

FOOD AND AGRICULTURAL PRODUCTION REVITALIZATION PROGRAM

(NI-0014)

EXECUTIVE SUMMARY

BORROWER AND GUARANTOR: Republic of Nicaragua

EXECUTING AGENCIES: National Rural Development Program [Programa Nacional de Desarrollo Rural] (PNDR) and the Ministry of Agriculture (MAG)

AMOUNT AND SOURCE:

IDB:	US\$40.00 million (FSO)
Local counterpart funding:	US\$ 4.63 million
Total:	US\$44.63 million

FINANCIAL TERMS AND CONDITIONS:

Amortization period:	40 years
Disbursement period:	4 years
Grace period:	10 years
Interest rate:	1% during the grace period and 2% thereafter
Inspection and supervision:	1%
Credit fee:	0.5%

OBJECTIVES: To contribute to a sustainable increase in the food and agriculture sector's competitiveness so as to maximize that sector's contribution to the economic growth essential to relieve poverty. The specific goal is to increase rural income and employment. Accordingly, the program contains measures to help boost the Nicaraguan campesino family's productivity and will equip small- and mid-size farmers with the productive resources required for sustained growth.

DESCRIPTION: The program has two components:

1. **Support to rural development** (US\$34.64 million)

This component will be carried out by the National Rural Development Program (PNDR). In terms of economic policy, it represents an infusion of nonreimbursable resources to low-income rural communities to finance productive investments in activities that the revitalization strategy considers essential: (a) enhancement of human capital through training, organization and technology-transfer projects; (b) better use of renewable natural resources; (c) rehabilitation and enhancement of

productive infrastructure; and (d) improved access of small producers to product and input markets.

With this component, beneficiary communities will have a hand in identifying, ranking, preparing and implementing productive projects and contribute to their financing. Extension and administrative agencies – specialized public or private agencies, nongovernmental organizations, organized labor groups and local governments – will be involved to assist the executing agency with project preparation and implementation.

Projects eligible for financing are those that have been prepared and analyzed according to predetermined methods, which includes computation of the economic internal rate of return and an analysis of cost-effectiveness, depending on the amount of the planned investment. The typology of eligible projects consists of the following categories: (a) projects that strengthen production incentives and access to markets, such as rehabilitation of rural roads and construction of collection centers; (b) projects that improve that access by supplying such marketing services as technical assistance to form and manage marketing cooperatives and for postharvest handling; (c) projects that improve the productive-resource base by building up the supply of physical capital, such as small irrigation systems, soil conservation works and practices, and communal nurseries; and (d) projects that improve the productive-resource base by building up human capital through such means as technology transfer and technical assistance in farm and business management.

2. Institution-strengthening (US\$2.22 million)

Subcomponent 2.A: Institutional strengthening of the Agriculture Ministry. The purpose of this component is to support the Ministry of Agriculture (MAG) in its efforts to: (a) establish a new institutional structure for the agricultural sector by developing its new organizational configuration and reshaping its relationship with the agencies in the sector; (b) strengthen the analytical skills needed to prepare policy and monitor the sector's performance; and (c) help develop capacities for better institutional management.

Subcomponent 2.B: Institutional strengthening of the PNDR. This subcomponent will improve the PNDR's management and internal controls and its capacity to

monitor and evaluate the results of projects it finances.

**ENVIRONMENTAL
PROCEDURES:**

The Committee on Environment and Social Impact (CESI) reviewed the program's social and environmental impact brief on August 8, 1997. Its recommendations were taken into account in designing the program and when the criteria for evaluating the projects and their environmental procedures were devised (paragraph 5.6). The environment and social impact report was approved by the CESI on November 3, 1997.

POVERTY-TARGETING: The program promotes economic growth and job creation in the rural sector as a strategy for combatting poverty. It qualifies as a poverty-targeted investment according to the Bank's Eighth Replenishment agreement (document AB-1704), as amended by document GN-1964-3 of June 3, 1997), since over 50% of the population it serves is below the poverty threshold. The program's rural development component will serve 91 municipalities, most in the central and Pacific regions, spread over an area of 11 departments. There are 1.32 million people living in this area, 73% of the country's rural population. Some 75% of the rural population of this region, i.e. 985,000 people, are poor. The program supports projects that further campesino women's personal growth and empower them to increase the family unit's productivity.

BENEFITS:

The proposed program will help re-energize food and agricultural production in Nicaragua by alleviating the problems that small- and mid-size producers have as a result of the inadequacy of their own fixed and human capital. The program works to correct disadvantages like the lack of technical and business-management know-how, the lack of protection for resources being depleted, little irrigation, and limited common resources such as roads and access to marketing centers. The measures and projects undertaken with this program will improve production and product quality, diversify production and processing, strengthen the producers' organizational capacity to enable them to interact with other parties in the agri-food chain, give them better access to markets and build up the institutional capacity for rural development management.

RISKS:

While Nicaragua has made important headway in its national reconciliation process, some significant differences still will need to be resolved before the country is, once and for all, on the road of national reconstruction and fully integrated into the market

economy. One of the most important issues of contention has to do with property disputes. To make agriculture secure, the transfer of property titles to the beneficiaries of the social reforms needs to be speeded up and the claims made by the previous owners settled with payment of adequate indemnization. The government and the political parties have said they intend to find a satisfactory solution to the property ownership problem. Failure of such a solution to be devised would be a major obstacle in the revitalization process.

Like privatization, decentralization, i.e., the transfer of powers and authorities to the local level, is vital to improving the quality of the basic services provided. Therefore, municipal governments' limited finances and their weak management capability pose problems for government at this level, especially for purposes of maintaining services and infrastructure. The activities planned under the program will improve management at the local level.

**PROCUREMENT AND
CONTRACTING:**

No international competitive bidding will be required, since no project will exceed US\$650,000 and goods procurement under the program, will not exceed US\$200,000.

**EXCEPTIONS TO
BANK POLICY:**

It is proposed that the loan resources be used to finance 26% of the recurrent outlays for professional and technical personnel hired during the program's four years. This is an incremental cost, and the staff involved will devote themselves exclusively to the program's activities. The amount involved would be US\$1.51 million. Up to 10% of the amount of the loan could be advanced (paragraph 2.28).

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

The Bank's strategy in Nicaragua was outlined in the country paper of October 1996 and confirmed during the programming mission of May 5-7, 1997. The objective of the strategy is sustained growth with equity. An essential precondition is maintaining economic stability. The strategy is to be pursued through four instruments: (a) promoting development of the private entrepreneur, especially in agriculture, which the driving force of the Nicaraguan economy; (b) eliminating financial limitations by reducing the foreign debt; (c) advancing human capital and reducing poverty; and (d) optimizing the use and conservation of natural resources. The strategy will be implemented through the program of loans, studies, projects in progress and an active dialogue on economic and social

practices. The planned program fits into this strategy.

Since 1990 the Bank has supported Nicaragua's readjustment and agricultural revitalization efforts through a number of loans and technical cooperation operations, such as the agricultural structural readjustment program, an agricultural services modernization program, an agroforestry development program, a program to support microenterprise, reform of the financial system and the first phase of a rural development program, which this program continues and builds upon.

**SPECIAL
CONTRACTUAL
CONDITIONS:**

1. Conditions precedent to the first disbursement

Before the first disbursement, the borrower is to submit evidence satisfactory to the Bank to the effect that: (a) the program's Operating Regulations are in force, which includes the model contract that will be used with extension agencies (EAs) and administrative agencies (AAs) (paragraph 3.7) for project implementation; and (b) a new departmental agency is operating for the departments of Madriz, Estelí, and Nueva Segovia (paragraph 4.12).

