

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

NICARAGUA

SOCIAL SECTOR PROGRAM IN SUPPORT OF THE ERCERP

(NI-0183)

LOAN PROPOSAL

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Electronic Links and References	
Basic socioeconomic data	http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata
Portfolio in execution	http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=678357
Tentative lending program	http://opsgsl/ABSPRJ/tentativelending.ASP?S=NI&L=EN
Information available in the RE2/SO2 technical files	http://ops3ws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=571453
Annex I. Comparative synthesis	http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=678360
Annex II. Priority budget programs	http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=678377
Annex III. Midterm indicators for program monitoring and evaluation	http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=678387
Annex IV. Policy letter	http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=678391
Annex V. Means of verification	http://ops3ws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=589358

ABBREVIATIONS

BCN	Central Bank of Nicaragua
CAFTA	Central American Free Trade Agreement
ERCERP	Enhanced Strategy for Economic Growth and Poverty Reduction
ESS	Enfoque Sectorial de Salud [Sector-wide health focus]
FSO	Fund for Special Operations
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Countries initiative
IMF	International Monetary Fund
LAF	Ley de Administración Financiera [Financial Administration Act]
MDG	Millennium Development Goals
MECD	Ministry of Education, Culture, and Sports
MHCP	Ministry of Finance
MIFAMILIA	Ministry of Family Affairs
MINSA	Ministry of Health
NFPS	Nonfinancial public sector
PAININ	Comprehensive Child Health Care Program
PBSS	Paquete Básico de Servicios de Salud [Basic Health Services Package]
PCT	Plan Común de Trabajo [Common Work Plan]
PINE	Comprehensive School Nutrition Program
PND	National Development Plan
PNS	National Health Policy
PRGF	Poverty Reduction and Growth Facility
RAAN	Región Autónoma Atlántica Norte [Atlantic Autonomous Region North]
RAAS	Región Autónoma Atlántica Sur [Atlantic Autonomous Region South]
RPS	Social Safety Net
SECEP	Presidential Office for Coordination and Strategy
SIGFA	Financial and Administrative Management Information System
SILAIS	Local Comprehensive Health Systems

PROJECT SUMMARY

NICARAGUA SOCIAL SECTOR PROGRAM IN SUPPORT OF THE ERCERP (NI-0183)

Financial Terms and Conditions ¹				
Borrower: Republic of Nicaragua			Amortization period:	40 years
			Grace period:	10 years
Executing agency: Ministry of Finance (MHCP)			Disbursement period:	Maximum 24 months
			Interest rate:	1% during the grace period and 2% thereafter
Source	Amount (US\$ millions)	%		
IDB (FSO)	30	100	Inspection and supervision fee:	1%
Local	0	0	Credit fee:	0.5%
Total	30	100	Currency:	U.S. dollars
Project at a glance				
<p>Project objective: The general objective of the operation is to place Nicaragua in a better position to achieve the social targets of the Enhanced Strategy for Economic Growth and Poverty Reduction (ERCERP) and the Millennium Development Goals (MDG) by supporting policy measures and protecting the budgets of priority social programs that will expand and improve coverage in primary education, basic health care, and comprehensive care targeted specifically at children under six, an extremely vulnerable population group.</p> <p>Special contractual conditions: The contractual conditions for disbursements under the program relate to three policy areas: (i) a stable macroeconomic setting; (ii) strategic actions in education, health, and social welfare; and (iii) budget support for priority social programs. Specific details on the disbursement conditions for each tranche are found in paragraphs 2.3 to 2.24 of this document and in the Program Policy Matrix (see chapter V). In addition, presentation of the corresponding Execution and Cooperation Agreements, duly signed, will be a special contractual condition of disbursement eligibility for the first tranche (see paragraph 3.6).</p> <p>Exceptions to Bank policies: None.</p> <p>Project consistent with country strategy: Yes [X] No []</p> <p>Project qualifies as: SEQ [X] PTI [] Sector [] Geographic [] Headcount []</p> <p>Verified by CESI on: 19 August 2005.</p>				

I. FRAME OF REFERENCE

A. The macroeconomic setting¹

1. Recent developments

- 1.1 The framework for the Nicaraguan government's economic policy over the last two years has been that of the financial plan outlined in the December 2002 Poverty Reduction and Growth Facility (PRGF) arrangement with the International Monetary Fund (IMF). During 2003 the country met the agreed targets for growth, macroeconomic stability and poverty reduction, and in January 2004 it reached the completion point under the Heavily Indebted Poor Countries (HIPC) initiative, representing forgiveness of 72% of the net present value of Nicaragua's total external debt at the end of 2002. As a result, the international community granted full debt relief for US\$124.4 million in 2004, of which 76.2% was earmarked for expanding the coverage of social services: education and health absorbed the greatest portion of this debt relief, although their percentage share of the budget did not thereby increase.
- 1.2 One of the main components of the program with the IMF is the reduction of fiscal imbalances, and a number of measures have been taken to increase tax revenues, reduce current public spending, and improve the public debt profile. The first steps were taken in 2003 with implementation of the Fiscal Equity Act, which broadened the tax base and raised the rate for the income tax, eliminated certain exemptions to the value-added tax, and imposed a business assets tax as a form of advance payment of business income tax, and measures were introduced to make customs duty collection more efficient. During 2005, supplementary legislation was passed reinforcing the measures taken in 2003, thereby improving the fiscal performance.
- 1.3 In 2004, tax revenues in real terms rose by 10% over 2003, reaching 16.3% of GDP, compared to 15.8% in 2003 and 14.2% in 2002. Total government expenditure declined to 21% of GDP in 2004, as a result of lower interest payments and the initial impact of measures approved in 2003 to enhance the transparency and efficiency of public spending, such as the Civil Service and Administrative Career Act, the Public Debt Act, and strengthening of the Financial and Administrative Management Information System (SIGFA).
- 1.4 As a result of these efforts at fiscal discipline and rationalizing public spending, the central government generated primary savings (i.e. excluding interest payments) of 2.5% of GDP in 2004. The operating balance (including interest) showed a surplus of 0.4% of GDP. This improvement in the central government's finances allowed net domestic financing of the government to turn negative, and has had a positive

¹ This section summarizes portions of the 2004 Annual Report of the Central Bank of Nicaragua (BCN) and of the Economic Situation and Outlook 2004 recently published by Region 2.

impact on the economy. After grants are accounted for, the central government fiscal deficit was 2.2% of GDP (compared to 2.8% in 2003).

- 1.5 The fiscal deficit for the nonfinancial public sector (NFPS) before grants was 4.9% of GDP, and was financed primarily with grants, which represented 3.6% of GDP and reflected the country's heavy dependence on external cooperation. After grants, the NFPS deficit was 1.3% of GDP in 2004, compared with 2.2% in 2003. Disbursements by multilateral agencies, amounting to around 6% of GDP, helped to close this fiscal gap and to compensate for negative domestic financing. For example, in 2004 disbursements by the IDB under the PRGF amounted to US\$120 million.
- 1.6 With the reduction in fiscal imbalances during 2003 and 2004, achieved through greater primary savings, plus the debt relief flowing from the HIPC initiative and the availability of external financing (grants and multilateral loans), the government was in a position to stimulate and support the output expansion phase that the country is currently experiencing, and to take advantage of the favorable external environment by increasing investment in infrastructure and by sustaining poverty reduction expenditure, as discussed later in this document. In turn, the government's reduced financial requirements allowed the Central Bank (BCN) to continue its flexible monetary policy, which seeks to reduce domestic debt and provide liquidity to the economy within a framework of relative macroeconomic stability and lower interest rates.
- 1.7 As a direct result of this macroeconomic policy, 2004 saw GDP growth of 5.1%, which compares favorably with growth of 2.3% in 2003 and 1% in 2002. The improvement was attributable mainly to strength in exports of primary products and a recovery in domestic demand, owing to increased investment and higher private consumption fueled by a surge in family remittances and easier access to credit. Inflation stood at 9.3% at the end of 2004: this was higher than the rate for the previous year and exceeded the BCN target set at the beginning of the year (6.5%). Inflation was due primarily to higher world oil prices and their impact on the costs of fuel, transport, and power generation, which affect all sectors of the economy.
- 1.8 Despite the successes achieved, the political panorama was disrupted in late 2004 and in early 2005 the PRGF was frozen, thus holding up the approval of pending structural reforms agreed with the IMF. Nevertheless, in October 2005, a political accord was reached to move ahead with legislation pending. This enabled the government to take the necessary steps to resume its economic program, including adjustments to the 2005 budget and approval of a 2006 budget, which was deficit neutral and protected spending on the poor, at the time that the free trade agreement was signed between the United States, the Central American countries, and the Dominican Republic (CAFTA).

