.

#### IV. VIABILITY AND RISKS

##### A. Viability

###### 1. Economic Viability

- 4.1 The infrastructure deficit mostly affects the poorest and most vulnerable segments of society such that its reduction would directly increase their living standards and enhance the effectiveness of other complementary social investments. Infrastructure investments not only improve the conditions under which the services are provided, but also the access to services (when subprojects expand or build new facilities). The project will not only provide a significant reduction of the deficit but will also improve the quality and sustainability of infrastructure.
- 4.2 For each project it finances, the FISE first confirms it is the least-cost alternative, determines the demand, dimensions, arrangements for operation and maintenance and its compliance with sector specifications. The FISE uses a regularly updated cost system to evaluate projects and set maximum financing levels. Criteria have been developed for each project category that, among other things, determine the maximum benefit per person, provide rules of thumb for minimum levels of demand, establish maximum project cost (by type of project and region). <sup>2/</sup>

###### 2. Technical Viability

- 4.3 The FISE is the most efficient entity in Nicaragua for the construction of basic social infrastructure. It works with the permanent public institutions to upgrade planning methodologies, selection criteria and maintenance arrangements. Its internal procedures have proved to be effective in targeting the desired groups, ensuring the technical viability and quality of investments and guaranteeing transparency.

###### 3. Institutional Viability

- 4.4 The policy measures to be expedited by the project will include the improvement of the inter-agency agreements between the FISE and the permanent institutions to ensure better coordination and more involvement in setting FISE targets and developing new procedures and methodologies. With regard to the policy component, the project could offer important externalities in as far as it constitutes a driving force for the definition of the overall social policy and the creation of the technical capacity to implement it.

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<sup>2/</sup> The indicative targets, presented in the logical framework, for the number of people that are expected to benefit from the project were derived from a rough projection of how many projects may be financed in each area and the maximums established in the Operating Regulations for benefits per beneficiary and the number of beneficiaries for each type of project.

- 4.5 The recent replacement of managerial and technical staff throughout the public sector has significantly reduced the institutional memory and operational capacity of the public institutions. The FISE stands as a stark exception. In addition, the ongoing economic adjustment program implies that most, if not all, public entities will have to cope with lower budgets and higher demands for their services. From this it is clear that the execution of the FISE project will take place in the context of weak and struggling counterparts.
- 4.6 In light of this, it may very well be argued that this is not an appropriate time to challenge FISE's newly debilitated partners with policy measures requiring internal improvements and greater efforts at coordination. However, Nicaragua and the Bank have adopted the explicit strategy of not succumbing to excuses for further delaying the efficiency measures needed to cut waste and improve the quality of services provided to the populace. Nicaragua does not have the luxury to postpone confronting glaring cases of duplicated effort, unproductive institutional rivalries and simple inefficiency.
- 4.7 Although the weakness of the FISE's partners will probably limit and hamper the policy improvements, this does not justify doing nothing in the hope they will be a bit more resilient a few years from now. It does, however, imply the need for setting modest and flexible policy goals and creating an incentive for the Government to attain them. The project represents about 40% of FISE's total program over the next few years and therefore could provide sufficient leverage to this end. Furthermore, it is not an isolated effort, but is fully consistent with the overall public sector reform program (RAP). Finally, upcoming projects in the social sector will provide the pincer movement by promoting efficiency measures and operational improvements in the FISE's partner institutions.

#### 4. Financial viability

- 4.8 The experience with earlier phases indicates there is little likelihood that the Government will not be able to provide the local counterpart resources in a timely fashion. No change in existing arrangements is anticipated. On the other hand, the overall reduction in public budgetary resources due to Nicaragua's agreement with the IMF is expected to bring pressure to bear on the Government's ability to maintain its expenditures in the social sector. It is hoped that the high priority placed on these expenditures will protect the sector from budget cuts, but there is little scope for increasing budgets. This could affect the ability of line ministries to expand coverage or even attain minimum quality standards in existing infrastructure.