2. Other conditions

Within one year of the date of the loan contract, the borrower will submit to the Bank evidence that: (a) the PNDR has commissioned and carried out the studies for enhancement of the management information system and operation of the internal auditing unit and that the new procedures are operational; (b) the PNDR has contracted for the studies of the special surveys in selected communities to establish the baseline data for the ex post evaluation of the program and that those studies are under way; (c) before October 31 of each year for the duration of the program, the borrower will submit to the Bank the next year's annual work plan, which is to contain the information indicated in chapter III of the loan proposal which follows; (d) the Bank may do sample checks of the documents submitted to substantiate disbursement requests (paragraph 3.4). Other conditions are set forth in the following paragraphs of the proposal: 2.26, interest financing; 2.27, recognition of prior expenses; 3.11, 3.15, 3.18 and 3.19, reports; 3.13, maintenance; and 4.14, auditing.

I. FRAME OF REFERENCE

A. Economic context

- 1.1 Nicaragua has one of the lowest levels of development in Latin America, one of its highest rates of poverty and one of its most uneven income-distribution patterns. The Nicaraguan economy deteriorated during the 1980s as a consequence of the civil war, centralized management of the economy and the political-social upheaval, so much so that by the early 1990s GDP and exports were 40% of what they had been in the late 1970s. With the support of the international community, in 1990 Nicaragua began to return to a market economy and to invest more in basic services and infrastructure in order to meet its very considerable reconstruction needs. To provide the needed investments, the country must achieve a sizeable increase in savings, make public investment spending more efficient and revitalize private sector investment.
- 1.2 In mid-1994, the government and the International Monetary Fund (IMF) agreed on a three-year Enhanced Structural Adjustment Facility to continue the reforms already launched: privatization of public enterprises, downsizing of State banking, settlement of problems involving property claims, and reduced public spending. The administration that took office in January 1997 has continued to implement measures needed to further revitalization. A new tax law enacted in June 1997 will increase fiscal revenues and boost investment and exports, especially in the food and agriculture sector. A public sector reform bill is in the pipeline, as is a plan for reducing the central government's deficit and for limiting the losses sustained by State-owned banks; at the same time, a program to modernize and privatize public enterprises is being carried out. Both operations are Bank-supported.
- 1.3 The economy has reacted well to the structural reforms instituted in 1990. Real annual growth of GDP has been over 4% for the past three years and in 1997 is expected to be at least as high as the 5.5% achieved last year. Unemployment dropped from 22% in 1993 to 16% in 1996, while annual inflation dropped from 20% in 1993 to 11% in August 1997. Although external debt service is down considerably, it nevertheless continues to be a sizeable fiscal burden. The government is hoping to conclude an agreement with the IMF by late 1997, for a second Enhanced Structural Adjustment Facility (ESAF II), this time for two years, and obtain debt relief through the Heavily Indebted Poor Countries initiative. The country could achieve the 6% annual growth it needs to re-energize its economy if it deepens the process of structural reform, tightens fiscal discipline and increases private-sector investment.

B. Agriculture and sectoral policies

- 1.4 That revitalization of the food and agriculture sector is central to Nicaragua's economic recovery and poverty alleviation is obvious from a review of the figures for the primary agricultural sector, which produces around 65% of total exports, generates 45% of employment, and accounts for 30% of GDP. The agricultural sector's vigor has spearheaded the growth of the last three years. That sector was up 15% in 1996. As for poverty, it is concentrated in rural areas. While 41% of the total population is classified as rural, 63% of the poor and 78% of the extremely poor live in rural areas.
- 1.5 Trade and price policies. The sectoral policies recently implemented, especially in the area of trade and prices, have enhanced the sector's competitive position. Until very recently, the incentives that influence resource allocation among productive activities have been in the form of trade-policy protective measures. Import protection has been pursued through tariffs, a price band for staple grains, prohibitions, advance licensing and tariff exemptions. Estimates of effective protection in 1996 indicate that in relative terms, historically the incentives system has been tilted in favor of the manufacturing industry, whose rate of effective protection was figured at 38%, whereas agriculture's was an estimated 24%.
- 1.6 The measures introduced into the new tax act passed in June 1997 modify the trade and price policy and create new incentives to re-energize agriculture, especially agricultural exports. In the area of trade, the tax on exports has been eliminated; exporters may claim a tax credit for taxes paid for goods imported for the productive process. Import licenses and nontariff barriers to foreign trade have been eliminated, except those related to plant health and safeguards in the Central American customs and tariff regime. In a Bank-supported operation, import/export procedures have been simplified by modernizing the customs system. The amendments introduced in the exclusive agency act will lower prices on inputs for agricultural production by reinstating conditions of free competition for importation of agrochemicals and machinery.
- 1.7 For two years, the agricultural sector will be exempt from payment of taxes on imports of raw materials, capital goods and spare parts, which means that for the next two years, the only tax the sector will have to pay will be the land tax created under that same act. The approved tax reform has reduced tariff dispersion. The tariff ceiling now in effect is 35%; by the year 2000, the import tariff on consumer goods will be 10%, 5% on raw materials, and 5% to 10% on capital goods. However, in recent months Nicaragua has taken the initiative to help build a new Central American consensus on agricultural tariffs and, under regional agreements, has raised them over previous levels. In

September 1995, Nicaragua became a member of the World Trade Organization.

- 1.8 Domestic taxes on agriculture have been lowered. Unprocessed and semi-processed agricultural goods, such as crops and grains, are exempt from the general sales tax, as are farm machinery leasing and the leasing and sale of property. The municipal income tax will drop from 2% to 1.5% as of 1998 and to 1% in the year 2000. The new tax act also makes sales of livestock, eggs, milk, cheese and meat exempt from the municipal income tax. As of January 1, 1998, trades on the farm commodities and stock exchanges will be entirely tax free. In short, on balance, the trade policies are conducive to revitalization of food and agriculture production.
- 1.9 The tax reform has simplified the tax structure. Tax officials now have considerably less discretionary authority to grant tax exemptions; penalties for tax evasion have been legislated. Fiscal control of the zero-rate system has been established, whereby paid taxes are reimbursed to the taxpayer subsequent to the operation, when the traded good becomes part of a tax-exempt finished product. The tax base has expanded and the minimum taxable annual income is 50,000 córdobas; therefore, even with the incentives, tax revenues are expected to rise by around 30%.
- 1.10 Property disputes. The lack of security in land tenure is one of the factors holding back revitalization of the food and agriculture sector. That insecurity is the result of disputes created when beneficiaries of the social reforms settled on the lands legally awarded to them, without the State having indemnified the previous owner. In this situation, those now living on such lands do not have good title to their property; the titles that the Nicaraguan Agrarian Reform Institute provided are not absolute titles and are therefore sometimes questioned by private lending institutions and rejected as collateral. The legalization and titling processes supported by the Bank in the cities and the World Bank in rural areas have helped reduce the size of the problem. However, estimates are that only 25% of the country's farm land is backed by an absolute title, which means that there is still a major challenge ahead on the land-titling front.
- 1.11 To guarantee the rights of the beneficiaries of the agrarian reform process and of other entitlements (persons cashiered out of the army and ex-members of the former Nicaraguan resistance), the Executive has prepared a new law legislating stability for beneficiaries of the agrarian and urban reform, which it will soon send to the Legislature. The bill regulates tenure, exercise, encumbrances and extinguishment of rights acquired to property belonging to the State or to its institutions under Laws 85 and 86 of March 1990; Law 88 of April 1990; Law 209 on ownership stability, November 1995, and the Agrarian Reform Act and its amendments. The new law would confirm the legal validity of the agrarian reform titles and allotment vouchers, first as public

documents that affect to the legitimacy of the property acquisition and second as authentic documents that will serve as provisional title until the agrarian reform title is issued. This bill is the fruit of a political pact worked out by the present administration and the opposition political parties to settle the property ownership problem.