- 1.9 An IMF mission visited Nicaragua from 14 to 23 November 2005 to review the progress made on the PRGF. In view of the program's verified successes, it was recommended that the Executive Board grant a technical extension of the facility to February 2006, thus giving the country time to complete the reforms in progress. In late December, the Nicaraguan government submitted to the IMF a Letter of Intent with a request to extend the program until December 2006. In the letter, the government outlined its economic program and agenda for reforms in the course of 2006. It set new indicative targets and the authorities committed to moving ahead on issues left pending from the year before. These issues had to do primarily with the Tax Code, the introduction of new fiscal rules, a review of the pension system, the decentralization process, and energy sector reforms. On January 18, the IMF Executive Board extended the PRGF until December 2006 based on the satisfactory evaluation of the government's proposed program and the commitment the executive branch had demonstrated in maintaining a favorable macroeconomic environment and following through on its agenda of reforms.
- 1.10 Preliminary official projections show that macroeconomic indicators continued to improve in 2005, with GDP expected to grow by 4%, in line with a slowing trend in the global economy and reflecting a deterioration in the overall business climate owing to political tensions. One exception is likely to be inflation, which at an estimated 9.6% exceeds the projected target and is up slightly from the rate in 2004, basically because of the sustained increase in oil prices.

2. Economic outlook

- 1.11 The economic program for 2006, outlined in the extension of the PRGF with the IMF, will keep in place a macroeconomic framework whereby the government will accord priority to consolidating its fiscal position, controlling inflation, and getting an agenda of reforms through the legislature. The most significant reforms have to do with the introduction of a bill proposing fiscal regulation, adjustments to the Tax Code, pension reform, a deepening of the decentralization process as more responsibility for spending is passed on to the municipalities, and new proposed legislation to strengthen the financial sector.
- 1.12 The economy will benefit from greater private investment at home and from abroad, spurred on by the incentive of the newly approved CAFTA and a brighter political climate. According to preliminary estimates, growth in GDP is reckoned to be around 3.5% to 4% in 2006. The electoral campaign in the run up to the general elections in November could introduce an element of uncertainty that could in turn reduce expectations for investment and growth.
- 1.13 The external sector, despite the slowdown in the global economy, will continue to be the country's main pillar of growth. It is estimated that exports will soar by nearly 13%, although imports will keep rising (11%), reflecting investment growth, an expanding economy, and more disposable income on the strength of remittances

(12.3%) from family members living abroad. The country will continue to experience external imbalances that will be adequately financed through capital flows in the form of remittances, donations, and foreign investment.

- 1.14 On the fiscal front, in 2006 there will be a ceiling on the budget and a new framework with the passage of the Financial Administration Act (LAF). The 2006 budget which has already been approved takes into account the government's growing tax revenue, anticipated increases in spending arising from the various reforms, the expenses associated with the implementation of CAFTA, the elections, and subsidies for the energy sector and transport companies. The LAF's new legal framework will allocate spending more efficiently and ensure the financing of programs considered of priority.
- 1.15 In summary, then, after overcoming a series of political hurdles, the Nicaraguan government has taken corrective steps to ensure a more efficient macroeconomic framework in the medium term. The steps it has taken include passage of a deficit neutral budget for 2006 that conforms to the terms of the economic program arranged with the IMF, and approval of major structural reforms also considered in the PRGF. These efforts are reflected in the IMF's decision to extend the program to December 2006.

B. The social situation

1. Poverty

- 1.16 According to the World Bank's 2003 Poverty Report, Nicaragua has made significant progress in reducing poverty over the last decade, although it is one of the poorest and least developed countries of Latin America. Poverty and extreme poverty rates declined systematically between 1993 and 1998, and again in 2001, both for rural areas and for the country as a whole. Overall, the poverty rate fell from 50.3% of the population in 1993 to 45.8% in 2001, while the extreme poverty rate declined from 19.4% to 15.1% over that same period. This improving trend in the poverty indicators was more pronounced in the 1998-2001 period than in the 1993-1998 period.
- 1.17 According to the same report, poverty continues to be overwhelmingly rural and to be concentrated among the indigenous population. More than two-thirds of rural people are poor, compared with less than one-third of urban residents. As well, more than 25% of people in rural areas live in extreme poverty, compared with 6% of urban residents.

2. ERCERP

- 1.18 In August 2001, under the technical leadership of the Presidential Office for Coordination and Strategy (SECEP), Nicaragua approved the Enhanced Strategy for Economic Growth and Poverty Reduction (ERCERP) as a strategic framework

of medium-term policies and programs for achieving economic and social development and reducing poverty. The ERCERP has four strategic pillars: (i) economic growth; (ii) investment in human capital for the poor, with priority on improving the coverage, quality, and integration of public education, health, and nutrition services, especially in rural areas; (iii) protection for vulnerable groups, both those affected by natural disasters and those with physical or family problems; and (iv) governance and institutional development.

- 1.19 The ERCERP has 10 major objectives, which are directly aligned with the Millennium Development Goals (MDGs), and have been built into the National Development Plan (PND) presented in 2004, with the objective of achieving high and sustainable economic growth rates by supporting local development and productive clusters, through the development of human capital and a social safety net, the enhancement of democratic governance with broad citizen participation, transparency and accountability, equity and continuing modernization of the State. Taking a 1994 baseline, most of these targets have a horizon of 2015 and include the following commitments: (i) reduce by one half the proportion of persons living in absolute poverty; (ii) reduce by two-thirds the mortality rates for infants and for children under five years; (iii) reduce maternal mortality by three-quarters; (iv) offer primary education to 90% of children of school age; (v) guarantee access to reproductive health services for persons of appropriate ages; (vi) implement a strategy of sustainable development for 2005; (vii) reduce the rate of chronic malnutrition to 7% of the population; (viii) increase the coverage of drinking water services to 100% of the population; (ix) increase the coverage of sanitation services to 95% of the population; and (x) cut the illiteracy rate to 10% of the population. For some of these indicators, the PND has established interim targets and goals for purposes of monitoring progress.
- 1.20 The Third Progress Report on the ERCERP, in reviewing the progress to December 2004, notes that the net primary school enrollment rate achieved the target of 82% for the year, and compares favorably with the 75% recorded in 1998, the year the ERCERP began, but this rate represents a decline from the coverage rates achieved in 2002 and 2003, of 84.7% and 83.5% respectively. Infant mortality stood at 30 per 1,000 live births: this compared favorably with the target of 32/1,000 set for 2004, and also with the 40/1,000 recorded in 1998. With respect to the interim coverage indicators, the report noted that of the 19 indicators monitored, only six met the targets set for 2004: there were shortfalls in the health sector, particularly for preventive checkups and immunization coverage. These shortfalls may reflect a combination of factors: (i) structural weaknesses in social institutions that undermine the efficiency and effectiveness of their work; (ii) stagnation in budgetary allocations for these sectors, which have remained constant in terms of GDP over the last five years; and (iii) population growth, which has been increasing the demand for services and exacerbating the shortfall.