## 5. Environmental and social viability

- 4.9 The Social and Environmental Committee approved the relevant sections of the Project Report at its meeting held on October 31, 1997. The actions to be followed in this regard are described in the following paragraphs:
- 4.10 Environmental issues: The FISE has already taken a number of important initiatives to consider environmental issues as an integral part of its decision making process. It has created and staffed an environmental unit and developed procedures to incorporate environmental selection criteria. Under the new loan, it will conduct training and sensitization programs and develop new environmental menu items that will be eligible for FISE financing. In addition, the community organization and training programs will include environmental sensitization components. The technical annexes include a document prepared by the FISE (with the assistance of the Country Office and the regional environmental specialist) that presents the advances achieved and the actions to be taken.
- 4.11 In developing projects and process tailored to the special needs of the indigenous groups (and others), the FISE faces a dilemma. On the one hand it seeks to work within national policies for decentralization, community development and municipal strengthening, and has a single set of internal operating procedures and methodologies. On the other it has encountered a situation that requires special arrangements in almost all these areas. For those matters that fall within its purview (internal procedures and methodologies) it is able to develop special new approaches and it has a plan to do so. However, the other considerations escape the authority of the FISE as they pertain to the MAS and INIFOM. The technical annexes include a document prepared by the World Bank which describes the planned initiatives for the Atlantic Region.
- 4.12 Under the last phase the FISE attempted to develop the special internal arrangements required by these groups. They succeeded in boosting the volume of resources but not the development of new arrangements. To a large extent this was due to the fact that the communities requested projects (such as credit) that are essentially inconsistent with the FISE's purpose. It was also due to lack of orientation by the Bank with regard to an activity that was entirely new to the FISE. The experience led the FISE to discover that it requires the services of local agents (including NGO's) as go-betweens with the target communities. To resolve the impasse, the FISE has developed those new projects that are consistent with its overall goals and will introduce them and others on a pilot basis during the execution of the new project. In addition, FISE is developing new ways to work with and through NGO's that have been the subject of two open meetings held this



year. Success in this endeavor would not only benefit the Atlantic Coast, but all areas served by the FISE.

- 4.13 Gender Issues. The FISE has agreed to undertake a consultancy in order to: (i) assess the degree of participation by women in FISE projects (both as beneficiaries and as participants in the project cycle; (ii) design internal and external training and sensitization programs and courses to promote the participation of women throughout the project cycle; and (iii) recommend pilot projects aimed specifically at women as beneficiaries that could be incorporated into FISE's menu.
- 4.14 Planning and Equity. The FISE is developing a microplanning initiative to make the process of allocating resources within municipalities more transparent by providing a modality for community participation in the planning process. The micro-planning pilot includes the following parameters: (i) maximize community participation without discrimination (to this end special procedures will be developed for minority groups); (ii) take account of environmental considerations; (iii) design the procedures that will enable the FISE to incorporate it as a part of its regular operating procedure; and (iv) develop performance and impact indicators.
- 4.15 There are four noteworthy aspects that still require more work during the design phase. Firstly, deficiencies in local development (organization, managerial capacity and representative structures of the beneficiary communities) will impede the ability of communities to participate effectively. FISE's efforts to correct this will be useful but not of sufficient magnitude to resolve the problem. The microplanning model will require closing the door to direct requests from the community groups or NGOs. Consequently, implementation of the model without the existence of representative structures could contribute to inequitable access. The final design of the initiative will have to include incentives for municipal authorities to promote equitable access.
- 4.16 Secondly, the micro-planning model is limited to FISE projects. By not extending it to the other programs available to the municipalities and communities there will be incentives to circumvent the new process. In this regard, the line ministries will also have to explicitly agree to delegate responsibility for investment decisions to the local level. Even if it is not carried all the way to the point of letting municipal governments channel all FISE demand, the micro-planning model can still be useful as a training tool to impart participatory planning techniques to the mayors.
- 4.17 Thirdly, since a central objective of the micro-planning model is to focus investments on the poorest areas within the municipalities, the municipal authorities must be able to identify them using objective criteria. Most, if not all, the municipalities do not have the basis for doing so. Accordingly,

the FISE will have to develop an operationally simple alternative to just relying on the personal knowledge and good will of the municipal technical staff to identify the poorest areas.