- 1.12 According to information from the Ministry of Finance, around 1,609 cases of properties in the rural sector have been settled, involving a total of 456,780 hectares, approximately 10% of the area devoted to crop- and stock-farming in Nicaragua. Claims have been filed on another 7,115 pieces of farm land, and there are a total of 5,764 claimants of rural and urban properties. For around 50% of the claims the government has made offers to indemnify the former owners, but only 28% of the cases have gone to settlement. The former owners of confiscated properties have been compensated with bonds denominated in córdobas and pegged to the United States dollar. They mature in 15 years, paying interest of 3% to 5%. Bonds totaling US\$580 million have been issued since 1993. There is an active market in these bonds, which are serviced on schedule. Bonds totaling US\$134.1 million have been redeemed.
- 1.13 The rural property problems, coupled with personal insecurity, certainly have an adverse impact on the growth of the land markets. Despite the general lack of security in land tenure, the property market is functioning relatively well in some areas of the country. However, to resolve the remaining problems and send out signals of security to the agriculture sector, the process where the beneficiaries of the social reforms receive definitive title to their property and claims brought by previous owners are settled by paying adequate compensation will have to be accelerated, which is precisely the strategy the government says it plans to pursue.
- 1.14 Rural financial services. The lack - real or perceived - of collateral owing to disputes or unclear ownership affects credit risks and the coverage and quality of financial services. These problems have prompted an effort to find innovative ways to supply credit, mainly through group borrowing with joint and several liability and collateral in the form of the crop or harvest itself. Local banks developed with support from various bilateral assistance programs are basically unregulated financial institutions that are partnerships sponsored by nongovernmental organizations, savings and loan cooperatives and foundations. The seed capital is put up by the donor or promotion agency, which in the case of communal banks is sometimes supplemented by small amounts of capital put up by the partners. The supply of financing is limited by the amount of capital available to meet demand and by legal restrictions on local savings.
- 1.15 Despite the efforts undertaken in the early 1990s to restructure State banks, their financial position, especially that of Banco Nacional de Desarrollo [National Development Bank] (BANADES), has

continued to deteriorate. The government recently issued a decree placing BANADES under an emergency regime and under the banking supervisor's oversight until May 1998. If by that date it is still not in compliance with the prudential standards in force, BANADES will be closed. The Bank is evaluating the public sector reform program, which includes State-owned banks, and will make disbursement conditional upon the progress made toward the goals established in the emergency regime.

- 1.16 The Bank is supporting the creation of alternative financial services for the rural sector through the establishment of regional banks, by way of specialized financial intermediaries, incorporating the legal regulatory framework into the Bank Act and building up these institutions under the microenterprise support program. A pilot program that the World Bank launched in 1995 is encouraging commercial banks to set up branch offices in rural communities that do not have financial services. It is using subsidies and technical assistance to finance the fixed costs involved in setting up those services. To date, three commercial banks have agreed to create a total of 10 branch offices under that program. And these efforts are starting to show results: in the first half of this year the formal financial system's loan disbursements to the agricultural sector were up 85% over the first half of 1996, from US\$322 million to US\$597 million.

C. The experience of the Bank and other donors

- 1.17 A sector adjustment operation was approved in late 1992, its main purpose being to establish the sectoral and institutional framework needed to restore the market economy after 11 years of central planning. In 1994, a loan was approved to finance a program to improve the public services that the Ministry of Agriculture must provide in the area of agricultural health, seed certification, agricultural statistics and price and market information. It is client-oriented and encourages private-sector involvement in the delivery of services. An agroforestry conservation and management program was approved in 1995, whose purpose was to improve sustainable management of protected areas and boost small producers' productivity by establishing agroforestry and agrosilvopastoral systems, management of natural woodlands and multi-use forests.
- 1.18 Also approved in 1994 was a loan for the National Rural Development Program (PNDR) (927/SF-NI), which has funded productive investments primarily intended to benefit small farmers. Resources from this program have been used to rehabilitate the public rural roads infrastructure and to finance projects involving training and technology transfer, communal marketing structures and investments in sustainable use of natural resources.
- 1.19 The proposed program continues and builds upon the earlier program. As of July 1997, 49% of the resources of the program in progress

had been disbursed, and another 25% committed for projects under way. Some 37% of the approved projects and 57.2% of the investments are for rehabilitation of rural roads (524 km); 27% and 15%, respectively, were for technology transfer and training; 14% and 10% for natural resource conservation; 17.4% and 15.2% for institutional strengthening of participating agencies.

- 1.20 Lessons learned from the evaluation of the ongoing phase of the rural development program have been built into the new operation, in the form of a number of improvement measures described at different points in this proposal: (i) targeting of demand, distributional equity, community participation - paragraphs 2.10, 2.14, 3.8, 4.16, and 5.17; (ii) evaluation criteria, types of projects, training - paragraphs 2.16, 2.17, and 3.16; (iii) institutional sustainability - paragraph 3.2; (iv) management development - paragraphs 3.3, 4.9, and 4.13; (v) project execution mechanisms and tapping of demand - paragraph 3.7; (vi) operation and maintenance - paragraph 3.13; and (vii) monitoring and evaluation - paragraphs 3.16 and 4.10.
- 1.21 Since 1993, the World Bank has been financing a program with a technology development and transfer component and one for land titling and a rural cadastre. In 1996 it also approved a project to strengthen rural municipal government in the departments of León and Chinandega, with the Nicaraguan Municipal Development Institute [Instituto Nicaragüense de Fomento Municipal] (INIFOM) as executing agency. A number of donors, mostly bilateral, are supporting the rural sector through 19 programs, targeted at benefiting groups of small farmers in various regions of the country with investments in livestock, forestry and agricultural development, and protection of woodlands and mangrove swamps. Ten of these projects have components for agricultural lending through nonconventional financial intermediaries.
- 1.22 With so many programs, each under a separate agreement and involving different methods of execution and objectives, it has been difficult for the sector to fit the programs into a cohesive policy vis-à-vis the sustainability of the nonconventional financial brokers in rural areas. During preparation of the operation described below, the Bank helped the MAG and the PNDR prepare the bases of a single set of regulations for more cohesive and efficient coordination of the programs mentioned here. This matter is still being reviewed and discussed in the MAG, and no decision has been made about it yet.

D. The Bank's strategy

- 1.23 The Bank's strategy in Nicaragua is outlined in the country paper of October 1996, and was confirmed during the programming mission of May 5-7, 1997. The strategy's objective is sustained growth with equity. The Bank regards revitalization of the food and agriculture sector as one of the pillars of the country's economic

renewal. A necessary precondition is preservation of macroeconomic stability. The strategy takes a four-pronged approach: (a) promoting development of private enterprise; (b) reducing the external debt; (c) enhancing human capital through training and poverty-reduction projects, and (d) sustainable management of renewable natural resources. The planned program fits into this strategy.