3. Public spending on poverty reduction

- 1.21 In 2004, total spending on poverty reduction amounted to 12.3% of GDP (US\$559.6 million), higher by 0.7% of GDP (US\$54.1 million) than the program agreed with the IMF and representing approximately 48.1% of primary expenditure by the nonfinancial public sector.² This performance compares favorably with the figures for 2002 and 2003, when poverty spending reached 10.2% and 11.4% of GDP respectively. Of this expenditure, 61.9% represented capital spending, which reached a record high of US\$346.5 million. Within poverty spending, investment in human capital remained the top budget priority, amounting to US\$270.6 million (48.4% of the total) in 2004.
- 1.22 Highlights in the education sector included the expansion of basic education coverage, the rehabilitation and construction of school infrastructure, improvements in the quality of education, and the adult literacy and basic education program. In the health sector, funds were earmarked for improving the coverage and quality of primary care services and for modernizing the hospital system. With respect to social welfare, funds were devoted to expanding the Comprehensive Child Health Care Programs (PAININ) and the Social Safety Net (*Red de Protección Social*, RPS).
- 1.23 With respect to funding sources, external resources remained a determining factor in the poverty reduction strategy, growing at a faster pace during the period 2003/2004: 72.6% of poverty spending in 2004 was financed with external resources (US\$406.4 million), including HIPC debt relief (22.2% of poverty spending). The volume of external funding reflects the willingness of multilateral agencies and bilateral donors to support projects for investment in human capital such as those described, the rehabilitation of roads and highways, the revival of the rural economy, and introduction of the water and sewage system, among others. Domestic sources of financing for poverty spending maintained their programmed pace in 2004, reaching US\$153.2 million.
- 1.24 There have been changes since 2002 in the sources of external financing for poverty spending. The decline in grants has been offset in part by an increase in loans: at the end of 2004, loans showed an increase of 0.9% of GDP, while grants fell by 0.2% of GDP. HIPC funds have also been growing, provided for the most part by multilateral agencies (IDB and the Central American Bank for Economic Integration) and by the Paris Club.
- 1.25 It must be recognized however that, given these figures and the speed with which poverty spending can be increased under the IMF agreement, some of the social targets in the ERCERP and some of the MDGs will not be met within the expected

² Poverty reduction expenditure represents public funds earmarked for financing the ERCERP, especially those targeted at basic service infrastructure, the social safety net, basic education, and primary health.

timeframe. In fact, recent estimates by SECEP show that there will be a US\$835 million shortfall over the period 2004-2015 in the funding needed to achieve the education and health targets, given current budget allocations and rigidities in the makeup of public spending. Under these circumstances, any new budget funds for key sectors such as health, education, and social welfare that might come from external sources such as grants, debt relief, and concessional loans would have to be devoted primarily to increasing the coverage of programs targeted at the poor, in order to maximize the prospects of meeting those targets.

4. Social policy challenges

- 1.26 **Education.** Nicaragua has made progress in improving its education system, but the pace is not sufficient to meet by 2015 the universal primary schooling goal set in the ERCERP and the MDG. A recent study of the current status of education reveals the great challenges still facing the sector. The preschool coverage rate is only 30.7%, for primary school it is 83.5%, and for secondary school 40%. In absolute terms, this means that nearly 800,000 children of school age still fall outside the education system at all its levels.³
- 1.27 One of the groups hardest hit by the lack of coverage are six-year-olds, of whom only 60.4% were enrolled in the education system in 2004. This means that approximately 57,000 boys and girls were registered neither in preschool nor in primary school. Part of the problem here is that primary school regulations require preschool as a condition for entry into the first grade for children under seven years. Together with a shortage of supply at the preschool level, this has meant that many children of this age are excluded from the school system. Unless concrete action is taken to expand the supply of education, current growth trends in the school system and in the population would see the primary school coverage rate worsen by 12 percentage points by 2015.
- 1.28 The system also faces great challenges in terms of quality, as reflected in student advancement and retention rates. The Common Work Plan (PCT) found that only 41% of children entering first grade will complete primary school in the scheduled six years, and of those who do only 30% will have acquired the expected skills in Spanish and only 12% in mathematics. The problem is most acute, in fact, in the first grade: of the 164,674 pupils between the ages of six and seven who enrolled in 2004, only about 60% were promoted to the next grade. This reflects in part the inadequate preparation of the teaching body: it is estimated that 35% of the country's teachers have no professional teacher training, and this group is concentrated at the primary level in the poorest municipios and regions. This situation widens the existing gap between the economically better-off and the poorest population segments, in terms of educational achievement.

³ Common Work Plan (PCT) 2005-2008, Ministry of Education, Culture, and Sports (MECD).

- 1.29 To address these challenges the Ministry of Education, Culture, and Sports (MECD) will need to direct its efforts, at the central, departmental, and municipal levels, to promoting the demand for education and to generating capacity within the system to offer adequate levels of quality to groups currently not attending school. Without losing sight of longer-term goals, the MECD could implement an immediate strategy to address these problems. For example, it could establish and promote the rule of timely enrollment (at age six) in primary school, it could require that primary school teachers have a teaching certificate, and it could strengthen the capacity of the departments (*departamentos*) and municipios to plan and manage increased coverage.
- 1.30 **Health.** Despite steps taken to modernize the health system in recent years, as embodied in the 2003 General Health Act and its regulations, the country is unlikely to meet the ERCERP and MDG goals for maternal and child health by 2015. The system still betrays major problems of coverage in basic health services for the poor, especially in rural areas where the indigenous population is concentrated and in the urban peripheral zones, a situation exemplified by a high profile of morbidity and mortality from avoidable and preventable causes. It is estimated that some 900,000 people lack basic health services or have only limited access to primary health care.
- 1.31 Extending coverage for the poor also poses significant management challenges for ensuring that the target population will actually receive the package of basic health services to satisfactory standards of quality and that the expected results are obtained, especially in the reduction of maternal and child morbidity and mortality. These challenges demand an initial set of regulatory steps to standardize certain key aspects of the process, such as targeting criteria and approval of the Basic Health Services Package (PBSS) for the target population, and openness to the possibility of complementarity between public and private efforts in extending service to the most isolated rural groups.
- 1.32 **Social safety net.** Finally, the main challenge for the Ministry of Family Affairs (MIFAMILIA) is to articulate the budgetary, operational, and administrative aspects of its programs so as to achieve greater coordination and efficiency in its interventions, especially those targeted at the country's most vulnerable groups (for example the 600,000 children under age six that MIFAMILIA and SECEP estimate are living in poverty). This means reinforcing complementarity between the various initiatives focused on this population so as to adjust some of the functions and responsibilities at the central and decentralized levels in order to achieve a gradual transition, without jeopardizing the strengths and the execution of each of these programs.

C. Country strategy

- 1.33 To address these challenges in the context of the ERCERP, Nicaragua has identified a number of social policy priorities in education, health, and social services. In education, the MECD has adopted strategic guidelines for moving toward the millennium goals during the period 2004-2009 and these are embodied in the Common Work Plan (PCT) agreed with the donor community. The first priority is to expand the coverage of quality education at all levels, with a particular focus on primary schooling.
- 1.34 In pursuit of this strategy to achieve greater coverage, the MECD is taking steps to resolve the problems of education supply and demand. On the demand side it is expanding the school meals program, encouraging timely enrollment (at six years), and developing a system of demand subsidies (still under discussion). On the supply side, it is striving to expand and make more efficient use of the system's installed capacity and to manage teaching resources more effectively through programs for professional upgrading and reforms to the Teaching Career Act. The intention is to ensure that the system has enough qualified teachers to handle the expected increase in enrollment.
- 1.35 In the health area, the central feature of the Ministry of Health (MINSA) strategy is the new National Health Policy (PNS). Guided by the PND and the objectives of the ERCERP and MDG, the PNS contains a series of policy guidelines for addressing problems and challenges in the health sector. Of particular importance, for its complementarity and close relationship with the ERCERP objectives of reducing maternal and child mortality, is the strategy to expand the coverage and improve the quality of primary care services in 12 Local Comprehensive Health Systems (SILAIS), which are prioritized by a compound index of health risk.⁴ The core of the strategy is delivery of a PBSS, targeted in particular at the maternal-child population in predominantly indigenous rural areas and in poor urban zones.
- 1.36 In terms of the social safety net, MIFAMILIA is the lead ministry and, in coordination with other social agencies, is responsible for efforts to improve living conditions for the country's vulnerable groups. It also administers directly a series of programs targeted at children and youth, the elderly, and poor families, to facilitate their access to basic social services such as nutrition, education and health. As its main policy priority it works directly with children under the age of six from poor families, especially those who are not yet in school and who have no access to MINSA health units.