- 4.18 Fourthly, the mechanism for monitoring the decision-making process whereby some projects are given priority over others by municipal authorities still needs to be refined to ensure decisions are based on objective criteria.
- 4.19 These aspects and others, will have to be taken into account in finalizing the model which must be accepted by the Bank before it can be implemented. It is noteworthy that the pilot phase of the micro-planning model is expected to extend over a significant part of the execution period and even then will only cover a fraction of the municipalities comprising Nicaragua. This implies that the vast majority of project resources will be channelled according to the traditional FISE modality for promoting projects.

## **B. Issues and Risks**

### **1. Coordination of Policy Measures**

- 4.20 Implementation of the policy measures requires actions by agencies over which no single entity currently has the institutional authority or technical capacity to ensure compliance. This implies a risk that FISE projects may be interrupted if the coordinating entity is unable to get other institutions to collaborate. The time needed to provide that entity with the requisite authority and capacity may also delay the component.

### **2. General Application of the Policy Matrix**

- 4.21 The IDB is the first of the major international agencies to commit funds to the FISE in support of its 1998-2002 operating program. Although the World Bank and KfW participated in the development of the policy matrix, there is no formal institutional agreement by either of them to adopt similar conditionality in their upcoming operations with the FISE. Given that 45% of the total program will be covered by these agencies a decision by them to not adopt the matrix would send mixed signals to the Government and could undermine the incentive for achieving the policy targets.

### **3. INIFOM**

- 4.22 The viability of shifting new responsibilities and authority to the municipal governments to channel community demand, manage the project cycle and coordinate maintenance is intimately dependent upon the corresponding transfer of additional resources to them. However, the new Municipal law (still in process of ratification) does not include such transfers. In addition, each new responsibility will have to be made consistent with the decentralization model yet to be chosen by Nicaragua. Permanent

monitoring, support and financial management arrangements will also have to be put in place. The FISE's temporary nature makes it ineligible to assume these functions and the permanent institution with responsibility, INIFOM, is unable to perform them without significant strengthening. There are, however, no specific plans to provide this strengthening. The sustainability of the initiative is therefore clearly at risk. The insistence on presentation of a plan to strengthen INIFOM mitigates but does not eliminate this risk.

#### 4. Local Development

- 4.23 The level of organization and training of communities is inadequate to permit them to participate fairly and effectively in developing projects at the local level. The public institution responsible for local development, MAS, has not developed a comprehensive policy, and the municipal governments which are responsible for implementing community development are wary of it. There is a multiplicity of external programs that operate without coordination and whose coverage is limited. This situation will dilute the impact of FISE's efforts to promote community participation. To partially compensate for this the FISE will develop training programs as a specific menu item aimed at increasing community organization and their capacity to participate effectively in local development initiatives. In addition, the plan for all requests for FISE projects to only be channeled through the municipal governments will not be realized until appropriate checks and balances are in place.

#### 5. Quality

- 4.24 By limiting itself to rehabilitating and expanding existing schools and health facilities the FISE maximizes the probability that its investments will be utilized. Although this strategy enhances efficiency, it creates equity concerns by not expanding coverage to those without access to basic social services. The inability of the line ministries to provide greater coverage while maintaining minimum quality levels is at the heart of the problem. Until measures are taken to expand their capacity, the FISE's strategy seems pragmatic and fully justified.

