

PROGRAM FOR INSTITUTIONAL STRENGTHENING OF THE TAX AND CUSTOMS ADMINISTRATIONS

(NI-0105)

EXECUTIVE SUMMARY

Borrower and guarantor:	Republic of Nicaragua	
Executing agency:	Ministry of Finance [Ministerio de Hacienda y Crédito Público] (MHCP)	
Amount and source:	IDB: (FSO)	US\$10.0 million
	Local counterpart funding:	US\$ 2.5 million
	Total:	US\$12.5 million
Financial terms and conditions:	Amortization period:	40 Years
	Disbursement period:	3.5 years
	Interest rate (first 10 years):	1 %
	Interest rate (thereafter):	2 %
	Inspection and supervision:	1 %
	Credit fee:	0.50 %
Objectives:	<p>The general objective of the program is to support the establishment of a Tax Revenue Administration (AIT) and a Customs Service Administration (ASA) and the strengthening of these entities which will be accorded the authority to decentralize their administrative, financial, and technical functions and human resources management. Specifically, the program seeks: (a) to raise the professional and technical level of AIT and ASA staff; (b) to support the process of modernization of administration, finance, technology, and human resources management in both entities; (c) to make the collection of tax revenues and customs duties more efficient; and (d) to modernize the audit and inspection methods used by both agencies. The various program components are described below.</p>	
Description:	<p>Organizational development and human resources management (US\$2.23 million). This component seeks: (a) to support the introduction of regulations governing tax and customs administration; (b) to strengthen institutional capacity for planning, management, and supervision in both institutions; (c) to restructure the decision-making process in both institutions; and (d) to</p>	

restructure human resources management and training, with a focus on developing management skills.

Support for audit and inspection (US\$2.07 million). To strengthen this aspect of tax and customs administration (a) support will be provided at the central level for activities with indivisibilities (planning, coordination of audits, and performance evaluation, etc.) and activities with significant externalities (high-impact cases, methodology development, and information retrieval, etc.); and (b) at a decentralized level, support will be afforded for operational activities.

Information technology (US\$2,859,000). The program will respond to AIT and ASA requirements for: (a) management skills and information systems development; (b) autonomy in the area of administration, finance, and human resources; (c) additional demands resulting from the new focus on audit functions; (d) expansion of communications networks; and (e) replacement of obsolete equipment. In addition, the ASA agreed to continue using the present SIDUNEA system, and support the development of applications to ensure its compatibility.

Infrastructure (US\$2.5 million). To remodel the DGA's existing customs facilities in order to expedite the flow and movement of customs traffic and in specific areas to support the development of information technology.

Benefits:

The program will support the creation of the AIT and the ASA and the strengthening of these entities, which administer tax revenues in an amount equivalent to 26% of GDP. The institutional development is expected to help balance fiscal accounts, raise social spending to acceptable levels, maintain economic stability, and generate higher domestic savings.

The program will help reduce evasion of taxes and customs duties, by bringing individuals who presently pay no taxes into the system, thus increasing tax revenues without raising taxes or customs duties and making for horizontal equity in the tax and tariff systems.

Also, taxpayers will benefit from the modernization of tax administration services through more efficient procedures while exporters, importers, transporters, shipping companies, and customs agents will benefit from more expeditious customs procedures.

Lastly, the program will consolidate and deepen previous operational reforms, particularly in human resources management, audit, information technology, management training, and support for institutional professionalism, all of which will result in more effective revenue collection and lower administrative costs.

Risks:

Operations such as the one proposed generally entail political risks during the phase of parliamentary debate and owing to the possible inability of leadership at the middle and senior management levels to carry through the reforms. Such risks have been minimized by the total support shown by the national authorities in pursuing the earlier operational reforms as well as those proposed in the present program. In this same vein, it is important to note that the support lent by the government for making reform in the area of audit and inspection feasible, i.e. meeting the fiscal targets of the IMF extended structural adjustment facility, the implementation of the Tax Fairness Act, and modernization of the customs system.

To minimize any problems associated with leadership at the various levels of management, consulting services will be used under the program for improving management skills and closely monitoring this component. Also, in the area of human resources management, mechanisms have been designed to heighten institutional awareness of the need for change and to counteract potential resistance to change by offering training for redundant staff, regular information on the reform process for officials, etc.

Relationship of project in the Bank's country and sector strategy:

The purpose of the Bank's strategy is to achieve sustainable development with equity based on the prerequisites of macroeconomic stability and consolidation of structural reform. The present program is consistent with this objective insofar as it supports the strengthening of agencies that take in public revenues, a factor that will generate domestic savings, lower fiscal inflationary pressures, and bring social spending up to acceptable levels.

Environmental review and social considerations:

The CESI recommended that: (a) ASA staff training should include subjects relating to the import of toxic materials, hazardous goods, endangered species, and exports of archaeological and historical artifacts (paragraph 2.5.d.v.), and (b) renovations at customs facilities take local environmental standards into account (paragraph 2.10).

Special contractual conditions:**Conditions precedent to the first disbursement:**

- (a) The Law establishing the Tax Administration and Customs Services Administration must be in force (paragraph 1.46).

- (b) The Steering Committee, the Executing Unit, and their two technical units must be set up and functioning, and the local and international coordinators for the program appointed (paragraph 3.1).
- (c) The National Regulations for the Central American Uniform Customs Code II (CAUCA II) must be in force (paragraph 2.5).
- (d) The agreements between the AIT and ASA governing program execution must be signed (paragraph 3.1).
- (e) The contract with the Inter-American Center of Tax Administrators for advisory assistance on technical execution and administrative management of the program must be signed (paragraph 3.7).

Special disbursement: Once the borrower has fulfilled the conditions precedent to the first disbursement specified in special condition (a) and conditions of article 4.01 (a), (b), and (e) of the general conditions, the Bank will authorize a special disbursement for the equivalent of up to US\$100,000 to initiate program activities, including actions to facilitate fulfillment of the conditions precedent.

Poverty-targeting and social sector classification:

This operation does not qualify as a social equity enhancing project as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704); nor does this operation qualify as a poverty-targeted investment.

Procurement:

International competitive bidding will be compulsory for the procurement of goods valued at more than US\$250,000 and construction works valued at more than US\$2 million. Contracts below these thresholds will be governed in principle by local legislation. In the case of consulting services with contracts valued at more than US\$200,000 (paragraph 3.4).

Exceptions to Bank policy:

It is suggested that the Inter-American Center of Tax Administrators (CIAT) be hired directly by the borrower. The CIAT will be responsible for procurement of goods and services and for hiring of consultants to ensure fulfillment of the relevant terms and conditions of this contract, in accordance with the Bank's procedures (paragraphs 3.6 and 3.7).

No other exceptions.