⁴ The compound index used for regional targeting was constructed from three indicators relating to: access to health services, poverty, and health status.

D. Bank strategy

- 1.37 The objective of the Bank's strategy is to support the government of Nicaragua in establishing and implementing the steps needed to achieve the ERCERP goals in three priority areas: (i) economic development, (ii) governance, and (iii) productivity for the poorest groups. With its focus on expanding and improving the coverage of social services, especially those targeted at the poor, this operation relates directly to the third strategic area, while at the same time reinforcing movement toward the ERCERP and PND goals in education, health, and the social services.
- 1.38 In this area, the Bank's most pertinent and immediate experience in Nicaragua was with the Social Policy Reform Program to Support the ERCERP (NI-0169; 1114/SF-NI). All the policy conditions under that loan have been satisfactorily fulfilled, and the second and last tranche will soon be disbursed since the Bank has issued a favorable macroeconomic evaluation based on the reactivation of the macroeconomic agreement between the IMF and the country. Because it was approved at the beginning of the current administration's mandate, the primary objective of that operation was to support pending legal reforms in education, health, and social services to help implement the ERCERP and support its immediate and long-term social objectives, while at the same time protecting the budget for priority social programs and monitoring the ERCERP's interim indicators closely.
- 1.39 In education, for example, the Education Participation Act and its regulations have come into force, with the objective of strengthening school autonomy and regulating the following key elements: (i) the administration and management of regular and special transfers of resources to schools; (ii) school board functions and powers, including their ability to hire and dismiss school personnel; and (iii) the functions and powers of parents' associations and teachers' councils. In the health area, the General Health Act and regulations were adopted to strengthen the normative and regulatory role of MINSA, and to regulate the following core elements: (i) the operation, financing, and benefit plans of current contributory, noncontributory, and voluntary systems; (ii) models to promote decentralization, deconcentration, and delegation within the health sector, stressing the transfer of responsibilities and resources; and (iii) the quality assurance system, including licensing and accreditation of medical service providers. In the area of social welfare, a common methodological basis has been adopted for targeting MIFAMILIA programs.
- 1.40 The principal lesson learned from this experience is that the Bank can bring significant value-added to the country's poverty reduction efforts. It does so by helping to establish social policies, regulations, mechanisms, and practices that are essential for moving toward the ERCERP targets and by constantly monitoring that progress through interim indicators that track medium and long-term coverage

objectives. Experience also demonstrates the importance of protecting the budgets for social programs that are essential to meeting those goals. The present operation complements and continues the policies supported under the social policy reform program (NI-0169)(see Annex I).

- 1.41 The Bank's investment programs have also focused financing in support of ERCERP efforts, through such operations as: (i) the Youth and Adult Basic Education Program (1528/SF-NI), the objective of which is to raise the educational level and productivity of young people and adults who either never attended school or dropped out early; (ii) the Education Reform Program (1034/SF-NI), which supported the strengthening of preschool education by supplying teaching materials to 3,420 education centers and training 1,600 teachers, thereby benefiting 45,000 children; (iii) the Maternal-Child Health Improvement Program (1607/SF-NI), the purpose of which was to achieve a series of interim and final health outcomes that would mark progress towards the ERCERP and MDG targets; (iv) the Comprehensive Child Care Program (PAININ) (1081/SF-NI) which used service providers to extend comprehensive care for children under six in the country's 66 most vulnerable municipios, focusing on stimulating early development and preschool education and encouraging timely enrollment for children in the formal education system, together with child weight and height monitoring and counseling services for pregnant women and nursing mothers;⁵ and (v) the Social Safety Net, Phase II (1109/SF-NI), which seeks to improve living conditions for the poor and boost their human capital, using service providers to work with beneficiary families and provide them incentives to look after the education, health, and nutrition of their children.
- 1.42 The principal lesson learned from these investment programs is that they must be accompanied by policies to facilitate their execution, together with adequate protection for financing and counterpart budgets. Both of these requirements can be addressed through the Bank's policy reform programs for bringing greater complementarity to efforts to stimulate the supply of and demand for social services.

E. Program rationale

- 1.43 Nicaragua has accepted the great challenge of overcoming poverty through the ERCERP and PND, but the prospects of meeting that challenge are threatened by persistent gaps in the coverage of basic social services precisely in areas where the country's poor are concentrated. The priority of policies and programs in education, health, and social services must therefore expand quality coverage of primary

⁵ The Bank is currently preparing a new phase of the PAININ (NI-L1009) to provide continuity of service for beneficiary communities and to enhance the quality of the comprehensive care model through innovative interventions in education and nutrition.

education, basic health care, and comprehensive services, respectively, through actions targeted at the most vulnerable groups.

- 1.44 In addressing these strategic challenges, it is clear that the Bank can offer significant value-added if, building on its previous experience with instruments of this type whereby it helped to implement the ERCERP and establish the legal foundation for this effort, it now continues to support ministerial decisions and actions essential for giving effect to those laws and regulations, so as to expand the coverage of basic education, health, and social services and to protect the budgets essential to sustain that effort. As the current administration's term draws to an end, the social policy measures and ministerial decisions adopted now are critically important because they will lay the basis for ongoing efforts to expand basic social services and maintain progress towards the social targets of the ERCERP. It is equally important that priority be given to protecting the budgets of the programs most directly relevant to expanding the coverage of basic social services.
- 1.45 Recognizing the importance of external financing for achieving the ERCERP and MDG targets, especially in the social sectors, coordination with the international community is essential for achieving the synergies needed to convert that support into tangible outcomes. The Bank has joined forces with donors under the initiative to provide global budgetary support to the country for addressing these challenges. In furtherance of such synergies, this program seeks in particular to support social policy actions relating to the global budget support initiative and, to the extent possible, includes similar interim coverage indicators for monitoring and evaluation. At the same time, the Bank is maintaining close coordination with the international community to support sector initiatives such as the Common Work Plan headed by the MECD, and the sector-wide health focus (ESS) led by the Ministry of Health.

II. THE PROGRAM

A. Objectives and description

- 2.1 The general objective of the operation is to place Nicaragua in a better position to achieve the social targets of the ERCERP, the PND and the MDGs by supporting policy measures and protecting the budgets of priority social programs that will expand and improve coverage in primary education, basic health care, and comprehensive care targeted specifically at children under six, the most vulnerable population group. More specifically, the idea is to help the social sector ministries themselves take the decisions and actions needed to expand and improve the coverage of these basic social services. The operation will also protect budgetary allocations and establish execution targets so that the social programs that are key to this effort can be effectively implemented and can meet a realistic coverage goal for the target population. All of the foregoing will be accompanied by monitoring and evaluation of the interim coverage indicators adopted in the PND for tracking progress towards the final outcomes targeted by the ERCERP and the MDGs.

B. Program structure

- 2.2 The program includes three areas of action (see the Program Policy Matrix in Chapter V): (i) a stable macroeconomic setting; (ii) strategic actions in the social sectors; and (iii) budget support for priority social programs.

1. The macroeconomic setting

- 2.3 As a general condition of disbursements, the government will maintain a macroeconomic framework consistent with program objectives for the duration of the operation.

2. Strategic actions in the social sectors

- 2.4 The program will support the following strategic actions in education, health, and social services, with a view to achieving the ERCERP and MDG targets:

a. Education

- 2.5 Since the country's primary education coverage is still low and an improvement requires not only adequate financing but also stronger institutional capacity and an appropriate regulatory framework, the program will support the MECD in developing and implementing a series of policy actions to expand coverage and improve the retention rate in primary education.