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MATRIX

Current Situation	FIRST PHASE	SECOND PHASE	THIRD PHASE	FOURTH PHASE
	Conditions for Board Presentation	Contractual conditions (Once all of the conditions prior to the first disbursement have been met, commitments and disbursements will be able to reach 50% of the total value of the financing)	Compliance permits commitments to reach 100%	Compliance permits continued commitments
Extensions of FISE Mandate: Scope of infrastructure deficit and involvement in decentralization require FISE's services over the term but FISE is limited to specific extensions of its mandate and criteria for extensions are unclear	a) Agree to clarify criteria that govern future extensions of FISE's mandate; and b) Agree to consult with the Bank on adjustments to FISE mandate that may arise from public sector modernization program	Within 12 months of contract ratification, agree on TORs for a consultancy to develop criteria.	Complete consultancy and present criteria to satisfaction of the Bank.	Demonstrate that criteria are being maintained.
Inter-agency Coordination: Weak coordination between FISE and other institutions results in conflicting priorities, duplicated efforts and inefficient expenditures	a) Describe parallel initiatives to strengthen planning and coordination functions for social sector; and b) Agree to review existing agreements with other entities to improve coordination until sector policy is operationalized	Within 12 months of contract ratification present plan to improve coordination mechanisms in FISE agreements with other entities.	Implement first stage of plan.	Implement second stage of plan.
Geographic Targeting: The methodology used with the Bank to target FISE operations is the Poverty Map (defined as the poverty gap based on the new MECOVI) and any change in the map requires prior agreement. Other maps are used or being prepared based on identified basic needs and the stated objective of MAS is to establish a target map.	a) Agree to continue targeting FISE operations with the Bank via Poverty Map; b) Agree to consult with the Bank prior to effecting changes in map.	Prior to the first disbursement, demonstrate that the agreement is being maintained.	Demonstrate that the agreement is being maintained.	Demonstrate that the agreement is being maintained.

Current Situation	FIRST PHASE	SECOND PHASE	THIRD PHASE	FOURTH PHASE
	Conditions for Board Presentation	Contractual conditions (Once all of the conditions prior to the first disbursement have been met, commitments and disbursements will be able to reach 50% of the total value of the financing)	Compliance permits commitments to reach 100%	Compliance permits continued commitments
Complementary Activities: Public infrastructure constraints limit ministries' capacity to deliver the services in infrastructure projects affected by FISE thereby affecting quality of projects.	Agree to link FISE annual sectoral allocation to commitment by corresponding line ministry to assign priority in budgets to maintain minimum quality standards in already built infrastructure as well as in infrastructure to be built by FISE.	Based on guidelines agreed between FISE and the World Bank, prior to the first disbursement present the terms of reference for the 1998 impact evaluation (FISE/LSMS98) regarding the quality of the services delivered and the sustainability of the investments	Based on the FISE/LSMS98 results agree with the Bank on the specific measures need to be implemented to improve the quality of the services delivered and the sustainability of FISE investments.	Implement the measures agreed with the Bank
Challenge: Limited financial capacity of ministries obliges Bank negotiations with FISE to be limited to maintaining existing public health and education networks. Equity issues may generate pressure for FISE and networks.	a) Confirm policy to limit expansion of health and education networks to budgetary availability of line ministries; b) Agree to limit new Bank financed FISE operation to rehabilitation and expansion of existing health and education networks.	Prior to first disbursement, demonstrate maintenance of policy decisions.	Demonstrate maintenance of policy decisions.	Demonstrate maintenance of policy decisions.
Challenge: Other programs also for basic social infrastructure to be rationalized.	a) Identify preliminary list of areas of duplication; and b) Agree on TOR of a consultancy to develop an action plan to rationalize initiatives for basic social investment.	Prior to first disbursement, contract consultancy to prepare action plan to rationalize public investment in basic social infrastructure.	Implement rationalization plan	