I. FRAME OF REFERENCE

A. Macroeconomic situation

1. The principal reforms

- 1.1 In response to the country's difficult situation in the early 1990s, the new government accorded priority to reestablishing peace and consolidating democracy and took the first steps toward stabilization of the economy and the elimination of macroeconomic disequilibria, thus laying the foundations for competitive markets by reducing government intervention in the production of goods and services and opening up the economy to the outside world.
- 1.2 International cooperation, with the Bank as a prominent participant, supported a package of reforms in the trade and financial sectors (loans 638/OC-NI, 864/SF-NI, 874/SF-NI, and 872/SF-NI). In the first of these reforms, the government monopolies were eliminated, controls on prices and trade were lifted, and some 350 nationalized enterprises were divested. In the financial sector support was given to the consolidation of four recently established private banks, the portfolios of the state-owned banks were cleaned up, and the first reforms were launched of the Central Bank and Financiera Nicaragüense de Inversiones. During that phase the agricultural sector program was approved (loans 724/OC-NI, 725/OC-NI, 726/OC-NI and 897/SF-NI), which made it possible to set up an institutional and sector policy framework, make a start on resolving property problems, take steps to reactivate production, and establish a framework for environmental protection.
- 1.3 The second phase of the reforms was supported by a program for reform of public utilities (loan 933/SF-NI), the purpose of which was to create conditions conducive to private-sector participation in the areas of electric power, hydrocarbons, telecommunications, and water and sewer service. This phase included the implementation of a rate policy to foster efficient use of these services and to establish legal and regulatory frameworks for separation of the regulatory, operational and sector programming functions.
- 1.4 Under the public sector reform program (loan 979/SF-NI) the stage was set for improving in an orderly way the central government's efficiency in administration, financial affairs, and taxation and for downsizing banks in the public sector, including the Law for the Organization, Jurisdiction and Procedures of the Executive Branch. This program also seeks to consolidate the tax reforms in progress by setting up a legal framework and providing support for continued reform of the DGI, and making human resources management more effective through a Technical Management System.
- 1.5 These reform programs were supplemented by investment and technical-cooperation projects to support national reconstruction. The areas targeted by these programs include infrastructure rehabilitation (roads, electric

power, etc.), privatization, reform of the Central Bank, modernization of tax, customs and financial administration, and poverty relief.

- 1.6 As part of the public sector reform program, Law No. 290 ("Organization, Jurisdiction and Procedures of the Executive Branch") was enacted. This law reduced the size and redefined the missions of the Central Government's agencies, eliminated duplication of responsibilities and functions, and centralized the coordination of economic and social policies and policy-making in the Technical Secretariat of the Office of the Presidency. It also eliminated duplication of efforts in the areas of natural resources, public investment, external debt management, and the management of international assistance. The Law further introduced the concept of the apex agency, thus eliminating several agencies directly under the Office of the Presidency, imposed order on government action, and strengthened institutional coordination.
- 1.7 In operations approved subsequently the reform of the financial sector was continued with the closing or privatization of government banks and the generation of conditions for the development of a healthy private banking system. Steps are also being taken to privatize large enterprises in the sectors of telecommunications, electric power and hydrocarbons. The Law on Tax Fairness, containing incentives for investment and setting up a framework for neutrality in taxation, was enacted in 1997. To consolidate the tax system the public sector reform program provided a tax code designed to reduce arbitrariness in taxation.
- 1.8 The government's pending reforms include a reform of the civil service to provide the human resources needed for modernization of the government, although the corresponding bill has not been prepared. The civil service bill provides criteria for recruitment, hiring, evaluation, promotion and termination, and for development of a policy on manpower training, for the purpose of freeing career service in the public sector from the influence of swings of political power.

2. The recent economic situation and its prospects

- 1.9 In 1998 GDP was up by 4%, although this growth was somewhat dampened by the effects of El Niño and Hurricane Mitch, which caused growth to slow particularly in the agricultural sector. According to projections of the International Monetary Fund (IMF), a sizable inflow of external aid could raise growth to about 6% in 1999.
- 1.10 The fiscal accounts showed an improvement over 1997. Income rose (29%) as a consequence of an expansion of the tax base and improvements in administration, while public expenditures grew more slowly (13%) thanks to lower external debt service, a moderate increase in capital formation and a reduction of transfers to public enterprises. Also, the government continued its prudent monetary and exchange policies to control the money supply, which were closely coordinated with the fiscal policy. As a result, the deficit shrank from 7% of GDP in 1997 to

2.1% in 1998. Including grants from abroad, which that year amounted to 3.4% of GDP, a surplus that came to 1.1% of GDP was produced. Nevertheless, the fiscal situation could deteriorate in 1999 because of the increase in reconstruction costs.

- 1.11 As of December 1998, the cumulative change in the consumer price index was 18% as a result of the drought caused the El Niño event and the devastation wreaked by Hurricane Mitch, in conjunction with higher public utility rates. For 1999, prices are projected to rise from 10% to 12% although an increase of this magnitude will call for austerity measures in the areas of spending and revenue.
- 1.12 The balance of trade declined from the preceding year owing to the drop in exports (13%) and increase in imports (3%) caused by the aforementioned meteorological phenomena. Projections for 1999 indicate that exports will drop 4% because of declines in the harvests of coffee, bananas, sugar cane and nontraditional products, whereas imports will be pushed up by increased demands for reconstruction. The government expects the wider deficit to be offset by increased assistance from abroad.
- 1.13 Despite the damage done by the meteorological events, the fiscal targets of the first year of the ESAF (1998) were met satisfactorily, as were most of the structural reforms provided in the economic program. The targets of the economic program for 1999 are under review with the IMF on the assumption that massive external aid will be available for pressing ahead and even stepping up the structural reforms of the ESAF. Since the country was ravaged by Hurricane Mitch, international aid has been generous, including bilateral debt service relief granted by the Paris Club and the creation of a fund to service the multilateral indebt. In connection with the country's eligibility for support from the facility for heavily indebted countries, joint missions with the World Bank and the IMF have been coordinated to conduct studies on debt sustainability.

B. The Nicaraguan tax system

- 1.14 In the early 1990s the Nicaraguan authorities introduced several reforms to reverse the country's economic decline. Two pillars of these initiatives were the reforms carried out in the fiscal area and the trade liberalization.
- 1.15 In the fiscal area, Nicaragua implemented a tax reform similar to those carried out in other countries of the region, the purpose of which was to simplify the existing structure, increase revenue and facilitate tax administration. The result was a tax system concentrated around three taxes: income, goods and services (GST),¹ and on specific consumer items.
- 1.16 The changes made in the income tax followed the guidelines of the 1986 U.S. tax reform in broadening the tax base and reducing the maximum rates from 50% to

¹ The goods and services tax is a levy on the consumer patterned on a value-added tax.

30% in stages. During that period, the nontaxable income was raised from an amount equivalent to 1.71 times to another 6.32 times per capita GDP. After an initial downturn, the revenue from this tax surged as the decade came to a close (see Table 2)

- 1.17 The GST was raised from 10% to 15% in 1994, and the tax base was broadened by increasing the number of taxable items. During the 1990s, these measures, and improvements in tax administration to be discussed in Chapter 2 have doubled the revenue from this tax as a percentage of GDP. It should be noted that the productivity of the GST has risen from 0.19 in 1995 to 0.29 in 1998, although tax evasion is still high, at approximately 40%.²

- 1.18 The greatest simplification of the tax system was carried out in the group of taxes on specific consumer goods. About 700 items were eliminated on which the rates had ranged between 5% and 150% and which affected receipts only slightly. The leading sources of revenue from these taxes are beverages (alcoholic and carbonated), tobacco and fuels. Meanwhile, a system for periodic adjustment of the prices of taxed articles was adopted to protect receipts from erosion by inflation.