- 2.6 For the first tranche, it must be demonstrated to the Bank's satisfaction that: (i) a ministerial resolution is in force making it compulsory for six-year-olds to be enrolled in first grade, whether or not they have had any preschool; (ii) a ministerial resolution is in force requiring that first-grade teachers be preferably certified, and establishing mechanisms to verify certification; (iii) evidence that the 19 departmental offices and their corresponding municipal seats, and the 20 education secretariats of the decentralized municipios have received from the MECD basic, municipio-specific statistical information and have been trained in using that information for planning the expansion of enrollment coverage; and (iv) a labor market study has been designed and commissioned to examine the various factors (regulations, salary and nonsalary incentives, training and contracting procedures) that affect the demand for and supply of qualified teachers.
- 2.7 For purposes of the monitoring process, for the second tranche it must be demonstrated to the Bank's satisfaction that: (i) the student enrollment in first grade at the beginning of the 2007 school year is bigger by 8,000 pupils than at the beginning of the 2005 school year; (ii) there is a positive trend in the indicators⁶ agreed for measuring progress against the standards set in the first tranche for accreditation of first-grade teachers; (iii) at least the 19 departmental municipal seats and the 20 education secretariats of the decentralized municipios have drawn up enrollment expansion plans for the 2007 school year in accordance with guidelines issued by the departmental offices. Those plans will contain: (a) an assessment of unmet demand; (b) a mapping of education supply and municipal education resources; and (c) strategies for increasing education demand and supply; and (iv) draft amendments to the Teaching Career Act providing incentives for training, recruitment, and retention of qualified teachers.
- 2.8 As one result of these education policy measures, it is expected that 8,000 children will be added to the six-year-old student population for 2007, representing an increase in the net primary school coverage rate of approximately four percentage points. At the same time, there is expected to be significant decline, estimated at 10%, in the proportion of uncertified first-grade teachers, thereby raising the quality and the retention capacity of primary schooling. Lastly, 39 municipios are expected to have enrollment expansion plans and strategies suitably supplemented with initiatives to foster education demand.

b. Health

- 2.9 As there are still problems of coverage in basic health services for the poor, particularly in rural areas with a heavy indigenous element and in low-income urban pockets, the program will help MINSA implement a series of regulatory and

⁶ These indicators will include alternatives such as professional development for teachers, reassigning certified teachers to the first grade within the same school, hiring certified teachers for new first-grade classes, or replacing uncertified teachers.

policy measures for expanding coverage, which will mean a major improvement in the delivery of basic health services for the poor, especially for women of childbearing age and for children under five years. Success in achieving this expanded coverage will depend to a large extent on decentralizing the organization and supervision of the social safety net to the SILAIS, and achieving complementarity between public and private service providers.

- 2.10 For the first tranche of the program, it must be demonstrated to the Bank's satisfaction that: (i) a ministerial resolution has approved the targeting criteria for identifying PBSS beneficiary groups in the SILAIS and in the prioritized municipios; (ii) a ministerial resolution has approved the PBSS for the target population, containing at least the specifications, frequencies and protocols for services to women of childbearing age and children under five years; and (iii) a model management agreement has been entered into with public health units and model management contracts with noninstitutional service suppliers, including actions to extend coverage to the target population, as well as care protocols and the associated resources.
- 2.11 For the second tranche, it must be demonstrated to the Bank's satisfaction that: (i) PBSS coverage has been expanded by 150,000 beneficiaries among the target population in the 12 prioritized SILAIS; and (ii) at least 17 management contracts have been signed with public health units, and at least three SILAIS have signed management contracts with noninstitutional providers.
- 2.12 As a direct result of these measures, the estimated coverage gap for primary health care is expected to be reduced by 17% by 2007, providing the PBSS for an additional 150,000 persons, primarily mothers and children, who will now have access to a basic set of health services with standardized care protocols. At the same time, the expansion of basic health coverage will involve a suitable mixture of public and private suppliers, which should generate additional incentives for improving the quality of care.

c. Social safety net

- 2.13 There is little coordination between the institutional social service programs offered directly by MIFAMILIA, a situation that constrains efficiency, generates duplication of efforts, and reduces the impact of interventions. The present program will coordinate the social service programs run by MIFAMILIA more effectively so as to ensure more integrated management and more efficient activities for the country's poorest people. MIFAMILIA will also be given help in maintaining at least the PAININ's current coverage (87,000 beneficiaries), which focuses primarily on education and nutrition for poor children under the age of six.
- 2.14 The first tranche calls for submission, to the Bank's satisfaction, of the technical proposal for budgetary, programming, operational, and administrative integration of

the social service programs of MIFAMILIA. For purposes of continuity, under the second tranche, it must be demonstrated to the Bank's satisfaction that: (i) a ministerial resolution on budgetary, programming, operational, and administrative integration of the social welfare programs of MIFAMILIA is in effect; and (ii) an annual average of around 87,000 poor children under six are receiving comprehensive care services from MIFAMILIA.

- 2.15 This support will allow MIFAMILIA to keep providing comprehensive care to 15% of the target population under 6 years, while at the same time improving its efficiency in administering the social safety net programs that it runs directly.

3. Budgetary protection for priority social programs

a. Selection criteria

- 2.16 The limited capacity for expanding public spending, including the social budget, poses a threat to the activities and coverage targets supported by the program. In education, priority is given to those budget items directly related to raising enrollment, since they will serve both to expand supply and to finance demand. Using this technical criterion, the following items have been selected for budgetary protection: (i) transfers to educational centers (including an enrollment-linked bonus), because they ensure availability of teaching materials and funds to pay teachers; (ii) transfers to municipal education secretariats, because they provide planning and administrative support to the system at the local level; (iii) training grants and professional development studies, because they support initial training for the new teachers needed to meet the increasing demand expected over the next three years; (iv) maintenance and repair of buildings and facilities, and construction of privately owned facilities, because they will ensure that classrooms are available for the new students; and (v) the Comprehensive School Nutrition Program (PINE), because its purpose is to provide meals for students and to have a favorable impact on demand for education, and on retention and promotion rates.
- 2.17 In the health field, priority will be given to the Expanded Coverage Program that finances delivery of the PBSS through governmental and nongovernmental institutions to people in poor rural and urban areas. As well, the Program for Improving Primary Health Care Units is focused in the 12 priority SILAIS and is intended to rehabilitate facilities and equipment for those units. At the same time, to improve quality and facilitate PBSS delivery for more complicated cases, the second level of care will be strengthened through the Hospital Construction and Rehabilitation Program. That program focuses on strengthening the "critical path" (i.e. perinatal and neonatal services, operating room and emergency procedures). Protection of budget lines for medicines, pharmaceuticals, and medical equipment, as well as equipment maintenance, will safeguard the recurrent inputs needed to deliver critical primary and secondary services of high quality on a sustainable basis.

- 2.18 In the area of social protection, budgetary priority will be given to PAININ so it can continue to provide comprehensive care for poor children under six. Protection for this program will maintain coverage for 87,000 poor children in 66 low-income municipios. This is a strategic activity in terms of giving beneficiaries greater opportunities to enter the formal education system at the appropriate age. Besides PAININ, a number of budget lines will be protected relating to MIFAMILIA's operating expenses, so that its local offices can provide care to the most vulnerable groups.
- 2.19 In terms of evaluating the main education programs or budget lines to be protected, there is information available on the school autonomy process supported by school transfers. That evidence shows that school autonomy allows principals and parents to assume a greater role in school management; it has a slight but meaningful effect on student academic performance; and it improves internal efficiency indicators, since autonomous centers have lower dropout and repetition rates than the centralized institutions. Other research has found that schools under the participatory system showed an advantage over the medium term: their repetition rates declined from 16.5% to 8.44% in seven years, and the proportion of uncertified teachers fell from 23% to 19% between 1998 and 2004.⁷
- 2.20 In the health area, available evidence relates to efforts to expand coverage of primary health care, a goal that is supported by all the protected budget lines. That evidence shows in general that programs designed to support a limited number of interventions do so with greater success than those that embrace a larger number of activities. Also, three of the 14 programs evaluated are operating outside the public facilities and health posts, working directly with the community, and it is these that show the best performance indicators. Such findings highlight the need to work with a basic package of clearly defined services and to involve noninstitutional service providers.⁸
- 2.21 Lastly, when it comes to protecting the most important budget line for MIFAMILIA, the interim evaluation of PAININ showed that criteria for targeting beneficiary communities have been strengthened and that programs are now focused on areas with the greatest number of at-risk households, and that at the same time performance-based pay mechanisms have been introduced for entities providing health and early childhood development services. The evaluation also demonstrates a positive impact on the use of education services: a net increase of

⁷ See the study by Arcia, Porta, and Laguna (2004) "Autonomía Escolar de Nicaragua: Aceptación y percepción en 2004", published online by MECD. See also the study by Castro (2004) "Contratos Laborales Docentes y su Impacto en los Indicadores de Educación para Todos", posted online by the International Institute for Educational Planning.