Current Situation	FIRST PHASE	SECOND PHASE	THIRD PHASE	FOURTH PHASE
	Conditions for Board Presentation	Contractual conditions (Once all of the conditions prior to the first disbursement have been met, commitments and disbursements will be able to reach 50% of the total value of the financing)	Compliance permits commitments to reach 100%	Compliance permits continued commitments
Maintenance: Fund allocations by the entities responsible for maintenance of built infrastructure are not sufficient to ensure adequate maintenance. The current initiative (Maintenance Fund) helps to correct the problem through ad hoc municipal and community contributions. Further efforts from responsible entities are still required.	a) Agree to keep line item in education and health ministries' budgets for maintenance and describe future plans for transfers to the local level in the context of the ministries' decentralization strategies; and b) Agree to apply new maintenance strategy at national level. c) Agree to associate future FISE investments to the fulfilment of MED and MINSA commitments.	Before first disbursement: a) Contract consultancy to determine institutional adjustments needed to adopt new maintenance initiatives. b) Present a four year schedule agreed between MED, MINSA, MIFIN and FISE to increase ministries' budgetary allocation for maintenance of FISE-financed health and education infrastructure.	a) Implement institutional changes. b) Demonstrate compliance with schedule; otherwise present evidence that new infrastructure investments in the involved sector have been suspended.	a) Implement and maintain institutional changes. b) Demonstrate compliance with schedule.
Centralization: The permanent entity, INIFOM, is weak, so FISE has been asked to spearhead a long term strategy of municipal strengthening. FISE is a temporary outfit INIFOM and other permanent institutions should be able to assume the associated formulation, supervision and management functions	a) Outline plan to strengthen INIFOM (money, systems and people), and; b) Identify other permanent entities, to eventually assume duties currently assigned to FISE or confirm that they will be retained by FISE.	a) Before the first year of contract ratification, contract consultancy to prepare plan.	Implement first stage of plan.	Implement second stage of plan.
Coordinating Entity. Lack of coordination with institutional or technical entities to coordinate the policy components included in this project.	a) Present the draft of the internal organization of the Presidency decree which identifies the entity responsible for the social policy. b) Confirm the institutional arrangement to measure the political impact of the project.	Within twelve months of contract ratification, demonstrate that the entity responsible for the coordination of the policy component has been created and is operational.	Demonstrate that the entity is operating in accordance with the terms agreed with the Bank.	Demonstrate that the entity is operating in accordance with the terms agreed with the Bank.

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LOGICAL FRAMEWORK

Narrative Summary	Indicators	Means of Verification	Assumptions
Overall Goal  Poverty alleviation with an emphasis on the poorest groups			
Purpose 1. Sustained improvement in living conditions of the poorest groups.	1.1. Number of students that complete education according to standards set by MED increased by the end of the project. Primary students from 14,500 to 18,000. Secondary students from 6,000 to 8,000. Technical/vocational students from 2,000 to 2,500	1.1. FISE impact indicators, LSMS studies and line Ministry statistics	1. Social Policy coordinates activities in support of the overall goal. 2. Rate of economic growth permits maintaining per capita expenditure. 3. Foreign remittances continue at least at current levels. 4. Political and economic stability maintained. 5. Public expenditure in social sector maintained.
	1.2. Increase in the number of users that receive health attention according to MINSA standards.		
	Health posts from 425,000 to 592,000.		
	Health Centers from 326,000 to 450,000		
	Latrines from 13,500 to 30,000		
	1.3. Increase in the number of people in rural areas with access to safe water services according to standards by INAA. In lightly populated rural areas from 8,000 to 10,000. In more densely populated rural areas from 20,000 to 30,000.		

	Between 20,000 and 30,000 people using waste disposal systems in their homes according to standards by INAA.		
	40,000 people with access to improved pluvial drainage at the end of the project.		
	1.4. 40,000 people use the services of new markets built by the project.		
	1.5. 20,000 people with paved streets by the end of the project.		
	1.6. 1,500 aged people are served by improved shelters by the end of the project.		
	1.7. 50,000 children receive services in improved centers by the end of the project.		
	1.8. 20,000 people use environmentally safe garbage disposal systems by the end of the project.		
	1.9. Useful life of social infrastructure increases from 5.5 years (without maintenance) to 15 after project implementation.		
	1.10. 145 local governments and communities provide at least 17% of maintenance costs.		



2. Policy context of FISE operations improved.	2.11. Policy measures: a) Criteria for FISE renewal defined. b) Improved coordination between FISE and its counterparts. c) FISE continues using effective poverty map. d) Quality of services delivered via FISE-financed infrastructure increases. e) FISE continues to link expansion of networks to budget availability. f) Duplication of effort reduced. g) New national maintenance regime in place. h) INIFOM strengthened. i) Coordinating entity for policy measures operational	Special sections of progress reports by policy coordinating entity.	
Outputs			
1. Social infrastructure network improved	1.1. 130 primary schools, 26 secondary schools and 10 vocational schools rebuilt/repared by the end of the project.		<p>1. Line Ministries establish and execute expenditure programs oriented towards improving services for the poorest sectors of the population.</p> <p>2. Other external agencies provide co-financing of FISE's new program for a total of US\$140.0 million.</p> <p>3. Civil Service Law to reduce turnover of public employees is approved.</p> <p>4. The real value of municipal budgets is maintained.</p> <p>5. Municipal authorities participate actively in pilot initiatives.</p> <p>6. Decentralization policy formulated.</p> <p>7. Local development policy defined.</p>