Table 1. Maximum Income Tax Rates (as % of taxable income)			
Corporations			
Countries	1986	1992	1997
Costa Rica	50.0	30.0	30.0
El Salvador	30.0	25.0	25.0
Honduras	55.0	40.2	30.0
Nicaragua	45.0	35.5	30.0
Ave. for Latin America (exclud. Brazil & Chile)	43.3	36.4	29.2
Individuals			
Countries	1985/6	1992	1997
Costa Rica	50.0	25.0	25.0
El Salvador	60.0	50.0	30.0
Honduras	40.0	40.0	40.0
Nicaragua	50.0	50.0	30.0
Ave. for Latin America (exclud. Brazil & Chile)	38.8	38.2	34.1

Based on Shome (1999) IMF Working Papers 99/19

Table 2 – DGI revenues (as % of GDP)								
Tax	1991	1992	1993	1994	1995	1996	1997	1998
Income	2.8	3.3	2.4	2.1	2.8	3.1	3.5	4.1
GST/VAT	2.2	2.3	2.9	2.8	2.9	3.3	3.9	4.4
Specific consumption taxes items	6.4	7.4	6.9	7.5	7.4	7.5	7.2	7.1
Others	1.6	1.1	1.1	1.2	1.1	0.8	1.0	0.7
Totals	13.0	14.1	13.3	13.6	14.2	14.7	15.6	16.3

- 1.19 Analysis of receipts of the DGI in the 1990s brings out significant changes in the Nicaraguan tax system during that time. Firstly, a sizable increase in receipts over

² This productivity is defined as the tax burden of the GST as a percentage of GDP divided by the rate of the GST.

the period, more than three points higher in terms of percentages of GDP.³ At the same time, the general increase was accompanied by a significant change in its composition.

Table 3 – Composition of DGI Receipts (in percentages)									
Tax	1991	1992	1993	1994	1995	1996	1997	1998	% Change 98/91
Income	21.2	23.5	18.1	15.6	19.8	21.2	22.7	24.9	3.7
GST/VAT	16.6	16.2	21.8	20.9	20.2	22.4	24.8	27	10.4
Specific consumption taxes	48.5	52.7	52.9	56.4	53.7	50.8	47.1	44.3	-4.2
Others	13.7	7.6	7.2	7.1	6.2	5.6	5.5	3.8	-9.9
Total	100	100	100	100	100	100	100	100	-

- 1.20 As has happened in most of the tax systems in the region, in this decade the three principal Nicaraguan taxes have increased as a percentage of total tax receipts. Proceeds of the income tax, the goods and services tax, and the tax on specific consumer goods have risen more than ten percentage points to more than 96% of total receipts. This was not a homogeneous change, for the share of levies on specific consumer items decreased while that of the income tax and especially that of the goods and services tax increased. These changes have made the Nicaraguan tax system more dynamic by increasing the share in total receipts of taxes that are highly elastic relative to GDP and more neutral in regard to resource allocation. Another feature of these levies is that they make for greater administrative complexity, and it may hence be said that the increase in their proportion was due essentially to the changes made in tax administration during the period.

C. The Nicaraguan tariff system

- 1.21 The process of trade liberalization began in 1990 and intensified throughout the decade. Import duties were reduced and many quantitative restrictions on imports eliminated. Concurrently, most taxes on exports were abolished. Table 4 shows that the increase in the volume of foreign trade offset the reduction of levies on it, and brings out a strong increase in customs receipts during the period.

Table 4 –DGA revenue (in percentages of GDP and in millions of dollars)							
	1992	1993	1994	1995	1996	1997	1998
Tariffs	1.2	1.3	1.5	2.0	1.8	2.6	3.9
GST/VAT	2.4	2.7	2.5	3.1	3.2	4.1	5.3
Other revenue	2.1	2.3	1.9	2.0	2.1	1.6	0.8
Totals	5.7	6.3	5.9	7.1	7.1	8.3	10.0
Imports in millions –CIF	855.1	744.0	874.7	961.7	1,141.9	1,532.1	1,600.3

³ The Nicaraguan tax burden as a percentage of GDP is high. However, this indicator is affected by underestimation of the national accounts of Nicaragua.

- 1.22 Nicaragua signed the General Treaty for Central American Economic Integration in 1960. This Treaty created the Secretariat for Central American Economic Integration (SIECA), which is the technical and administrative arm for the process of Central American economic integration. Customs activity is governed by the Central American Uniform Customs Code (CAUCA), a piece of regional legislation governing procedures in Central America. These regulations are among the conditions of the present program.
- 1.23 The Treaty also gave rise to the Central American Common Market (CACM), one of whose purposes was the establishment of a common external tariff (CET). A new tariff nomenclature based on the Central American Tariff System (CATS) went into effect in 1993. The tariff consists of three parts. The first comprises the items for which a CET has been established and applies to 70% of the imports to Central America. The second is for intermediate products and raw materials, which comprise about 7% of the region's imports. Its treatment is not harmonized among the countries but depends on the existence of regional replacement products. The third group of products applies to 23% of the region's imports and comprises goods of high impact on receipts.
- 1.24 Below is a grouping of tariff items by rate ranges:

Range	0-5%	6-10%	11-15%	16-20%	>20%
Nicaragua	42%	12%	10%	35%	1%

Source: Castilla, M. (1998) "Tax harmonization in the integration of the smaller economies", working paper, Integration and Regional Programs Department, IDB.

D. Tax administration

- 1.25 The DGI is the agency that administers the taxes for which the Central Government of Nicaragua is responsible. The agency's operating structure is deconcentrated into 20 regional revenue administrations (RRAs) across the country and one General Directorate for Large Taxpayers (Dirección General de Grandes Contribuyentes) in the city of Managua. This unit is expensive to operate, absorbing the equivalent of 4.4% of total receipts in 1998. Forty percent of that cost was for personnel, which number 1,260 at present. Because of the weaknesses of the financial system, its participation in the collection of taxes is confined to taking receipt of the payments of the 13,400 fixed-quota taxpayers, while the rest make their payments to agencies of the DGI. The DGI handles about 54,000 active taxpayers.
- 1.26 Loan 885/SF-NI, approved in March 1992 for the equivalent of US\$2.5 million, aimed to launch the modernization of the General Revenue Directorate (Dirección General de Ingresos) [DGI]. The leading activities of this program were concentrated in the fields of standards, regulation of tax reform, information technology associated mainly with implementation of the collection process, segmentation of taxpayers into groups on the basis of their economic significance, and personnel training in the processes of tax administration.

- 1.27 In terms of standards, the program assisted in the specific modifications of each tax and the tax code bill was prepared, the purpose of which is to reduce arbitrariness in tax administration. At the same time, organizational adjustments were made that focussed the standard-setting functions in the Central Administration in Managua and transferred operational functions to the RRAs. Another important feature that has had an important impact on the structure and operations of the DGI is the segmentation of taxpayers on the basis of their economic significance. On the basis of this segmentation, the Large Taxpayers Administration was established in Managua, the RRAs were assigned the intermediate taxpayers, and the rest of them are subject to fixed quotas.
- 1.28 The streamlining of the tax system was accompanied by simplification of tax returns and payments, which has facilitated voluntary compliance and control by the administration. The collection process required development of the Tax Information System (TIS) and its installation in the principal revenue administrations in the country.
- 1.29 Loan 969/SF-NI, which is in the final stages of execution, intensified the modernization launched in the first phase, extending the TIS to the revenue administrations responsible for 95% of the country's tax receipts. Also under this second program, a communication system was set up for the DGI, and modernization of the oversight and control of management was begun. In the organizational area, a financial administration system has been developed and is being implemented for the agency, and in the area of human resources a policy has been implemented on training for the management of the institution and the oversight officers.
- 1.30 The growth of receipts summarized in Table 2 was made possible by the recovery of economic activity, the streamlining of the tax structure, and administration improvements. The DGI, however, still shows significant weaknesses both organizationally and in the specifics of tax administration. The division of work between the Central Administration and the RRAs has become blurred, with the former having resumed operational functions and neglecting its planning and supervisory functions, while the RRAs are organizing and carrying out their tasks without regard for the centrally charted planning. In addition, while the strategy of taxpayer segmentation has given generally good results, the roster of fixed-quota taxpayers has to be reviewed because middle-level payers are believed to have infiltrated it. Meanwhile, human resources management has been adversely affected by the high turnover of its officials and by the absence of civil service policies.
- 1.31 Despite the pilot development of modern auditing procedures, the greatest shortcomings in Nicaraguan tax administration are found in inspection and audits. The reason for this is that fiscal auditing in Nicaragua is still oriented to the verification of accounting statements, and little analysis is given to understanding the economic situations of taxpayers. There is practically no comparing of that information with data from third parties and economic statistics to determine its

veracity. Nor are analyses done of the installed capacities of payers, of their cash flows, physical inventory controls, etc. Moreover, in practice more attention than necessary is given to income tax and not enough to the goods and services tax (GST). The results of this work are usually minor relative to the resources allocated, which are usually settled on the legal level – the next step in the audit process.