E. Conceptual base of the program

- 1.24 The Nicaraguan government has declared that poverty alleviation is one of the top priorities on its agenda. Under its rural development strategy, plans, activities and mechanisms for reducing rural poverty are to be designed and implemented. Economic growth is the best means to combat poverty problems on a sustainable basis. The underlying premise of the program is that productive revitalization of the food and agriculture sector is the most effective way to accomplish that objective, since that sector accounts for the largest share of the value of exports, represents an important percentage of the economy, can react quickly to investment stimuli, is labor-intensive and accounts for the largest percentage of total employment.
- 1.25 The revitalization objectives can be achieved via three main lines of action:
 - a. Better use of the factors of production through the marketplace. Short-term growth can get a significant boost from better use of resources. The structural adjustments and sector reforms now under way are providing that stimulus. However, as is apparent from the sectoral situation briefly described here, the right conditions are needed for the land market, rural financial services, marketing and development and transfer of technology to function better.
 - b. Better endowment of productive resources to sustain growth. The country has to invest in enhancements to its human capital, technology and physical infrastructure in order to broaden the foundation of growth. Accordingly, measures must be taken to energize public and private investment.
 - c. Better public management of the agricultural sector. The functions of public institutions in the agricultural sector need to be adjusted, as do their size and capacity to react quickly to provide needed regulations and services and to build a capacity for dialogue with the private sector, civil society and the other institutions of government, in order to propose and implement strategies that support the sector's productive revitalization. Important elements here are decentralization of services and interagency coordination.

- 1.26 The new program devised will more effectively address three essential elements of the strategy to combat poverty by promoting economic growth: (a) improvement of human and institutional capital and more efficient use of productive technology in the food and agriculture sector; (b) rehabilitation and improvement of productive physical capital; and (c) improved access of small producers to markets of products and inputs. The program's basic premise is that small- and mid-size producers, who constitute the majority of Nicaragua's food and agriculture producers, need support in order to successfully take on the challenges and opportunities that an opening economy is offering and to adapt to the new competitive environment.
- 1.27 Experience with similar projects has shown that a solid program of transfers to implement productive investments that target the priorities identified and ranked by the beneficiary rural communities can jump-start production, thereby helping to create jobs and reduce rural poverty, if it is underpinned by a well-structured, enabling framework of macroeconomic and sectoral policies. The program proposed here fits into that strategy.

II. THE PROGRAM

A. Objectives and impact expected of the program

- 2.1 The program's general purpose is to contribute to a sustainable increase in the competitiveness of the food and agriculture sector in order to maximize its contribution to economic growth, a condition *sine qua non* for alleviating poverty problems. As the specific objective is to increase rural income and employment, measures are planned to spur the Nicaraguan *campesino* family to be more productive. The program helps correct the disadvantages that small- and mid-size producers have in terms of production resources for sustained growth.
- 2.2 The activities that the program supports will serve the following essential goals of the revitalization strategy: (a) improvement of human capital through training, organization and technology transfer; (b) better use of natural resources; (c) rehabilitation and improvement of the productive infrastructure, and (d) better access to markets of products and inputs for small producers.
- 2.3 The following actions will be instrumental in achieving the program's objectives: higher output and better product quality; diversification of production and processing activities; building producers' organizational capacity to interact with other links in the food and agriculture chain; facilitating market access; building capacity for rural development management, in the public and private sectors alike, and spurring the development of private technical-assistance services.

B. Description

- 2.4 The program has two components: 1. support to rural development, and 2. institution-strengthening.
 1. Component: support to rural development
- 2.5 The rural development support component to be carried out by the National Rural Development Program (PNDR) endeavors to involve the beneficiary rural communities in identifying, ranking, preparing and carrying out eligible productive projects and enlisting them in the project financing. Project are prepared and implemented by the executing agency working through extension agencies (EAs) and administrative agencies (AAs), which may be specialized private and public entities, nongovernmental organizations, organized labor groups or local governments.
- 2.6 Target population. In terms of economic policy, the program represents a transfer of nonreimbursable resources to low-income rural communities. Consequently, special consideration has been

- given to the distributive equity of the benefits. The direct beneficiaries are in two groups: (a) poor small rural farmers who earn barely enough to satisfy their basic food needs and some basic services, generate little or no surplus, but have the potential to generate it if they have access to land and the minimum essential elements for farming; and (b) mid-size producers that generate some surplus but have limited access to services, basically technology, production organization and marketing.
- 2.7 The population that will indirectly benefit are poor rural wage earners whose income is frequently not sufficient to provide adequately for the family's food needs and who have no access to land. They will get the jobs generated by the producers and benefit by other economic opportunities that the productive revitalization will create.
- 2.8 The rural development support component of the proposed program continues and builds upon the phase of the program already in progress, which covers only four departments in the central region: Boaco, Chontales, Matagalpa and Jinotega. These areas were selected at the time because they had the highest incidence of rural poverty and productive potential and because the program in these areas dovetailed with projects supported by other donors.
- 2.9 Support for rural development in the form of productive investments that bring growth and employment is needed throughout the country. Given the limited resources, the following targeting criteria were considered to identify the potential beneficiary target population in the program's new stage: (a) incidence of rural poverty at the municipal level; (b) the productive potential of the various geographic zones; (c) the presence of other programs and projects funded by other donors; and (d) the institutional capacity for management. Using these criteria, a target population of 1.32 million rural inhabitants has been identified; around 985,000, or 75%, are poor. In geographic terms, the coverage of the program's rural development support component will be extended to a total of 11 departments, which have a total of 91 municipalities and are mainly in the Pacific and central regions, where 73% of the country's rural population lives.
- 2.10 Criteria for allocating resources. The procedure for approving investments has thus far operated on the basis of 'first come, first served' for eligible projects that have met the required evaluation criteria. This mechanism, which has functioned reasonably well during the initial period of limited demand, is not the best for the expanded program. Therefore, a simple resource-allocation mechanism has been developed, operating on the basis of poverty and development-potential indicators. The resource-allocation unit is the municipality, which is the basic political-administrative unit into which the country is divided. There are now 145 municipalities in Nicaragua, distributed among

- 17 departments. The latter are territorial units and have no governmental functions.
- 2.11 Few data have been compiled at the municipal level. For example, there are no data on schooling levels by municipality, which would be an indicator of the development level of human capital. However, there is information on the number of farms per municipality and the number of rural poor; the ratio between those two numbers could be an indicator of participation and development potential. The higher the ratio, the fewer large farms there would be and the number of families with access to land would be higher, as opposed to the number of wage earners, who have less growth potential. Since the measurement of growth potential is partial, it has been assigned a 25% weight, while a 75% weight has been given to the poverty factor, represented by the number of rural poor in the municipality relative to rural poor in the department as a whole.
- 2.12 The figures adjusted by the Social Emergency Fund (SIF) were used, applying 1995 census data to the map of municipal poverty of Nicaragua prepared by researchers from Duke University's Research Triangle Institute. Those studies, in turn, were based on a 1993 national survey to measure living standards for the poverty survey done by the World Bank. Since the household survey will be updated every three or four years, the indicators will detect any changes in poverty levels, new jobs created in the formal and informal sectors, and migration. Another program activity planned is a special survey to determine what the baseline conditions are.
- 2.13 An initial (indicative) allocation has been made that represents 70% of the resources that will be available for each municipality, based on the criteria described here. As for the allocation timeframe, no annual per-municipality allocation has been set, since municipalities with less capacity might be discouraged from organizing and preparing project proposals. The other 30% of the resources will not be apportioned until later, when 50% of the implementation period has passed; those resources will go to the municipalities that have been most energetic at identifying, preparing and carrying out projects.
- 2.14 Community participation. In this new stage, the program will try to get communities more involved in the project cycle. The project ideas and initiatives can be generated by the communities or by the groups that directly benefit, or by organized labor groups and cooperatives. However, they must have consensus support and be ranked at the local level using participatory procedures, which is where the Municipal Development Committee comes in. Specialized public and private institutions and nongovernmental organizations may help the communities develop their ideas for projects.
- 2.15 Project eligibility. Projects will be eligible for financing under the program if they meet certain technical, economic, gender-

related, environmental and participatory requirements and criteria which will be spelled out in the guidelines included in the Operating Regulations for identification, preparation, evaluation and execution of projects. The only projects that will qualify will be productive investments that conform to the community consultation procedures, whose project briefs are consistent with the program's guidelines and criteria, that have satisfied the requirements concerning proof of economic viability, that fall into one of the categories identified in the project typology and satisfy other requirements stipulated in the program's Operating Regulations.