⁸ See the study by Bitrán y Asociados (2004) "Evaluación de los Programas y Proyectos en Apoyo de la Atención Primaria de Salud", published by the Technical Secretariat to the Office of the President of Nicaragua.

42.7% in attendance at early childhood programs, and a net increase of 17.7% in first-grade enrollment for six-year-olds leaving the PAININ program.⁹

b. Policy actions

- 2.22 In light of the foregoing, this area of policy actions seeks to protect nonwage budgets for education, health, and social programs regarded as priorities for increasing coverage and improving the targeting of basic social services for the poorest population groups. In protecting budgets for these programs, the government is not, however, committed to increasing the social sector budget during the program, and consequently there should be no impact on the fiscal deficit. What is involved, in fact, is a reallocation and a real effort to target and spend resources more effectively so that the coverage of basic services can be broadened with the same budget resources.
- 2.23 From this perspective, the first tranche of the operation calls for presentation to the Bank's satisfaction of evidence that the National Budget for 2006 has the corresponding budgetary allocations for the protected amounts agreed in Annex II. For the second tranche, it must be demonstrated, to the Bank's satisfaction, that: (i) budgetary spending for 2006 represents at least 80% of the total amounts protected for each sector, in accordance with Annex II; (ii) the national budget for 2007 contains corresponding budgetary allocations for the protected amounts consistent with Annex II; and (iii) budget spending for 2007 is at least (a) 30% of the total protected for each sector as shown in Annex II, if the disbursement request is submitted within 30 days after the close of the first half of 2007, or (b) 80% of the total protected for each sector as shown in Annex II, if the request is made after that date.
- 2.24 To summarize, all these programs have been protected because they are the best targeted ones and because they are the ones that will do most to improve the coverage of basic social services and thereby help achieve the interim targets of the ERCERP. In comparative orders of magnitude, budget protection for 2006 represents about 16% of total spending on poverty in 2004, and 32% of the portion of total poverty spending invested in human capital. By stressing budget protection for social spending, the proposed program is consistent with the global budget support initiative led by the international community of donors.

C. Cost and financing

- 2.25 The cost of the program is US\$30 million and it will be financed from the Bank's Fund for Special Operations (FSO). The size of the operation is justified given the resources needed to carry out the set of policy actions planned for the various social

⁹ See the final report of ESA Consultores (2004), "Mid-term Evaluation of the Comprehensive Child Care Program for Nicaragua (1081/SF-NI)", available in the operation technical files.

sectors, and the economic authorities' forecasts of the amounts needed to maintain an adequate external reserves position and/or to cover budget gaps within the external funding program contained in the arrangement with the IMF. Hence, the resources provided under this operation will represent a significant portion of the Bank's programmed disbursements for Nicaragua, estimated at US\$160 million for 2006, disbursements that are in turn a significant portion of total external financing requirements for that year, which the IMF estimates at US\$1.085 billion.

III. PROGRAM EXECUTION

A. Borrower and executing agency

- 3.1 The borrower will be the Republic of Nicaragua, and the Ministry of Finance (MHCP) will be the executing agency, in coordination with the Presidential Office for Coordination and Strategy (SECEP). The Ministry of Education, Culture, and Sports (MECD), the Ministry of Health (MINSA), and the Ministry of Family Affairs (MIFAMILIA) will have technical responsibility for implementing the proposed activities and measures.

B. Project execution and administration

- 3.2 Responsibility for coordination and execution will fall to the MHCP, acting through the Office for Fiscal and Economic Affairs and in the Directorate of Budget, especially for monitoring protection targets and budget performance through the SIGFA. In this role, the MHCP will: (i) serve as the government's primary technical liaison with the Bank; (ii) ensure that resources earmarked for budgetary protection under the program are properly allocated; (iii) administer quick-disbursing funds in accordance with Bank rules for policy-based loans; and (iv) compile and submit to the Bank information required for approving disbursements under each tranche, including background and documentation demonstrating that the policy conditions in the loan contract have been fulfilled.
- 3.3 The SECEP, through the Social Sector Coordination Office, will see to technical coordination of the social sector ministries (MECD, MINSA, and MIFAMILIA), in carrying out the strategic policy actions and monitoring the interim coverage indicators, compiling evidence of fulfillment of policy conditions and reporting progress against the MHCP monitoring indicators. The SECEP will therefore be responsible for: (i) supervising activities by the social institutions participating in the program, especially with respect to the policy triggers for disbursing the two loan tranches; (ii) monitoring progress in fulfilling the agreed policy conditions for the second tranche by preparing semiannual reports that include information on the interim coverage indicators; and (iii) presenting to the Bank, through the executing agency, a final evaluation report on the program.
- 3.4 The MECD (through its Directorate of Forecasts and Policy), the MINSA (through its Directorate for Planning and Development) and MIFAMILIA (through its Directorate of Strategic Development and Planning) will have technical responsibility to the SECEP for reporting on the progress of the policy measures relating to budget protection as agreed with the MHCP and for ensuring timely fulfillment of the strategic actions and the agreed budget execution goals. They will also report on progress against the indicators of the program's monitoring and evaluation system, as frequently as their information systems permit.

- 3.5 The MHCP, the SECEP, and the participating social agencies will designate technical coordinators who will have operational responsibility within their respective areas of activity and will ensure that the documentation required by the Bank for approving disbursements is delivered on time and in the proper form. This execution and coordination scheme, which gives preference to the line departments of all the participating ministries, could be technically and administratively reinforced, insofar as is strictly necessary, through initiatives now under way for the institutional strengthening of the Nicaraguan public sector.
- 3.6 For purposes of program execution and to ensure compliance with the agreements in the Policy Matrix, execution and cooperation agreements will be signed between the MHCP, as the executing agency, and SECEP, MECD, MINSA, and MIFAMILIA as participating agencies. Those agreements will establish the terms and conditions that enable the MHCP to submit timely disbursement requests to the Bank: consequently, the Policy Matrix as well as the Loan Contract will form an integral part of those agreements. Because of their importance, submission of these agreements, signed by the highest ministerial authorities, will be a special condition of eligibility for the first disbursement.

C. Execution period and disbursement schedule

- 3.7 The execution period will be 24 months. The financing will be disbursed in two tranches of US\$15 million each, given the importance of the policy actions agreed for each tranche. In line with the expected timing of the agreed policy actions, the first tranche is expected to be disbursed in the first quarter of 2006, and the second in the third quarter of 2007.

D. Disbursement triggers

- 3.8 The disbursement of each tranche will be conditional on fulfillment of the agreed policy actions as set forth in Chapter II and in the Policy Matrix in Chapter V of this loan document. The first tranche will also be subject to the general conditions precedent to the first disbursement that are part of all policy-based loan contracts.
- 3.9 The project team will assess the information submitted by the country on compliance with the agreed policy actions and will prepare the corresponding reports for the Bank's Management and Board of Executive Directors, for purposes of authorizing disbursements in accordance with Bank policy.