E. Customs administration

- 1.32 The DGA is the administrator of the tariffs, the goods and services tax on imported merchandise and other levies. In addition, through its functions in the control of merchandise transit, it is responsible for the implementation of policies relating to the protection of national interests (e.g., environmental protection, control of toxic and illicit substances, etc.). It also has critical functions in the application of the country's trade policy, for example, in the application of the system of tariff preferences, verification of compliance with the Rules of Origin for imported goods, etc.
- 1.33 In 1998, administration costs reached about 2.9% of total receipts. Forty-six percent of the expenditures went on remuneration for the entity's 680 staff members. The DGA's operations are decentralized in seven customs houses and 23 suboffices distributed on a regional basis throughout the country and an Executive Board of Customs in Managua, supported by General Administrative, Technical and Audit Subdirectorates and a Coordination and Supervision Division. In 1998 the DGA processed about 177,000 foreign trade operations and collected US\$186.5 million in revenues.
- 1.34 In the early 1990s the General Customs Directorate suffered from pronounced weaknesses, including poorly qualified staff and foci of corruption, obsolete administrative procedures, a weak information processing system, excessive and ineffective import and export formalities, and significant shortcomings in audit functions. As a result, the customs service was unable to control high levels of smuggling, which were reflected in heavy losses of revenue.
- 1.35 In October 1994, the Bank approved ATN/SF-4667/NI for the equivalent of US\$950,000 to support the modernization of the General Directorate of Customs and turn it into an institution that would facilitate international trade. This operation concentrated on the establishment of a new legal framework, the reengineering of the procedures for clearing goods through customs, the automation of those procedures, and a first phase in personnel training.
- 1.36 Resources of the program were used to draft Law No. 265 establishing "self-clearance" for imports, exports and other regimes. This law went into force on February 16, 1998. It lays the legal foundation for simplification of customs procedures for merchandise imports and exports, and reduces the types and numbers of formalities. The law authorizes private agents to operate through their customs agents to determine the duties from the clearance formalities carried out.

In addition to speeding up the formalities, the simplification facilitated their automation and inaugurated a computer network among the customs offices. In addition, computers were installed to automate procedures in the Air Freight Center at Managua Airport.

- 1.37 However, customs modernization is still at a preliminary stage. Deepening it and making it sustainable will take measures in the organizational area, including human resources management, extension of the self-clearance system to the other customs offices in the country, reinforcement of the audit procedures, and investments in information technology and infrastructure. Moreover, modernization of the customs administration requires development of the institution's capacity to apply the country's foreign trade policy. The DGA presents severe shortcomings both in the tariff classification of goods and in the administration of tariff preferences, the Rules of Origin, antidumping duties, etc.
- 1.38 Among the processes of customs administration, investigation will require the greatest modernization effort. The new Law on Self-Clearance replaces the inspection of goods and their documentation upon entry into the country with an ex post facto inspection, once they have been forwarded to their destination. For this change to be successful, the universe of foreign trade agents will have to be segmented, and the capability for processing large volumes of information reinforced so that the cases for which audit procedures are called may be identified. Not only does the DGA not possess this capability at present; it also lacks the human, technological and management resources to develop it.

1. Strategy for institutional strengthening

- 1.39 There are essentially three purposes of the proposed autonomy: (a) to make the administrative, technical and financial operations more flexible and responsive, (b) to produce a human resources system that contains elements of a civil service, and (c) to eliminate, or at least reduce, the effects of policy changes on both institutions.
- 1.40 Nevertheless, the proposed autonomy will be governed by the provisions established in the financial administration for decentralized entities and by those of the Law on the Organization, Sphere and Procedures of the Executive Branch (Law 290) relating to administrative matters in the sense that both institutions are subordinate to the Ministry of Finance as the apex entity of the system.
- 1.41 In view of its financial constraints, the government has carried out a pilot civil service project called Government Management and Technical Service (Servicio Gerencial y Técnico del Estado) [SGTE], involving some 300 Central Government officials in key directorial and technical positions, and will apply the lessons drawn from it to the two agencies under the present program.

- 1.42 The positions and programs of the SGTE have been defined under the following criteria: (a) the positions and programs must correspond to plans, programs and projects rated as strategic for the country's development;⁴ (b) the career posts must correspond to functions relating directly to the mandates of the institutions in the areas of direction, planning, policy-making and/or tasks of highly technical content; (c) appointments to positions of political trust must cover only the managerial, professional and technical functions for which high qualifications are required as established by the General Public Service Directorate of the MHCP, and must not exceed 5% of the total cost of the pilot project; (d) a position may be eligible for the SGTE for not more than five years, and the posts may vary yearly as established in the national budget; (e) any entity of the Central Government may participate in the SGTE, but priority will be given to those that have subscribed Institutional Restructuring Agreements.

2. Legal framework for decentralization of the tax and customs administrations

- 1.43 The authority for decentralization in the administrative, financial, technical and human resources management areas will be conferred by a specific law. The proposed legislation, a copy of which has been forwarded to the Bank, will create two entities: the Tax Revenue Administration (AIT) and Customs Service Administration (ASA), which will be granted the appropriate powers. At an operational level, these entities will continue to report to the Minister of Finance.
- 1.44 The budget of each entity (the AIT and ASA) will be prepared on the basis of an annual plan of operations that will be approved by the MHCP, subject to the controls provided by law. The two entities will be funded by portions of the revenues automatically set aside for the purpose, which will be determined by the Law establishing them. The amount so withheld by each entity will be used under the corresponding expenditure item in the National General Budget.
- 1.45 The Law will confer functions of decentralized human resources management on the AIT and ASA. These functions will be legal support of the career posts in the tax and customs spheres which will be designed with the support of the program, and will encompass the recruitment, evaluation, promotion, continued employment and termination of the personnel of these institutions.
- 1.46 Other aspects to be covered by the Law relate to the terms for the framing and implementation of regulations, the introduction of efficiency incentives in the tax and customs administrations, and the authority of the entities to apply fiscal incentives. This Law must be adopted to the Bank's satisfaction as a condition for signature of the contract. The entry into force of this Law and its implementing regulations will be a condition precedent to the first disbursement of the loan.

⁴ The strategic project rating will be assigned in the Law on the National Budget.

3. The Bank's country strategy

- 1.47 The Bank's strategy accords priority to reform of the State, with a focus on downsizing of the central government and strengthening of revenue capturing institutions in the public sector, in a move to bring social spending up to acceptable levels and to increase fiscal savings so as to generate a surplus and reduce taxed-induced inflationary pressures. The program meshes well with this strategy insofar as it seeks to consolidate reform of the State and support efforts to strengthen fiscal management.