	1.2. 56 health posts rehabilitated and 5,000 latrines built or rehabilitated by the end of the project.	1.1. FISE's reports on project progress and supervision.	
	1.3. 27 potable water projects in densely populated rural areas and 13 in lightly populated rural areas by end of project.		
	1.4. 18 sewage projects connections completed.		
	1.5. 10 drainage systems built.		
	1.6. 6 markets built.		
	1.7. 30 blocks of paved streets.		
	1.8. 10 Old people's homes rehabilitated and/or built.		
	1.9. 30 reforestation programs completed.		
	1.10. 17 systems of solid waste disposal.		
	1.11. 150 maintenance packages completed.		
2. Trained local government officials coordinate local communities and non-governmental organizations in the planning, operation and maintenance of FISE projects.	2.1. 30 municipal governments trained in municipal planning.		
	2.2. 145 municipal governments trained in coordination of project maintenance.		
	2.3. The new mechanisms are implemented by 75% of the trained local governments at the end of the project.		

3. Trained INIFOM officials monitoring the process of planning, operation and maintenance of FISE projects.	3.1. 8 INIFOM officials trained in social infrastructure planning and maintenance at the end of the first year of project execution.		3. Civil Service Law is approved and properly implemented.
	3.2. 8 INIFOM officials trained in planning and management of the project cycle at the end of the third year of project execution.		
	3.3. INIFOM officials train 25% of municipal governments in planning and maintenance of social infrastructure at the end of the project.		
4. Communities manage maintenance and participate in microplanning.	4.1 Hundreds of communities participate actively in new modalities.		
5. Quantity and quality of FISE services improved.	5.1. FISE's dual system of project management (traditional and decentralized) in operation starting 1999.		
	5.2. There is a minimum of 10% reduction in working days FISE spend in the processing of applications.		
	5.3. Operating costs do not go above 10% of disbursements.		
6. Improved social policy and program coordination and implementation at national and local government levels.	6.1 Agreement reached on criteria to renew the FISE.	6.1. Special policy section of progress reports.	
	6.2. Plan to improve coordination completed.		
	6.3. Agreement on FISE targeting tool maintained.		
	6.4. Quality of services increased.		

	6.5. Policy to limit network expansion to budget availability maintained.		
	6.6. Action plan to reduce duplication completed.		
	6.7. New national maintenance regime instituted.		
	6.8. INIFOM strengthened.		
	6.9. Coordinating entity for social policy measures operating according to terms agreed with the Bank.		
Activities:			1. A significant number of staff are available for training. 2. Funds can effectively be committed to project execution. 3. Line ministers fulfill agreements with FISE. 4. INIFOM gets complimentary resources to fulfill its new role. 5. Demand for projects is maintained.
1. Process requests for social infrastructure rehabilitation.	1.1. Determine preinvestment requirements.	Disbursement requests and progress reports.	
	1.2. Select and contract supervisory services.		
	1.3. Monitoring of work execution.		
	1.4. Prioritize and define the time table for training activities in areas pertaining to municipal development, project cycle improvements and policy implementation.		
	1.5. Designing of decentralized system for Project management.		