E. Program monitoring and evaluation

- 3.10 In light of the execution period established for this program, it has been agreed with the executing agency that semiannual monitoring reports will be submitted to confirm compliance with the policy actions, especially for approval of the second disbursement. To this end, the budget items that will be monitored have been clearly codified so that expenditure under each protected line item can be

pinpointed and confirmed. Thus the monitoring reports will show the progress achieved by the executing agency, against key milestones agreed with the Bank for the strategic actions and for budget execution. Those milestones will also provide early warning of any slippage so that corrective actions can be taken to ensure fulfillment of all the agreed policy actions.¹⁰

- 3.11 For the final valuation of the program, which will be included in the Project Completion Report, a series of midterm tracking indicators has been agreed with the Nicaraguan authorities to gauge performance against the planned actions and measures. A 2004 baseline has been established for the following interim coverage indicators: (i) *education*: the number of six-year-olds enrolled in first grade, the first-grade dropout rate, and the percentage of first-grade teachers who are uncertified; (ii) *health*: coverage ratios for early pregnancy detection, the fourth prenatal checkup, institutional childbirth, tuberculosis vaccination, pentavalent vaccination, and polio vaccination; and (iii) *social safety net*: number of poor children under six receiving care through PAININ. Targets for each of these coverage indicators have been established for the years 2005, 2006, and 2007, designed to show progress against the 2004 baseline or, in the case of PAININ, to demonstrate that coverage has at least been maintained. Annex III describes the baselines and the targets for each of these performance indicators.
- 3.12 Given the importance of this operation for achieving the ERCERP and MDG targets, a series of outcomes indicators has also been agreed for measuring the program's effectiveness in terms of its contribution to social indicators such as primary school enrollment, and maternal and child mortality rates. These outcome indicators are shown in Annex III, with a baseline for 1990 and sets of targets to 2010 and 2015: the first set relates to post review of the program, and the second to the international community's commitments under the MDGs.
- 3.13 Consistent with existing policies and procedures, the Nicaraguan authorities were asked about their interest in a post review of the program. They expressed the wish that such an evaluation not be carried out, but are committed to maintaining information on the performance indicators referred to in Annex III and making it available to the Bank should a post review of the program be necessary.

F. Policy letter

- 3.14 The Bank concurs with the borrower on the policies outlined in the Policy Letter attached as Annex IV to this document. That letter summarizes the economic and social policies pursued by the Government of Nicaragua and the status of the arrangement with the IMF. It also refers briefly to the main contents and

¹⁰ The report on fulfillment of policy actions for the second tranche will include as background a summary of outcomes of the final evaluation in the Project Completion Report for the Social Policy Reform Program in Support of the ERCERP (NI-0169 – 1114/SF-NI).

achievements of the ERCERP and the National Development Plan in the social areas, and describes the strategic actions that the proposed operation will support to expand the coverage of basic social services, and their importance to the country.

G. Eligibility of expenditures

- 3.15 The resources from the quick-disbursing policy-based loan may be used to finance the aggregate foreign-currency cost of eligible imports from Bank member countries. In this case, Bank procedures for policy-based lending, as established in Document GN-2001-2, will apply. The funds will be disbursed when the borrower so requests, upon presentation of evidence that all contractual conditions have been met to the Bank's satisfaction.

H. External audit

- 3.16 The Bank reserves the right to ask the borrower to present financial reports on the use of resources from the loan, audited by independent auditors acceptable to the Bank. To this end, the borrower undertakes: (i) to keep separate accounting records and supporting documentation for any external audits or verification of the use of resources that may be requested; (ii) to keep a segregated bank account in which the loan funds will be deposited; (iii) to prepare disbursement requests and present them to the Bank; and (iv) not to use loan funds to purchase articles on the negative list or for procurement of goods from countries that are not IDB members.

I. Inspection and supervision

- 3.17 The Bank will establish such inspection procedures as may be deemed necessary for satisfactory execution of this policy reform program. To that end, the borrower, through the executing agency, will cooperate fully and provide all the necessary information and assistance. The project team, working closely with the Bank's Country Office in Nicaragua, will be responsible for supervising the program on the basis of the reports and the monitoring and evaluation tools agreed in this loan document. At the request of the Country Office, administration and technical supervision missions will be conducted as necessary for optimum execution of the program; in principle, they will take place on at least a semiannual basis.

IV. FEASIBILITY AND RISKS

A. Feasibility

- 4.1 Given the political difficulties Nicaragua is currently experiencing, every effort has been made to reconcile this policy support operation with a national focus and to secure a political and social commitment that extends beyond the mandate of any one administration. In this respect, the ERCERP has the support of all segments of Nicaraguan society, of the country's political parties, and of the international donor community, as a medium and long-term strategy for reducing poverty. The broad public participation in formulating that strategy gives it legitimacy and a solid foundation for its execution. Moreover, within the context of the ERCERP, initiatives by the international community such as the HIPC are linking the release of funding to the financing of poverty reduction expenditure, thereby lending international backing and financial sustainability to these efforts.
- 4.2 In terms of institutional viability, one important factor affecting the success of this operation is the agreements that have been reached on its execution mechanisms, whereby it is the line departments in the participating ministries that will exert the technical and operational leadership, with specialized technical and administrative support from initiatives now under way to strengthen public-sector institutions. This is helping to create a more permanent institutional management capacity within the MHCP, SECEP, MECD, MINSA, and MIFAMILIA, and means that the know-how acquired can be applied beyond the execution horizon of this transaction, while avoiding duplication of functions and the potential organizational conflicts that can emerge when coordination units work in isolation from line departments.
- 4.3 With respect to technical feasibility, this program is being meshed as closely as possible with the ERCERP in order to expand and improve the coverage of basic social services such as primary education, primary health care, and comprehensive care for children under six, which are priorities for helping the poor of Nicaragua. Thus the strategic actions sponsored by the program, the protection accorded priority budget items of social sector ministries, the coverage goals for the target population, and the monitoring of interim tracking indicators are all fully consistent with the country's expectations that it will be able to progress more readily toward the ERCERP and MDG goals. These actions were negotiated in close coordination with the participating social sector ministries and they can count on the MHCP's budgetary support and the SECEP's monitoring, factors that enhance the prospects that they will be implemented as planned and will be sustainable over the longer term.

B. Social and environmental impact

- 4.4 Because of its concentration in the social sectors and the expected benefits that will flow from it, this operation qualifies as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). Because it is a policy-based operation, it does not qualify as a poverty-targeted investment (PTI).
- 4.5 Because of its design characteristics, this operation will have no direct impact on the environment and no environmental precautions will need to be taken during its preparation and execution. Budgetary protection for investment programs intended to expand the coverage of basic social services relates to existing programs that have been evaluated as consistent with the country's environmental policies and those of international financial organizations.
- 4.6 With respect to cultural appropriateness, the MHCP has placed much emphasis on adjusting the educational materials and the teacher training modules to the multicultural and bilingual context of the Región Autónoma Atlántica Norte (RAAN) and the Región Autónoma Atlántica Sur (RAAS) at all educational levels. It is expected that at least 9% of the overall increase in first-grade enrollment coverage under the present initiative will target the indigenous population, given its current representation in total first-grade enrollment.
- 4.7 It is also important to note that the MINSA already has in place a legislative, regulatory, and technical framework that gives special treatment to the country's ethnic groups, as embodied in particular in the National Health Act and its regulations. In terms of primary care for rural areas, to be delivered by institutional and noninstitutional providers, the MINSA has clear guidelines and special criteria for selecting those service providers, especially in the indigenous communities of RAAN and RAAS. Those criteria include recognizing the existence of service providers in beneficiary communities, the availability of local support, and gender and linguistic considerations, with a view to enhancing quality and community ownership of services delivery. In this line of work, it is estimated that the expanded coverage of the basic health services package for indigenous people will benefit 27,874 women of childbearing age and 9,814 children under one year in RAAS and RAAN.
- 4.8 With respect to MIFAMILIA activities, the PAININ offers services to most of Nicaragua's indigenous peoples and communities: it is involved in eight of the 22 legally recognized indigenous communities, including Waspam and Puerto Cabezas in RAAN, which are the two municipios of Nicaragua where the Miskita population constitutes the absolute majority. The PAININ in fact serves 11,212 indigenous children under the age of six, representing 13% of all the children served in the country. The services that this program provides have been adapted to the culture and specific characteristics of Nicaragua's indigenous zones. For

example, teaching materials used by PAININ, such as the manuals entitled “*Mira Cómo me Desarrollo*” and “*Expediente de la Familia*” have been published in the Miskita language and draw upon this culture for their images and graphic presentations. In addition, more than 850 people born and living in the indigenous communities have been trained as promoters and volunteer mothers, in a move to ensure the cultural relevance of program activities.