II. THE PROGRAM

A. Objectives

- 2.1 The general objective of the program is to support the establishment and strengthening of the AIT and the ASA, to which entities administrative, financial, technical and human resources management functions will be assigned.
- 2.2 The specific objectives of the program are as follows:
 1. To raise the professional and technical level of the personnel of the AIT and ASA by carrying out specific, ongoing training plans and introducing career opportunities for the staff of both institutions;
 2. To support the modernization process in the administrative, financial and technical areas and in human resources management;
 3. To enhance the effectiveness of tax and customs-duty collection in terms of productivity in accordance with indicators to be established, and
 4. To modernize the audit methods at the two institutions.

B. Targets and expected results of the program

- 2.3 Execution of the program and of other initiatives of the AIT and ASA is expected to produce the following specific results:
 - a. Creation of the AIT and ASA with decentralization functions in the administrative, financial, technical and human resources management areas;
 - b. Sustainability of the institutional strengthening of the tax and customs administrations;
 - c. Introduction in the AIT and ASA of an organizational model featuring high capabilities for planning and supervision at the central level plus decentralized operations;
 - d. All management personnel trained;
 - e. Implementation of career employment in the AIT and ASA under the civil service guidelines;
 - f. Inspection procedures implemented at AIT and ASA based on modern audit techniques;
 - g. Work stations connected to the AIT and ASA computer network;

- h. Tax and customs information to be available on the AIT and ASA networks within 24 hours;
- i. All customs operations processed by the computer system;
- j. All merchandise in domestic and international transit controlled;
- k. Implementation of World Trade Organization (WTO) valuation system;
- l. Entry into force of the Central American Uniform Customs Code (CAUCA).

C. Description of the program

2.4 Consolidation of the institutional strengthening of the tax and customs administrations is part of a new generation of reforms being implemented by Nicaragua to create conditions for sustainability in the AIT and ASA. To accomplish these goals the program will fund activities under the following components:

1. Organizational development and human resources management (US\$2.23 million)

2.5 The aims of this component are (a) to support implementation of the legal standards that will govern the institutional functioning of the Nicaraguan tax and customs administrations and implementation of the regulations for CAUCA II, (b) to strengthen the capacity for planning, management and supervision in the two institutions, (c) to reframe the decision-making process in the two institutions, and (d) to strengthen human resources management, including manpower training and particularly the development of management capacity with a view to strengthening the decision-making process. To accomplish these specific objectives, the following subcomponents have been structured:

- a. Support for administrative and financial decentralization in the AIT and ASA (US\$186,000): Strengthening of the capacity for the formulation and execution of budgets, accounting, purchasing and cash management in the two institutions so that they may take on the functions of administrative and financial decentralization provided for in the Law establishing the AIT and ASA. The degree to which decentralization is to be carried out at each institution will be worked out in the detailed design of the component.
- b. Strengthening of the capability for planning, management and supervision of tax and customs procedures (US\$106,000): The organizational structure of the two institutions will be adapted to the tax and customs procedures as they are revised. This requires speeding up the transfer of operations to the RRAs and customs offices, while the planning and supervision of these activities will remain at the central level. The areas of regulatory

formulation, technical and legal management, institutional communications, administration, human resources and information technology will also be kept at the central level.

- c. Development of management capacity (US\$299,500): the organizational reform requires a transition from a management that controls procedures to one that controls results.⁵ The principal activities envisaged are:
- (i) Establishment of a management structure based on a review of procedures. Determination of the value added contributed specifically by each managerial link in the institutional hierarchy;
 - (ii) A diagnostic of the personnel currently performing management functions and a determination of their suitability for the roles and profiles of the management groups;
 - (iii) Development of management skills in the areas of leadership, communications, teamwork, planning, management control, supervision, etc., and
 - (iv) Awareness building of the institutional reform of the tax and customs administrations in order to internalize the vision of the institution's mission and strategies.
- d. Human resources management (US\$1,638,500): The activities envisaged in this subcomponent derive from the decentralized human resources management functions that the AIT and ASA will have. This requires the formulation and implementation of a human resources policy for both entities. The principal activities will be as follows:
- (i) Formulation of the legal framework and human resources policy that will govern the tax and customs administrations. This policy will apply to the procedures for recruitment, hiring, evaluation, promotion and termination of staff and to their remunerations and incentives. It also covers intrainstitutional communications;
 - (ii) Development of systems for administration of human resources policy. This will include the procedures mentioned in the preceding paragraph and others involved in personnel management (e.g., files, training, communications, manuals of human resources management procedures, etc.);

⁵ The term management ("gerencia") encompasses the senior staff (the General Director, the Assistant General Directors, and the Area Directors), the middle-level staff, and the supervisors. In the two institutions the number of staff at this level totals 123.

- (iii) Implementation of an AIT and ASA human resources policy. Includes definition of post profiles and their organization in accordance with the procedures used by both agencies. It also calls for the evaluation and reassignment of personnel currently employed in the two institutions and implementation of the policies designed with support of the program;
- (iv) Reductions in force at the AIT. About 430 staff members currently employed in the DGI are expected to be affected. A consulting firm will be retained to ensure the transparency of the process;⁶ and
- (v) Formulation and implementation of a training policy includes identifying training needs, programming activities, and measuring their effectiveness and relevance to the personnel evaluation policy. The courses will include specific subjects relating to (a) customs and taxation procedures, (b) the development of teamwork skills, and (c) reinforcement of the ethical values of the staff members. Also, in compliance with the recommendations of the Environment and Social Impact Committee (CESI), the training for ASA staff members must include importation and exportation of toxic materials, hazardous materials, endangered species, and exports of archeological and historical artifacts.

2. Support for the audit function (US\$2.07 million)

- 2.6 The purpose of this component is to strengthen the audit function in tax and customs administrations, which requires activities at both the central level and in the different branches of the AIT and ASA. At the central level, strengthening will be provided for those activities with indivisibilities (such as planning, organization, coordination of audits, performance evaluation) and significant externalities (high-impact cases, methodological developments, information retrieval, etc.). Meanwhile, the operational activities will be done at the deconcentrated level. The principal activities envisaged are:
- a. Strengthening the central capabilities for planning, coordination and evaluation of the audit function in tax administration;
 - b. Development at the central level of methodologies for identification, analysis and audit procedures to be used in each economic sector, for each tax and for each economic category of taxpayer. The principal audit and inspection programs to be adopted by the Nicaraguan tax administration are (a) the comparison of declared operations (COA), (b) the debit/credit ratio

⁶ To facilitate the reintegration into the economy of staff to be let go, orientation groups will be formed and training courses held to improve their reemployability.

of the IVG, (c) asset differences, (d) verification of performance of formal obligations, and (e) review of taxpayers listed under the fixed-quota regime.

- c. Implementation of the methodologies referred to in the preceding paragraph in the General Directorate of Large Taxpayers and in the Regional Revenue Administrations;
- d. Improvement of access to external and internal sources of information to support case selection and field work;
- e. Establishment at the central level of an area of economic and tax studies for the early detection of activities and economic agents not yet identified and included in the AIT's plans of action;
- f. Creation at the central level of a Fiscal Intelligence operations group for the early detection of and action against organizations set up to commit fiscal crimes;
- g. Modernization of the invoicing system;
- h. Reinforcement of the central-level capability for planning, coordination and evaluation of the foreign trade audit and inspection function;
- i. Development at the central level of methodologies for identification, analysis and audit procedures to be used in customs inspection procedures for each economic sector, and for each economic category of customs service user. The principal activities will relate to (i) tariff classification, (ii) application of Rules of Origin, (iii) valuation, (iv) control of goods in transit, (v) the establishment of a unit to monitor major importers and exporters, and (vi) control of entities operating with special customs facilities (bonded warehouses, couriers, bonded assembly plants, etc.);
- j. Establishment at the central level of an area of economic-customs studies for the early detection of activities and economic agents not yet identified and included in the ASA's action plans;
- k. Establishment at the central level of a Customs Intelligence operations group for the early detection of and action against organizations set up to commit customs crimes;
- l. The strengthening at the decentralized level of the capacity for programming, selecting, and exercising and overseeing control of foreign trade activities based on the guidelines laid down in the customs inspection plan and guided by the facilitation modality that should take precedence in modern customs work.