	1.6. Replace, rehabilitate primary, secondary and vocational technical school buildings.		
	1.7. Replace, rehabilitate and provide basic furniture to health centers and posts.		
2. Improve Project Cycle			
	2.1. 8 consultants hired for municipal development training.		
	2.2. 23 consultants hired to improve policy implementation.		
	2.3. Design of workshops and seminars for line ministries officials, local government officials and local communities to improve their participation		
3. Effect policy measures	3.1 Four consultancies contracted to improve policy implementation.		
	3.2 Policy decisions formulated and maintained		
	3.3 Coordinating Entity created and operational		

**PROCUREMENT PLAN**

Main Procurement	Financing %			Procurement method	Pre- Qualifica tion	Expected SPN Publication Date
	IDB	OPEC	Local			Semester - Year
<b>A. Social Infrastructure Projects</b> <b>Total Cost: US\$ 49.04 million</b>  This is a demand-driven global component such that allocations by sector and numbers of projects cannot be determined ex-ante.						
(i) <u>Works</u> : estimated at 88.5% of total	80.6	6.0	13.4	DC up to US\$50,000 PCB from \$50,000 to \$150,000 LCB from \$150,000 to \$1,000,000 ICB above \$1,000,000	No	
(ii) <u>Consulting Services</u> (for preinvestment and supervision): Estimated at 10% of total	80.6	6.0	13.4	DC up to \$50,000 PCB from US\$50,000 to \$200,000 ICB above \$200,000	No	
(iii) <u>Goods</u> : Estimated at 1.5% of total	80.6	6.0	13.4	DC up to \$50,000 PCB from \$50,000 to \$150,000 LCB from \$150,000 to \$1,000,000 ICB above \$1,000,000	No	
<b>b. Consultancies</b> <b>Total Cost: \$1,8 million</b> <b>(I) Municipal Development (\$675,000)</b> 3 Consultancies for 30 municipalities (microplanning). 3 Consultancies for 30 municipalities (project administration). 1 Consultancy for 145 municipalities (preventive maintenance). 1 Consultancy for the development of pilot projects for community leaders	83.3	16.7	0	PCB up to \$200,000 ICB above \$200,000	No	

Main Procurement	Financing %			Procurement method	Pre-Qualification	Expected SPN Publication Date
	IDB	OPEC	Local			Semester - Year
<b>(II) Project Cycle (\$830,000)</b> 1 Consultancy for developing projects in the Atlantic Region. 1 Consultancy for gender incorporation in FISE processes. 1 Consultancy for incorporation of environmental considerations in FISE procedures. 1 Consultancy for impact monitoring implementation. 1 Consultancy for improving methodologies of potable water and sewerage. 1 Consultancy to develop methodologies for evaluation of shelters for the aged. 17 Consultancies to improve stages of project cycle (promotion, evaluation, follow up and control, information systems, auditing, finance and administration).	83.3	16.7	0	PCB up to \$200,000 ICB above \$200,000	No	
<b>(III) Outreach (\$195,000)</b> 1 Consultancy for organizing communities 1 Consultancy to improve attention to the Atlantic Region 1 Consultancy to incorporate more social projects in the menu	83.3	16.7	0	PCB up to \$200,000 ICB above \$200,000	No	
<b>(III) Policy implementation (\$100,000)</b> 1 Consultancy to propose criteria to govern future extensions of the FISE 1 Consultancy to improve rationalization across public entities. 1 Consultancy to institutionalize national maintenance regime	83.3	16.7	0	PCB up to \$200,000 ICB above \$200,000	No	

**Legend:**

DC: Direct Contracting <sup>1/</sup>  
 PCB: Private Competitive Bidding ("Concurso de Precios")  
 LCB: Local Competitive Bidding  
 ICB: International Competitive Bidding <sup>2/</sup>

<sup>1/</sup> Direct contracting will only be allowed in rural areas that are difficult to access. Only 12% of the total amount of the financing may be procured using this modality.

<sup>2/</sup> Under the current Operating Regulations, the maximum project size is US\$400,000 so no individual contracts will exceed this amount. There is, however, the intention to increase the maximum project size to US\$1.0 million which will automatically increase the potential size of contracts.

Original signed  
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PROPOSED RESOLUTION

NICARAGUA. LOAN \_\_\_\_/SF-NI TO THE REPUBLICA DE NICARAGUA  
(Social Infrastructure Investment Program, Stage IV)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the República de Nicaragua, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a Social Infrastructure Investment Program, Stage IV. Such financing will be for the amount of up to US\$50,000,000 or its equivalent in other currencies, except that of Nicaragua, which are part of the resources of the Bank's Fund for Special Operations, and will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.