- 2.16 Project appraisal. Two standards will be used to evaluate eligible investments. If the investments are equal to or higher than the equivalent of US\$100,000, feasibility studies must be done, computing the net present value and economic internal rate of return, using 12% for the opportunity cost of capital. When the investments involve less than US\$100,000, simpler cost-effectiveness analysis criteria will be used. The methods for the economic appraisal and cost-effectiveness analysis are described in the program's Operating Regulations.
- 2.17 Project typology. The eligible projects described in the project typology are investments that will help improved the endowment of productive resources so as to sustain growth. They fall into the following categories: (a) projects that improve production incentives and access to markets, through construction work to expedite marketing and small industries, such as rehabilitation of rural roads and construction of collection centers and slaughterhouses; (b) projects that improve that access by providing marketing services, which includes technical assistance to form and manage marketing cooperatives and for postharvest management; (c) projects that build up the productive resource base by enhancing physical capital, for example, small irrigation systems, soil conservation works and practices, reforestation, agroforestry systems, herd upgrading by means of artificial insemination, communal nurseries and perennial seedlings; (d) projects that strengthen the productive resources base by building up human capital, through the development of private technology-transfer and technical assistance services for farm and agrifood business management, using a methodology to be agreed upon.
- 2.18 Allocation of resources among project categories was considered inadvisable, since the program needs to be responsive to the rural communities' demands and priorities and promote their involvement. The only exception would be the projects for rehabilitation of rural roads. To keep a proper balance among the various types of projects, the Operating Regulations will stipulate that no more than 50% of the total amount of programmed resources may be used for investments to rehabilitate rural roads, which in the first phase of the program had absorbed a sizeable percentage (58%) of

the portfolio. However, this criterion will be revisited during the mid-term evaluation and might be changed.

2. Institution-strengthening component

- 2.19 The institution-strengthening activities under the program focus on two institutions: (a) the Ministry of Agriculture, which develops policies and strategies for rural and agricultural development and promotes growth in the private food and agriculture sector, and (b) the National Rural Development Program (PNDR), which implements rural development strategies.

a. Subcomponent 2.A: Institutional strengthening of the MAG

- 2.20 The basis of the strengthening strategy is support to the Ministry of Agriculture (MAG), whose present structure has some weaknesses. During preparation of the program, the agency's strengthening needs were examined, specifically to: (a) establish the agricultural sector's new institutional structure by developing its own organization and its relationship to entities within the sector; (b) help strengthen the analytical skills needed to formulate policies and monitor the sector's performance; and (c) help build capacity for improved institutional management.
- 2.21 In the area of State reform, a new law on the organization of the executive branch of government is to be placed before the legislature for approval. Under that law, the functions and structure of the public agricultural sector will be redefined, and the MAG will be given the authority to pilot the sector. Examined by the project team, the bill contains the basic guidelines suggested in the recommendations made in the institutional analysis performed by the team's consultant specialist of the agricultural public sector at the time the program was being prepared. Consequently, the institution-strengthening plan designed squares with the plan proposed in that bill.
- 2.22 The proposed strengthening involves a set of measures to complete a cycle, namely: (a) strategies for the sector that are consistent with macroeconomic policies and the government's overall strategy; (b) specific policies for the various facets of the sectoral policy: rural development, creation and transfer of technology, services to producers; (c) institutional mechanisms to prepare programs and projects and their implementation, including reformulation of legal frameworks, restructuring, identification of the profiles of the staff required, the technologies to be used and rules and standards to be established. The component provides support in two stages of this cycle: formulation of specific policies and institutional design. Additional measures to implement the designs are not included since they are not yet ready.

b. Subcomponent 2.B: Institutional strengthening of the PNDR

- 2.23 The Bank will support institutional strengthening of the PNDR's management and internal controls. The analysis done of the PNDR detected what strengthening is needed, whereupon a technical assistance plan was devised to upgrade the following functions: (a) management information system, evaluation and design; (b) improvement of the operations of the internal auditing unit; (c) evaluation of projects, updating and training; (d) environmental auditing; (e) design, implementation and analysis of a survey to establish the baseline for the evaluation of program results. A mid-term evaluation of the program's rural development component is needed in the second year. Particular attention will be given during this evaluation to the dovetailing and coordination of Social Emergency Fund strategies and programs and those of the PNDR.

c. Logical framework

- 2.24 Annex I-1 contains a summary Logical Framework for the program, showing objectively verifiable indicators against which progress toward the program's main objectives can be gauged, and its impact on rural employment and income, agricultural GDP, and overall real value-added in the areas covered. Quantitative targets for the "Purpose" and "Objectives" benchmarks will be devised when a survey to gather baseline data has been conducted and its findings have been analyzed. Given the demand-driven nature of the program it would not be feasible to set *a priori* quantitative targets for the rural development component.
- 2.25 Terms of reference for the survey have been agreed upon with the Bank. It will be performed within one year after the loan contract is signed. The household survey also will furnish baseline information for the ex post evaluation of the program's accomplishments.

d. Program cost and financing

- 2.26 A loan for the equivalent of US\$40 million from the resources of the Fund for Special Operations is recommended. As an exception to Bank policy, financing of up to 26% of the recurrent outlays is recommended to cover the costs of the professional and technical personnel to be contracted during the program's four years. The sum of US\$1,514,000 million will be used to that end. The interest will be paid with loan resources for the duration of the program. The total cost of the proposed program is US\$44.63 million, as shown below:

PROGRAM COSTS (in thousands of US\$)				
ITEM OF EXPENDITURE	IDB FSO	BORRO WER	TOTAL	%
I. PNDR ADMINISTRATION:	2,573	4,240	6,814	15.3%
1.1 Administrative expenditures	1,514	4,240	5,754	12.9%
1.2 Consulting services and training	651	0	651	1.5%
1.3 Vehicles and equipment	409	0	409	0.9%
II. SUPPORT TO RURAL DEVELOPMENT (PNDR)	34,641	0	34,641	77.6%
2.1 Training for participating agencies	3,464	0	3,464	7.8%
2.2 Support for sustainable production	31,177	0	31,177	69.9%
III. MAG INSTITUTIONAL STRENGTHENING	1,569	0	1,569	3.5%
3.1 Consulting services and training	1,249	0	1,249	2.8%
3.2 Equipment	320	0	320	0.7%
IV. FINANCIAL COSTS	1,217	389	1,606	3.6%
4.1 Interest	817	0	817	1.8%
4.2 Credit fee	0	389	389	0.9%
4.3 IDB inspection and supervision	400	0	400	0.9%
TOTAL	40,000	4,630	44,630	100.0%
PERCENTAGES	89.6%	10.4%	100.0%	

- 2.27 It is suggested that up to the equivalent of US\$300,000 be recognized for eligible investments made prior to the disbursement eligibility date, to contract the consulting services needed to conduct priority activities under the component to strengthen the MAG and the PNDR.
- 2.28 **Advance of funds.** An advance of up to 10% of the loan proceeds is recommended, a figure justified given the pace at which the first phase of the PNDR was implemented.
- 2.29 The maximum value of each project will not exceed US\$650,000 and the value of goods acquired for the program will not exceed US\$200,000. Therefore, no international competitive bidding is anticipated.