3. Information technology (US\$2,859,000)

- 2.7 Both entities have major needs in information technology. Those of the AIT relate mainly to (a) management and development of information systems, (b) the requirements arising from the decentralization of administrative, financial and human resources management functions, (c) the new requirements generated by the new approach to auditing, (d) expansion of communications network capacity, (e) the reconditioning of obsolete equipment, and (f) in the case of the ASA, continued support for the development of applications to ensure compatibility of the computerized customs management system.
- 2.8 The ASA's requirements in this component are similar to those of the AIT though starting from a lower level of institutional capacity. Hence the envisaged requirements in the customs area are (a) development of information management capability, (b) adaptation and implementation of the systems currently in use for decentralization of the administrative, financial and human resources management areas in the DGI, (c) support for enhanced customs inspection requirements, (d) a larger infrastructure for information systems, and (e) supplementary development of the information processing system in current use.
- 2.9 The ASA will continue using SIDUNEA as its customs information system. The principal developments to be made in this area will include systems for the control of the domestic and international transit of merchandise and the inspection system. In addition, the collection system will be incorporated into SIDUNEA, and modules for the extraction, integration and consolidation of information into a data base.

4. Infrastructure (US\$2,500,000)

- 2.10 This item is included in the program because of the precarious nature of customs infrastructure; it comprises primarily the upgrading of existing facilities and, in some cases, the erection of structures adjacent to those already standing. The areas targeted for upgrading and construction will house units strengthened by the program, mainly in the information processing and audit and inspection functions. In keeping with the CESI's recommendations, action will be taken to ensure that the works for remodeling of the customs facilities take account of local environmental standards.
- 2.11 The following works are envisaged: self-clearance, spot check, and single-window modules, and housing of information processing and communications equipment. These facilities are essential to expedite flows and movements of merchandise, bringing them into line with the new customs procedures including outfitting with the necessary information systems. They also include metal barriers to regulate vehicle control (control needles) and the construction of gutters, sidewalks, sanitary drains and outside lighting. Moreover, additional structures will be built to house the audit and inspection function and information processing at ASA headquarters.

D. Performance indicators

- 2.12 Programs to strengthen tax and customs administrations are generally associated with increases in revenue collection even though this variable is also determined by factors beyond the control of the strengthened entities (e.g., the economic cycle, economic policy, etc.). In the case of this program, the country and the Bank have decided to include among its expected results the AIT and ASA tax revenues targets that Nicaragua and the IMF may agree to set.⁷
- 2.13 In addition, to monitor the tax and customs administrations, a set of indicators will be prepared, the baseline data for which will be used in the initial report.

E. Cost and financing

- 2.14 The cost of the program comes to US\$12.5 million, of which the Bank will finance 80% with resources from the Fund for Special Operations; the loan which will be reimbursable in accordance with current provisions, will be granted on the following terms and conditions:

Term of amortization and grace period: a term of amortization of up to 40 years from the effective date of the contract, and a grace period of 10 years from the same date.

Interest rate: 1% during the grace period and 2% thereafter.

Credit fee: 0.5% on the undisbursed portion of the financing. It will begin to accrue 12 months after the date of the resolution adopted by the Board of Executive Directors and will be payable in United States dollars on the same dates and at the same interest rate.

- 2.15 In summary, then, the Bank will be financing information processing (software and hardware) and communications equipment, systems development, institutional communications, and part of the cost of consulting and training services and infrastructure. The local contribution will go on infrastructure, training and contingencies. In addition, the Bank will finance the cost of the reductions-in-force at the DGI because of the overstaffing in that institution, audit and inspection activities, the information technology and financial charges (not including the credit fee), as well as part of the administrative, organizational development and infrastructure expenses. The principal items to be financed under the program are shown in Table 7.

⁷ At this writing a 36-month economic program supervised by the IMF has been in progress for 15 months. Given the country's economic situation and commitments associated with the HIPC initiative, that program is expected to continue throughout the time of execution of the present loan.

- 2.16 The sources of cofinancing for the infrastructure works and information processing technology are being identified. In view of the large financial requirements for these two components, the cofinancing obtained would increase the amount of the operation or replace the Bank financing. If the cofinancing materializes after the operation for the program, the Management of the Bank will amend the loan contract.

Table 7 – Estimated Budget (in thousands of United States dollars)				
COMPONENT	FINANCING			
	IDB	LOCAL	TOTAL	%
Organizational development and human resources management	1,860	370	2,230	17.8
Audit and inspection	1,650	420	2,070	16.6
Information technology	2,400	459	2,859	22.9
Infrastructure	2,000	500	2,500	20.0
Components subtotal	7,910	1,749	9,659	77.3
Executing unit	350	260	610	4.9
Specialized agency	320	200	520	4.2
Auditing	150	-	150	1.2
PPF Reimbursement (loan 1040/SF-NI)	470	-	470	3.7
Contingencies (3%)	300	141	441	3.5
Operational subtotal	9,500	2,350	11,850	94.8
Finance charges	500	150	650	5.7
- Credit fee		150	150	1.2
- Insp. and Superv.	100		100	0.8
- Interest	400		400	3.2
Totals	10,000	2,500	12,500	100.0

III. PROGRAM EXECUTION

A. Executing agency

- 3.1 The Ministry of Finance (MHCP) acting through the program executing unit and in coordination with the technical units of the Tax Revenue Administration (AIT) and the Customs Service Administration (ASA) will be responsible for execution of the program. To coordinate program execution, a Steering Committee will be established consisting of the Minister or Deputy Minister of Finance and the heads of the AIT and ASA. This Committee will be assisted by the Executing Unit, whose functions are described hereafter. As a condition precedent to the first disbursement, the agreements signed by the MHCP with the AIT and ASA, respectively, setting out the responsibilities of each party in program execution shall have been presented. It shall also be a condition precedent to the first disbursement that the Steering Committee and the Executing Unit be established.
- 3.2 To conduct the daily execution of the program, an Executing Unit will be assembled with a small staff consisting of an International Coordinator, a Local Coordinator and an administrative support staff of two persons. This unit will receive as needed the support of specific consultancies to be commissioned for execution of the program, which will give priority in their work to the AIT and ASA.
- 3.3 In addition, it is proposed that the CIAT be employed as a specialized agency for execution of the tax component. This agency will support the AIT in the area of taxation techniques, and will also select, hire and pay the consultants and do the related administrative work.

B. Procurement, works and consulting services

- 3.4 Procurements, works and consulting services will be carried out in keeping with the Bank's policies and procedures. International competitive bidding will be mandatory for procurements of goods in excess of US\$250,000 and contracts for works costing more than US\$2 million. Procurement in amounts below the stated ceiling shall be governed, in principle, by the provisions of domestic law. For the selection and hiring of consulting services for more than US\$200,000, announcements must be published in *Development Business*.
- 3.5 Since the infrastructure component of the program envisages a large number of small-scale works in widely separated localities, it is recommended that before invitations are issued to submit bids, the executing agency of the program indicate to the Bank its nonobjection to (a) a procurement program based on the preliminary plan presented in Annex II, and (b) the simplified designs of the major works.