C. Benefits

- 4.9 With the boost that this operation will give to strategic actions to increase the coverage of basic social services, and the budgetary protection it will provide for priority programs in education, health, and social welfare, the country should be in a better position to meet the ERCERP and the MDG goals, by ensuring that more children from low-income groups complete primary education, that they and their mothers face less risk of disease and of dying at birth, and that the nutritional and educational status of vulnerable groups (represented by children under the age of six living in poverty) can be improved.
- 4.10 By the end of the program there will be in place a set of regulations and actions that will be important for making further progress towards the coverage objectives for basic education, primary health care, and protection for vulnerable groups, backed by clearly defined coverage objectives for the target population, as stipulated in the Policy Matrix. At the same time, and as a direct result of this operation, there should be improvements in the coverage indicators for net six-year-old enrollment, prenatal health checks and immunization, nutritional services, and preschool education for children under six.

D. Risks

- 4.11 The main risk to this operation lies in the current political tensions between the executive branch and the legislature, which have sharpened as the current administration nears the end of its term and which constitute a source of instability that not only makes further policy reforms very difficult but also threatens the sustainability of the policies adopted to date. To mitigate this risk, the operation focuses on supporting the social targets of the ERCERP and the MDG, which are not only a priority of the current government but represent a national policy that will endure despite political difficulties. In recognition of this special situation, the operation is to be supported by a selected set of policy actions that come under the direct purview of the social sector ministries and give tangible expression to a series of policy decisions that are key to the poverty reduction strategy.
- 4.12 Another significant risk is the potential for resistance on the part of unions and professional groups in the social sectors, which could obstruct progress with the ERCERP through work stoppages or strikes, especially in education and health. To mitigate this risk, the authorities have agreed on the importance of maintaining and

deepening dialogue with all stakeholders, and especially with the people who will benefit from the expansion of basic social services, in the hope that the public will become a strong partner in pursuing the ERCERP and the PND.

V. POLICY MATRIX

Problem	Action	Impact	Disbursement conditions	
			First tranche	Second tranche
I. Macroeconomic setting				
Instability and weak economic growth impede efforts to expand coverage of social services in pursuit of the ERCERP	Help the country to close the external and domestic resource gaps so as to maintain economic stability and spur growth.	Contribute to sustained economic growth as a basis for macroeconomic stability	The macroeconomic framework remains consistent with program objectives	The macroeconomic framework remains consistent with program objectives
II. Strategic actions in the social sectors				
A. Education				
Primary education coverage is still low, and requires not only sufficient financing but also an appropriate institutional structure and regulatory framework for addressing this challenge in a coordinated and sustainable manner.	Help the MECD develop and implement policies to expand coverage and improve the retention rate in primary education.	Improved access and retention rates for the school system, thereby enhancing prospects that the ERCERP and MDG goals can be met.	<p>A ministerial resolution is in force making it compulsory for six-year-olds to be enrolled in first grade, whether or not they have had any preschool.</p> <p>A ministerial resolution is in force requiring that first-grade teachers must preferably be certified, and establishing mechanisms to verify certification.</p> <p>Evidence that the 19 departmental ministry offices, their municipal seats and the 20 education secretariats of the decentralized municipios have received from the MECD basic, municipio-specific statistical information and have been trained in using that information for planning the expansion of enrollment coverage.</p>	<p>Enrollment in the first grade at the beginning of the 2007 school year is bigger by 8,000 pupils than at the beginning of the 2005 school year.</p> <p>There is a positive trend in the indicators agreed for measuring progress against the standards set in the first tranche for the professional accreditation of first-grade teachers.</p> <p>At least the 19 municipal seats and the 20 education secretariats of the decentralized municipios have drawn up enrollment expansion plans for the 2007 school year in accordance with guidelines issued by the departmental offices. The plans must contain: (i) an assessment of unmet demand; (ii) a mapping of education supply and municipal education resources; (iii) strategies and plans for increasing education demand and supply.</p>

Problem	Action	Impact	Disbursement conditions	
			First tranche	Second tranche
			Design and commissioning of a teacher market study to analyze the different factors (regulatory, salary and nonsalary incentives, training, hiring systems) affecting demand for qualified teachers and the supply in the country.	Draft amendments to the Teaching Career Act providing incentives for training, recruitment and retention of qualified teachers.
B. Health				
There are still major problems of coverage in basic health services for the poor, especially in rural areas where the indigenous population is concentrated and in the urban peripheral zones, a situation exemplified by a high profile of morbidity and mortality from avoidable and preventable causes.	Support and sustain a set of public health policy priorities aimed at expanding coverage, which will require a significant improvement in the delivery of basic health services to the poor.	Improve health conditions for the target population, primarily mothers and children living in poverty and social exclusion, thereby enhancing the prospects of meeting the ERCERP and MDG goals	<p>Ministerial resolution approving the targeting criteria for identifying PBSS beneficiary groups in the SILAIS and in the prioritized municipios.</p> <p>Ministerial resolution approving the PBSS for the target population, containing at least the specifications, frequencies, and protocols for services to women of childbearing age and children under five years.</p> <p>Model management agreement with public health units and model management contracts with noninstitutional service suppliers, including actions to extend coverage to the target population, as well as care protocols and the associated resources.</p>	<p>PBSS coverage has been expanded by 150,000 beneficiaries among the target population in the 12 prioritized SILAIS.</p> <p>At least 17 management contracts have been signed with public health units, and at least three SILAIS have signed management contracts with noninstitutional providers.</p>
C. Social protection				
The lack of coherence among the social protection programs run by MIFAMILIA constrains efficiency, generates duplication of efforts, and reduces the impact of interventions for the poor.	Implement an integration strategy for articulating social protection programs and improving the quality and efficiency of service delivery to vulnerable groups.	More and better coverage of social safety net services for the vulnerable groups, particularly for children under the age of six.	Presentation of the technical proposal for budgetary, programming, operational, and administrative and financial integration of the social protection programs of MIFAMILIA.	<p>Ministerial resolution on budgetary, programming, operational, and administrative and financial integration of the social protection programs of MIFAMILIA.</p> <p>An annual average of around 87,000 poor children under six are receiving comprehensive care services from MIFAMILIA.</p>

Problem	Action	Impact	Disbursement conditions	
			First tranche	Second tranche
III. Budget protection for priority social programs				
The limited capacity for expanding public spending, including the social budget, poses a threat to the activities and coverage targets supported by the program	Protect non-wage budgets for education, health, and social programs of priority for increasing coverage of basic social services for the poorest population groups.	Comprehensive improvement in social service coverage for the poorest population, thereby improving prospects of meeting the ERCERP and MDG goals.	The National Budget for 2006 has made the corresponding budgetary allocations for the protected amounts agreed in Annex II	<p>Budgetary spending for 2006 represents at least 80% of the total amounts protected for each sector, in accordance with Annex II.</p> <p>The national budget for 2007 contains the corresponding budgetary allocations for the protected amounts agreed in Annex II.</p> <p>Budget spending for 2007 is at least (i) 30% of the total protected for each sector as shown in Annex II, if the disbursement request is submitted within 30 days after the close of the first half of 2007, or (ii) 80% of the total protected for each sector as shown in Annex II, if the disbursement request is submitted after that date.</p>

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/___

Nicaragua. Loan ____/SF-NI to the Republic of Nicaragua
Social Sector Program in Support of the Enhanced
Strategy For Economic Growth and Poverty
Reduction (ERCERP)

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 Republic of Nicaragua, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a social sector program in support of the enhanced strategy for economic growth and poverty reduction (ERCERP). Such financing will be for the amount of up to US\$30,000,000, 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 Financial Terms and Conditions and the Special Contractual Conditions of the Executive Summary of the Loan Proposal.

(Adopted on __ _____ 2006)

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NI-0183

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