III. PROGRAM EXECUTION

A. The National Rural Development Program

- 3.1 Since its creation in early 1995, with Bank support the PNDR has become an efficacious agency for financing nonreimbursable investments most of which benefit small- and mid-size farmers. In the three years since its creation, the PNDR has infused resources into those sectors to finance rehabilitation of rural roads, projects in training, technical assistance and technology transfer, communal marketing works and investments for sustainable exploitation and conservation of natural resources.
- 3.2 In the program's first phase, the PNDR relied heavily on resources from the Bank financing to cover: (a) almost all the investment expenditures; and (b) a large percentage of the administrative costs, including 100% of the salaries and per diem of the institution's permanent staff. The intention now is to move away from that reliance so that the PNDR will sustain itself beyond the life of this program. Given the problems with the fiscal deficit, a plan of budgetary contributions has been prepared in which the central government will gradually increase the financing of the PNDR's administrative expenses from 25% in the first year to 100% by the program's fourth year.
- 3.3 As part of the evaluation of the program's first phase, areas were identified that need institutional strengthening to: (a) improve the administrative efficiency and build up capacity to manage the project cycle; (b) reinforce the internal control mechanisms and procedures; and (c) build the capacity to further dialogue and processes at the community level to determine development priorities and identify project ideas. The rural development support component of the program proposed herein will finance all those institution-building outlays.
- 3.4 In accordance with memorandum RE1/DAU-M-013 of June 19, 1997, which provides that project teams and the Bank's Country Offices must do a financial evaluation of the executing agency to consider the possibility of delegating to it the responsibility for keeping custody of documents that substantiate the disbursement of program resources, the evaluation of institutional management was done with that possibility in mind. The view is that the PNDR would be a good candidate for such delegation once the activities to correct the areas that need adjustments have been carried out. To that end, it is suggested that compliance with the strengthening plan be reviewed one year from the date of the loan contract.

B. The cycle of the rural development support component

- 3.5 The rural development support component will be carried out by stages, with the component's implementation divided into four annual work plans (AWPs). Those plans will combine the pipeline of projects approved in the various departments that the PNDR covers. At the end of each period or stage, the results will be evaluated.
- 3.6 The AWP is to include the following: (a) the investments to be financed, which are to be evaluated and ranked in order, including the financing structure and implementation schedule; (b) the distribution of projects by department, municipality and district; (c) the timetable for implementing the institution-strengthening activities, including procurement of goods and services and contracting of consulting services and training services; (d) the plan for training the communities in community participation, and (e) the annual internal auditing plan.
- 3.7 In preparing the rural development support component, the PNDR's Operating Regulations were reviewed and modified. The reformulation allows for: (a) better control of the mechanisms for project implementation and for harnessing demand; and (b) more rigorous management of the institution's internal control procedures to guarantee that resources earmarked to the component are administered properly. As a condition precedent for the first disbursement, the Operating Regulations are to be in force to the Bank's satisfaction.

C. The project cycle for the rural development support component

- 3.8 The projects will be implemented in the following sequence, described at greater length in the Operating Regulations: (a) PNDR headquarters and departmental rural development agencies (DRDAs) will launch strategies to publicize the component locally; (b) the PNDR will respond to requests from the communities to assist them with identification of rural development priorities; (c) the beneficiary communities and/or organizations will identify the projects and submit them to the DRDAs; (d) the DRDAs will determine the eligibility of the communities' project ideas using technical screening criteria and a menu of investments that the component can finance; (e) the eligible projects will be ranked by the Municipal Development Committees; (f) the ranking of projects and their costs will be compared with the financing tentatively earmarked for the municipality; (g) the beneficiaries will prepare project profiles according to the PNDR manuals and, if necessary, will prepare feasibility studies; and (h) the DRDAs will evaluate the project profiles and feasibility studies and, if the social, economic and technical criteria are met, will pass them on to the next stages of the approval process.
- 3.9 A cap of US\$300,000 equivalent is suggested on the amount of financing per project if the community contribution is the minimum

- 10% required under the Operating Regulations. However, that cap can be raised if the community contributes more than the minimum. For every additional US\$10,000 that the community puts up beyond the \$30,000 minimum, for large projects, the cap could go up by US\$50,000, the maximum being US\$550,000. This same rule would apply for multi-municipal projects, which thus could have a ceiling of US\$650,000. The PNDR will use one more criterion, which is that the cost of the projects not exceed the equivalent of US\$2,000 per beneficiary. Furthermore, the only eligible private beneficiaries are small- and mid-size producers.
- 3.10 Eligible projects costing US\$100,000 or less in PNDR resources may be approved, by delegation of the Executive Director, by the director of the DRDA backed up by the technical evaluation report by the pertinent staff of the agency. Projects costing over US\$100,000 in PNDR resources but not more than US\$300,000 have to be approved by the Executive Director and supported by the DRDA's technical evaluation reports and a review by the Planning Department and the Finance and Administration Department at headquarters. Projects costing over US\$300,000 will have to be approved at all the above levels and have the Board of Directors's final approval. Projects approved at this last stage will be submitted to the Bank for clearance.
- 3.11 The projects evaluated and approved according to this procedure will be combined to form the AWP that the Planning Department is to assemble. The Executive Director will submit the AWP to the Board of Directors for approval, then to be transmitted to the Bank for review and clearance before October 31 of each year.
- 3.12 The PNDR will operate through extension agencies (EAs) and administrative agencies (AAs), which will share responsibility with the PNDR and the beneficiaries during the promotion and implementation of the projects. The EAs will assist the beneficiary communities with internal dialogue processes aimed at raising local development levels and will help them identify, prepare and present project ideas to the PNDR. The AAs will implement projects and/or supervise the contractors and administer the resources that the PNDR and the beneficiaries assign to them for project implementation. If the eligibility criteria set forth in the Operating Regulations for administrative, financial and technical matters are met, an EA could qualify as an AA. The PNDR will monitor for performance of contracts, including project preparation, implementation, contracting, operation and accomplishment of objectives. DRDA technical officers, together with private supervisors, will monitor the progress and quality of the works, for which special tracking forms will be used.
- 3.13 The operation and maintenance of completed projects will be the job of the beneficiary communities, which will undertake contractual obligations with the PNDR. In the case of projects that are in the

public interest, such as rehabilitation of rural roads, the beneficiary communities and the municipalities will be jointly responsible for operation and maintenance.