1. Direct contracting of the CIAT

- 3.6 To ensure the continuity of the technical assistance that the CIAT has been providing to the DGI in the institutional strengthening of the tax area, the government has expressed interest in directly contracting that institution, which specializes in this area. The CIAT will provide advisory assistance to the Steering Committee with such tasks as the latter may seek assistance and will be responsible for hiring the consulting services, procurement of goods and services, and performance of the necessary administrative measures, all areas in which it has an advantage owing to its multidisciplinary approach, its ongoing relations with the countries, and its extensive experience and proven track record with consulting firms and individual consultants.
- 3.7 The CIAT is an agency with considerable experience in tax administration and programs financed by the Bank, having satisfactorily supported execution of the two programs mentioned earlier. It is therefore recommended that the CIAT be contracted directly for continuation of the services it has been providing so as to capitalize on its earlier experience and continue the technical assistance work without interruption. Presentation of the signed contract between the AIT and the CIAT will be a condition precedent to the first disbursement of the loan.

2. Execution period and disbursement schedule

- 3.8 The proposed execution period is three years, and the disbursement period is three and one half years, with both terms beginning on the effective date of the contract.
- 3.9 The tentative disbursement schedule is as follows:

Disbursement schedule (in US\$ thousands)					
	1999	2000	2001	2002	Total
IDB	100	3,600	5,000	1,300	10,000
Local contribution	40	1,000	1,200	260	2,500
Total	140	4,600	6,200	1,560	12,500
%	1	38	52	9	100

3. Supervision, reports and evaluation

- 3.10 The Bank will supervise the execution of the program through its country office in Nicaragua and technical supervision missions by the project team, to review the progress of the two institutions, the accomplishment of the set objectives and the execution of the annual work plans.
- 3.11 At least once a year the Programming and Evaluation Committee will meet to monitor the program, discuss the fulfillment of the detailed work plan of the preceding year and approve the work plan of the coming year based on a draft of the work plan updated yearly by the Executing Unit in coordination with the AIT and ASA as indicated in paragraph 3.12 (a). This meeting will be attended by

members of the Steering Committee, the Executing Unit, and Bank representatives, who will include the members of the project team from the Fiscal Division and Country Division 3.

3.12 The Executing Unit will submit to the Bank the following reports:

- a. An initial report as a condition precedent to the first disbursement. This report will identify the personnel of the Executing Unit and its duties; a work plan based on a model agreed upon with the Bank in advance. This plan will be detailed for the first year and will contain amongst other data the benchmark values for the years thereafter and present performance indicators, the terms of reference of the principal consultants, the content of the training courses and the terms of reference for design of the administrative career path. In addition, the work plan will be updated annually as a condition for execution.
- b. Quarterly progress reports, on the program performance indicators to be agreed on in advance with the Bank.
- c. Semiannual progress reports should describe mainly the accomplishments made under the preceding program and the results achieved in terms of program performance indicators, explain any divergences that may have occurred and indicate any changes that are recommended, together with details of procurement, training courses, and the contracting of the principal consultants.
- d. Final report, which must describe at least the accomplishments of the program, the principal impediments to its execution, and the lessons learned and recommendations.

3.13 The primary purpose of the final evaluation of the program is to measure the quantitative and qualitative gains achieved in the audit function and human resources management, with the main emphasis on implementation of the career service and accomplishment of the institutional purpose. It will also verify the improvement in collections by the AIT and ASA. At the end of the execution period of the program, the Bank, the Steering Committee and the Specialized Agency will agree on a mission for final evaluation of the program. This mission will assess the degree to which the objectives and goals of the program have been attained and its activities carried out, and the benefits and results achieved in the areas of collection, audit and inspection function, and the career service.

4. External audit

3.14 In keeping with accounting practice, the executing agency will establish and maintain the necessary accounts and accounting records. These accounts and records will be audited at the end of each fiscal year by an independent firm of

auditors acceptable to the Bank. As requested by the executing agency, the costs of this audit will be charged to the loan.

IV. JUSTIFICATION, BENEFITS AND RISKS

A. Justification

- 4.1 This operation is part of the Bank's strategy for support to the reform of fundamental government institutions. The institutions considered here are responsible for the collection of all the internal revenue of the central government. The operation will make it possible to consolidate the reforms in the fiscal area undertaken under the three previous operations by making sustainable the Tax Revenue and Customs Service Administrations.

B. Benefits

- 4.2 The program will support the creation and strengthening of the AIT and ASA, the entities that will administer tax revenues in an amount equivalent to 26% of GDP. This additional institutional development will further help to balance the fiscal accounts, ensure that economic stability is successfully maintained, generate domestic savings to supplement external assistance which is on the decline, and make it possible to raise social spending to acceptable levels.
- 4.3 An additional benefit is that it will help reduce evasion of taxes and levies on foreign trade by bringing delinquent payers into the system and increase the government's capability to formulate and execute its fiscal and foreign trade policies. In addition, the reduction of tax and customs duty evasion will increase revenue without having to increase taxes or foreign trade levies, and will enhance the horizontal equity of the tax and tariff system by combating tax fraud.
- 4.4 Taxpayers will benefit from improvements in tax administration services as a result of the improvements to be made in procedures, and exporters, importers, carriers, shipping companies, customs agents, etc., will benefit from the simplification of customs procedures and the greater flexibility of formalities.
- 4.5 Lastly, the program is expected to consolidate and deepen the reforms carried out under the three preceding operations, particularly in inspection, information processing technology, senior management training, and support for institutional professionalism, which, together with the downsizing of the two entities to levels consistent with their new missions, will reduce collection costs and increase revenues.

C. Risks

- 4.6 An operation like the proposed program always involves political risks from possible inadequacies in the leadership to implement the reforms (by the high and middle management levels) and in the stage of parliamentary support. To reduce this risk, the sector authorities, including the Minister of Finance, have declared the

program a high priority and expressed their full support for the reforms envisaged in the preceding operations and the one presented here. The government's support is also clearing the way for reforms in the fiscal area, for example, fulfillment of the ESAF fiscal targets, enactment of the Law on Tax Fairness, modernization of the customs system, etc. Similarly, the authorities have asked the Bank to provide professional support for the operation in the Assembly and to open dialogue with the representatives in order to present to them its advantages for the country.

- 4.7 Another potential risk lies in the response of the management of the two institutions, since processes such as those envisaged in the program usually run into obstacles due to limited management skills in administrative and technological innovation, resistance by personnel to institutional change, and the complexities of the reforms themselves. To minimize these risks the program provides consultancies for the strengthening of management capacity and close supervision and monitoring of this subcomponent. Concurrently, the human resources management component is designed to neutralize resistance to change through public information on the organizational changes in prospect, including training for the personnel to be let go and through staff participation in the reforms themselves.