D. Monitoring implementation of the rural development support component

- 3.14 The component will be monitored by tracking fulfillment of the objectives and activities, checking: (a) execution of investments; (b) the performance of the administrative and control mechanisms and other institutional aspects; (c) implementation of the institution-strengthening component; and (d) introduction of the training work at the municipal and community level.
- 3.15 The monitoring to check for fulfillment of the technical, administrative, financial, economic and environmental criteria that the Bank and the PNDR agree upon will be done as follows: (a) the PNDR will submit to the Bank consolidated six-month reports on the component's implementation and progress, including monitoring and evaluation reports; environmental evaluation and monitoring of projects carried out and in progress; implementation of the AWP in its various areas; internal audits and the introduction of corrective measures; and (b) if problems are pointed out to the PNDR or its implementation of the component is found to be unsatisfactory, within 30 days following the date on which the Bank makes known its objections, the PNDR will have to submit the corrective measures it will undertake and the implementation timetable.
- 3.16 The PNDR must demonstrate a capacity to implement an adequate volume of projects, given the annual goals established in the AWP, the institutional budget, the availability of resources from the Bank's financing and local counterpart funding, and the institution's installed operating capacity. Using the evaluation, monitoring and control system, the PNDR's Planning Department will: (a) assess the quality of the planning and the process whereby projects requested in the various departments are combined into the AWP; (b) launch the investment process; (c) check the quality of the project portfolio; and (d) through its monitoring and evaluation system, make certain that the AAs operate investment monitoring systems satisfactory to the institution. For its part, through the DRDAs and the Finance and Administration Department, the PNDR will closely monitor management of the resources assigned to the AAs under the contracts signed for implementation of projects.

E. Implementation and monitoring of Subcomponent A: Institutional-strengthening of the MAG

- 3.17 The MAG institution-strengthening component would be implemented over a two-year period. The MAG will hire a professional with solid qualifications as coordinator of the component, to the Bank's

satisfaction, to work full time on implementing the programmed activities. His/her fees will be paid with resources from the financing. The coordinator's principal functions will include: (a) coordinating and directing, together with the pertinent MAG personnel, the implementation of the proposed institution-strengthening component, in keeping with its objectives, goals and time frames; (b) monitor implementation of the component and the quality of the consulting services, training, procurement of goods and services with resources from the financing and their incorporation into the MAG's administrative and operational systems; and (c) propose corrective measures during the implementation process.

- 3.18 The monitoring will be done by means of periodic measurements of targets accomplished, both for quality and timing. The targets are to be agreed on with the Bank. The institution-strengthening component will be monitored by means of six-month reports that the MAG, working through the coordinator, will submit to the Bank on the implementation process and progress made. Those reports are to include the following: (a) the progress with physical and budgetary execution regarding the contracting of consulting services, training, and procurement of goods and services; (b) inclusion of the goods and services acquired with resources from the component in the MAG's operating, administrative and planning systems; (c) an audit report prepared by the MAG's internal auditing unit, including matters relating to administrative control, procedures and budgetary/financial execution; and (d) reports on the introduction of needed corrective measures.
- 3.19 If any problem is pointed out and/or if the Bank is dissatisfied with the institution's implementation of the component, within 30 days of the date on which the Bank expresses its objections the MAG, through the coordinator, is to submit the corrective measures it will take and a timetable for implementation thereof.

IV. THE BORROWER, THE EXECUTING AGENCY AND OTHER PARTICIPATING AGENCIES

A. The borrower and the executing agency

- 4.1 The borrower would be the Republic of Nicaragua and the executing agencies the Ministry of Agriculture (MAG) and the National Rural Development Program (PNDR). Both institutions are members of the Consejo Nacional Agropecuario [National Agricultural Council] (CONAGRO), created by Decree 36-92 and chaired by the Minister of Agriculture. Its purpose is to strengthen the formal linkage of the key institutions in the government agricultural sector.

B. The PNDR

- 4.2 The National Rural Development Program (PNDR) was created by Decree 41-94 of October 4, 1994, as a government agency under the Office of the President of the Republic, with status as a legal entity and its own assets, technical, administrative and management autonomy, and full authority to acquire rights and undertake obligations.
- 4.3 The decree creating the PNDR stipulates that it is a temporary agency, with a 15-year extendable life. Its objective is to improve the capacity of public and private agencies to generate and promote sustainable rural development to benefit small- and mid-size farmers and farm workers. Its continuation and long-term sustainability are keyed to the country's need for a specialized agency to promote rural development and to the institution's effectiveness and efficiency in contributing to sustainable economic, social, institutional and environmental rural development.
- 4.4 The PNDR is the executing agency for the first phase of the rural development program financed by the Bank. Also, and in keeping with the mandate given to it in the decree that created it, the PNDR coordinates the activities of rural development projects financed by other organizations, mainly bilateral assistance agencies and specialized multilateral organizations such as the International Fund for Agricultural Development (IFAD). Some of these programs and projects receive funds by way of the monetization of donations in kind, such as machinery and inputs, which are sold to raise counterpart funds, which are then passed on to the target population in the form of a credit, inputs or technical assistance through various intermediaries such as cooperatives, nongovernmental organizations, nonconventional financial intermediaries and municipalities.
- 4.5 Each program has its own mechanism of execution and its own executing unit. The PNDR's coordination involves supervision to ensure compliance with the various financing agreements. The PNDR

assigns a team of six persons, three technical officers from headquarters (the Monitoring and Coordination Unit) and three at the DRDA in the department of León, to handle coordination of these programs.

- 4.6 As executing agency for the program's rural development support component, the PNDR will bear chief responsibility for carrying out and supervising the component's implementation. It will be responsible for efficient and transparent management of the funds earmarked for the component and for strict compliance with the financing rules, including application of the Operating Regulations and the agreements established for monitoring the operation.

1. Organizational structure

- 4.7 The PNDR's current organizational structure is functional and adequate to implement the program's rural development component. This structure includes: (a) the Board of Directors; (b) the Office of the Executive Director; (c) the Finance and Administration Department; (d) the Planning Department; (e) the departmental rural development agencies (DRDAs), (f) the Internal Audit Unit; and (g) the Coordination and Monitoring Unit.
- 4.8 The **Board of Directors** of the PNDR is the institution's highest authority and is composed of nine members from the public sector, nongovernmental sector and private sector. They discharge their functions *ad honorem*. The Executive Director is the PNDR's legal representative and directs and administers the institution's operation.
- 4.9 The principal function of the **Finance and Administration Department** is to provide administrative, logistical and financial-accounting support to the PNDR's various units to ensure that their activities and functions are carried out efficiently. The **Budget and Accounting Units** of the Finance and Administration Department do the monthly consolidation of budget activity and accounts and prepare the financial statements. The adjustments recommended by the evaluation done during preparation of the operation will be made, which means that the budget and accounting systems will be integrated by way of a management information system; accounting for beneficiary contributions will be monitored more rigorously and a database of unit costs will be introduced for better estimates of the costs that the regional agencies will incur to carry out projects.
- 4.10 The chief functions of the **Planning Department** include preparation of the annual work plans, promotion, coordination and monitoring of projects, and support to enable the DRDAs to manage the project cycle effectively. Under the institution-strengthening component of the operation proposed herein, resources will be earmarked to

strengthen the system for evaluating and monitoring projects and make it part of the management information system.