LOGICAL FRAMEWORK

Narrative summary of objectives	Objectively verifiable indicators	Means of verification	Assumptions
<p>Enhance management efficiency of Revenue Administration (AIT) and Customs Service Administration (ASA) through more effective revenue collection and professional skills of personnel.</p>	<p>Total cost of AIT and ASA as percentages of total tax and customs revenue.</p> <p>Results of performance evaluations of management and officials of AIT and ASA.</p>	<p>Official publications of fiscal statistics.</p> <p>AIT and ASA official publications.</p> <p>Performance evaluations of management and staff of AIT and ASA.</p> <p>Surveys of satisfaction of taxpayers and users of the customs system.</p>	<p>Passage of law converting DGI and DGA into the Tax Revenue Administration (AIT) and the Customs Service Administration (ASA).</p> <p>Enactment of the Regulations for the Central American Unified Customs Code (CAUCA).</p> <p>Continued technical and political support for the program.</p>
<p>GOAL</p> <p>Support strengthening and modernization of AIT and ASA by implementing a high capacity organizational model for planning and supervision at central level and for centralized operations.</p>	<p>Implementation of systems for tax, customs, financial and human resources management.</p> <p>Implementation of management control systems.</p>	<p>Periodic progress reports on the program.</p> <p>Results of budget execution. Accounting information.</p> <p>Performance reports on use of indicators for control of tax and customs administration.</p>	<p>Political support is sustained and AIT and ASA have the necessary human resources and technical assistance to implement the program.</p> <p>Resistance to organizational change overcome.</p>
<p>COMPONENTS</p> <p>Organizational development and human resources management.</p>	<p>1.1 Introduction of career path for staff of AIT and ASA.</p>	<p>1.1 Personnel administration manuals and legal frameworks for career path in AIT and ASA.</p>	<p>Political support for the program</p>

Narrative summary of objectives	Objectively verifiable indicators	Means of verification	Assumptions
<p>Support for audit function.</p> <p>Information technology.</p> <p>Infrastructure.</p>	<p>1.2 Adoption of new organizational structures at central and decentralized levels.</p> <p>2. Coverage (no. of tax payers) and yield (collection) produced by audit and inspection function.</p> <p>3.1 Implementation of systems for control of merchandise in transit.</p> <p>3.2 Integration of tax collection system with customs system (SIDUNEA).</p> <p>4.1 Completion of works to improve ASA infrastructure.</p>	<p>1.2 Organizational charts of AIT and ASA and manuals of tax and customs administration procedures.</p> <p>2. Official statistics on results of audit programs.</p> <p>3. Progress reports on the program and review of operability of the systems.</p> <p>4. Verification of completion of programmed works.</p>	<p>AIT and ASA have the human and financial resources and technical assistance they need for development of the program.</p> <p>Availability of qualified consulting services.</p> <p>Resistance to change is overcome.</p>
<p>Support for administrative/financial decentralization of AIT and ASA.</p> <p>Development of management and operating skills at AIT and ASA.</p> <p>Optimization of human resources management.</p>	<p>1.1 Implementation of integrated financial administration system (budget, accounting, cash flow and procurement).</p> <p>1.2 Separation of management and operational personnel whose evaluations between their initial and subsequent performance evaluations have dropped to unsatisfactory.</p> <p>1.3 Change in mobility of middle-level and operational personnel from present situation, measured in terms of promotions and relocations.</p>	<p>1.1 Progress reports on the program.</p> <p>1.2 Evaluation reports on management and operational personnel.</p> <p>1.3 Official AIT and ASA reports on personnel promotions and relocations.</p>	<p>Political support for the program.</p> <p>AIT and ASA have the necessary human, financial and technological resources and technical assistance to carry out the programmed activities scheduled.</p> <p>Availability of qualified consulting services.</p>

Narrative summary of objectives	Objectively verifiable indicators	Means of verification	Assumptions
<p>Creation of areas of Fiscal Intelligence and Tax and Customs Economic Studies.</p> <p>Improvement of audit programming functions.</p> <p>Use of more efficient methods for audit functions.</p> <p>Adjustment of systems to new requirements for decentralization of administrative/financial and human resources management.</p> <p>Adjustment of information systems to new requirements of audit functions.</p> <p>Renewal and expansion of infrastructure for information technology in AIT and ASA.</p> <p>Upgrading of principal customs facilities to needs generated by law on self-clearance.</p> <p>Construction or upgrading of facilities to support AIT audit activities and information technology.</p>	<p>2.1 Revision of new organizational structures at central and decentralized levels.</p> <p>2.2 Economic return on audit programs.</p> <p>2.3 Evaluation of information exchange methods and of information sources used.</p> <p>3.1 Implementation of administrative/financial and human resources management systems in AIT and ASA.</p> <p>3.2 Updating of Tax Information (AIT), SIDUNEA systems and availability of information in data bases.</p> <p>3.3 New communications equipment, systems and networks installed and operating at AIT and ASA offices.</p> <p>4. Verification of completion and quality of upgrading works.</p>	<p>2.1 Organizational charts and manuals of organization and functions of AIT and ASA.</p> <p>2.2 Official collection statistics and annual reports of AIT and ASA.</p> <p>2.3 Progress reports on the program.</p> <p>3.1 Progress reports on the program.</p> <p>3.2 Technical and user manuals.</p> <p>3.3 Computer and data base programs available. Contracts for procurement of equipment and systems.</p> <p>4. Quarterly progress reports on execution of the works, including their costs.</p>	<p>Resistance to change is overcome.</p>

TENTATIVE PROCUREMENT PLAN

(in thousands of US\$)

Principal procurement	Amount	Financing		Modality	Prequali- fication	Tentative dates (quarter)
		IDB	Local			
<u>Consulting services</u>	<u>3,271.0</u>	<u>1,913.0</u>	<u>1,358.0</u>			
- <u>Consulting firms</u>	<u>979.0</u>	<u>620.0</u>	<u>359.0</u>			
- Organization development	309.0	200.0	109.0	ICB	YES	IV 1999
- Auditing	150.0	100.0	50.0	LCB	NO	IV 1999
- Specialized agency (exception)	520.0	320.0	200.0	DC	NO	IV 1999
- <u>Individual consultants</u>	<u>2,292.0</u>	<u>1,293.0</u>	<u>999.0</u>			
- International consultants (192 months)	1,554.0	1,113.0	441.0	RC	NO	IV 1999
- Local consultants (401 months)	738.0	180.0	558.0	RC	NO	IV 1999
<u>Equipment and supplies</u>	<u>413.0</u>	<u>399.0</u>	<u>14.0</u>			
- Organization development (two calls for tenders)	123.0	123.0		PS	NO	II 2000
- Auditing (three calls for tenders)	250.0	250.0		PS	NO	II 2000
- Executing Unit	40.0	26.0	14.0	PS	NO	I 2000
<u>Infrastructure</u>	<u>2,600.0</u>	<u>2,000.0</u>	<u>600.0</u>			
- Auditing	40.0		40.0	PS	NO	I 2000
- Information technology	50.0		50.0	PS	NO	II 2000
- Executing Unit	10.0		10.0	PS	NO	II 2000
- ASA infrastructure (various calls for tenders)	2,500.0	2,000.0	500.0	LCB	NO	I 2000
<u>Hardware</u>	<u>1,845.0</u>	<u>1,845.0</u>	<u>0</u>			
- Organizational development (various purchases)	85.0	85.0		PS	NO	I 2000
- Auditing (one call for tenders)	325.0	325.0		ICB	YES	II 2000
- Information technology (three calls for tenders)	1,420.0	1,420.0		ICB	YES	II 2000
- Executing Unit	15.0	15.0		PS	NO	I 2000
<u>Software</u>	<u>1,075.0</u>	<u>1,075.0</u>	<u>0</u>			
- Organizational development (various purchases)	65.0	65.0		PS	NO	I 2000
- Auditing	305.0	305.0		ICB	YES	II 2000
- Information technology	700.0	700.0		ICB	YES	II 2000
- Executing Unit	5.0	5.0		PS	NO	I 2000
Total	<u>9,204.0</u>	<u>7,332.0</u>	<u>1,972.0</u>			

Note: ICB = international competitive bidding; LCB = local competitive bidding; PS = price shopping; RC = register of consultants; DC = direct contracting

PROPOSED RESOLUTION

NICARAGUA. LOAN ____/SF-NI TO THE REPUBLICA DE NICARAGUA
Program for Institutional Strengthening of the
Tax and Custom Administrations

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 Program for Institutional Strengthening of the Tax and Custom Administrations. Such financing will be for the amount of up to US\$10,000,000, or its equivalent in other currencies, except that of Nicaragua, which are part of the resources of the 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.