- 4.11 The **DRDAs** are the PNDR's operating units at the departmental level. Accordingly, their main function is to accomplish the objectives and goals of the PNDR in each of the departments in which the program operates. At the present time, the PNDR has five DRDAs located in the capitals of the departments of Boaco, Chontales, Jinotega, Matagalpa and León. The León DRDA's only functions is to monitor other projects coordinated by the PNDR in the area. For the present operation, financial resources will cease to be supplied to the León agency. For that agency, consisting of two technical officers and one secretary, the PNDR will obtain separate financing from the central government or from the instituting financing the project coordinated in that zone.
- 4.12 To meet the needs posed by the expansion of the program's coverage, support will be provided to set up a new DRDA in the departmental seat of Estelí, which would serve the departments of Nueva Segovia, Madriz and Estelí. The Chontales DRDA, which now serves the departments of Chontales and six municipalities in central Zelaya, would serve one other department, Río San Juan. Headquarters in Managua will serve the departments of Managua, Carazo and Rivas, where the IFAD-financed PROCESUR program is under way with its own executing unit. As a condition precedent to the first disbursement, the PNDR is to demonstrate that it has set up the DRDA for Nueva Segovia, Madriz and Estelí, staffed with the team it needs to discharge its responsibilities.
- 4.13 The functions of the **Internal Auditing Unit** include: (a) preauditing of PNDR operations and its accounting, financial and administrative records, monitoring for compliance with the institutional procedures, and preparation of suggestions on corrective measures; and (b) concurrent reviews of projects under way and carried out. Under the proposed institution-strengthening component, the Unit's capacity to discharge its functions effectively will be reinforced.

2. External auditing

- 4.14 The financial statements of the PNDR and of the program will be audited annually by independent external auditors acceptable to the Bank. The Bank's Country Office in Managua is launching a series of orientation programs for external auditors on what the Bank's requirements are in relation to annual external audits in terms of accounting, financial and internal control procedures in general. For the present phase, presentation of the external audit findings, according to the guidelines to be set-out in the above-mentioned programs will be requested.

3. Personnel

- 4.15 At the present time, the PNDR's central office has a staff of 15 professionals and technical officers, seven aides and nine support personnel, which includes secretaries, drivers, and maintenance staff. DRDA staff consists of a total of 28 professionals and officers and 12 secretarial, security and maintenance personnel. The agency's total technical and professional staff thus numbers 43, which is 61% of its total staff of 71.
- 4.16 The program proposes to improve the performance of the institution's personnel. To that end, and as part of the preparation process, a review of the functions manuals has been done and the existing technical staff complement will be streamlined, mainly by eliminating duplicated functions and/or by having the DRDAs and headquarters share professional and technical personnel. For two years, the staff of the DRDAs of the PNDR will be increased by five officers to promote community participation. Their role will be to publicize the program and encourage the communities to participate in the identification of projects. In turn, and to better monitor the projects' environmental impact, three more environmental specialists will be added to the DRDAs' technical staff. The personnel needed for the new DRDA in the department of Estelí to function would be contracted; the staffing structure would be similar to that of the existing DRDAs.

4. Cumulative budgetary execution and commitments

- 4.17 From the time it was launched in 1995 to June 30, 1997, the closing date used for the present evaluation of the PNDR's budget performance, of a total of US\$33.4 million from the operation now in progress (US\$30 million from the Bank loan and US\$3.4 million in local counterpart funding), a total of US\$13.5 million has already been expended: (a) US\$3.6 million (27%) for operating expenses and PNDR strengthening; (b) US\$9.5 million (70%) for investments in strengthening and training EAs, AAs, and municipalities, and for investments in projects; and (c) US\$0.4 million (3%) for finance costs. Also, as of that date, the PNDR had already committed a total of US\$9.4 million for the period from July 1997 to December 1998, which breaks down as follows: (a) US\$2.4 million (26%) for operating expenses and strengthening of the PNDR; (b) US\$6.1 million (65%) for investments in training EAs, AAs, communities and municipalities and for investment projects, and (c) US\$0.9 million (9%) for finance costs.

C. The Ministry of Agriculture (MAG)

1. Background

- 4.18 Under Decree Law 1-90, the MAG's chief responsibilities are to: (a) lead and coordinate the National Agricultural Council (CONAGRO); (b) pilot agricultural policy; (c) determine priority

interventions in the agricultural sector; (d) distribute and coordinate functions with the Ministry of Environment and Natural Resources (MARENA), the Nicaraguan Agrarian Reform Institute [Instituto Nicaragüense de Reforma Agraria] (INRA) and the Nicaraguan Agricultural Technology Institute [Instituto Nicaragüense de Tecnología Agropecuaria] (INTA); (e) supply animal and plant health services and plant protection and animal health control services; (f) produce statistics and information on agricultural markets and prices, and (g) support the growth of the agricultural private sector.

- 4.19 Presently, MARENA is charged with management and conservation of natural resources; INRA with agrarian reform, and INTA with agricultural research and extension. However, there is some duplication, especially with regard to the management of renewable natural resources. There are problems with operational coordination of the agencies in the sector; the MAG does not have the tools to pilot sectoral policies; there are gaps and overlapping in the performance of functions, and programs that do not fit into a framework of common rural and agricultural development policies.

2. Information system

- 4.20 The MAG does not presently have a modern computer system to manage data and track the plans and programs of the entities within the sector. The staff now managing the system do not have good technical credentials, which is an impediment for an effective management information system.

3. Objectives of the MAG institution-strengthening

- 4.21 The institution-strengthening plan devised will provide the MAG with the elements needed to resolve these problems. Once that plan is carried out, the MAG will be able to: (a) establish a new institutional system for the agricultural sector by developing its new structure and its new relationship with other entities in the sector; (b) help cultivate analytical capabilities for preparing policies and monitoring the performance of the sector; and (c) help develop capacity for improved institutional management.

V. JUSTIFICATION OF THE PROGRAM

A. Technical viability

- 5.1 The program is informed by the experience acquired in the first phase and its economic performance. As noted in chapter II, the eligible investments are relatively simple projects that use technologies known and applied in Nicaragua, both by the PNDR in carrying out the first phase of the program, and by other projects and programs financed by the Bank and by other donors. During their preparation, design and implementation, the projects are to conform to the criteria, standards and technical specifications indicated in the Operating Regulations.
- 5.2 The specific technical features that apply in each case depend on the nature and characteristics of the various types of project. For example, when there are national standards for carrying out public works, as with the projects for rehabilitation of rural roads, the standards and specifications of the Ministry of Construction and Transport for design and construction of roads of a similar type are applied. In the case of technology transfer projects, the content of the technology packages to be disseminated are proven technologies, developed for the very agroecological conditions where they will be used. The technology package and the professional qualifications of the technicians who will effect the transfer will be validated and certified to respectively, by the Nicaraguan Agricultural Technology Institute (INTA). The transfer services will be performed by private firms or individuals, in keeping with the program's principle of fostering development of private-sector technical assistance services. The enhancement of the productive-resource base and natural resource management practices will be based on forestry and agroforestry technologies developed for Nicaragua and other Central American countries by the Tropical Agricultural Research and Higher Education Center (CATIE) and by such local institutions as the Universidad Agraria Nacional.
- 5.3 The inspection tours that Bank technical staff made of various projects either already carried out or in progress confirmed their technical soundness. For this second phase of the program, the selection criteria have been reinforced and stated in more explicit terms, which should make the portfolio of projects all the stronger.

B. Institutional and operational viability

- 5.4 The portion of the program's first phase that has already been carried out confirms that the institutional organization of the agency executing the rural development support component, the PNDR, is satisfactory for the program's implementation. Based on the experience acquired thus far, the plan in this second phase is to

strengthen community participation and, through Municipal Development Committees, give communities more of a voice to articulate their development priorities. Those committees are already in place in some of the municipalities that the program's second phase will cover.

- 5.5 The following are among the measures adopted to strengthen community participation: hiring of experts in social outreach to work directly with community groups; expansion of the extension agencies' area and the introduction of feedback mechanisms for better presentation and preparation of project ideas and profiles.

C. Environmental viability

- 5.6 To verify the program's environmental viability, an impact evaluation was done by analyzing a sample of 44 projects and reviewing the environmental procedures in place for the rural development environmental procedures system (SISPADRU). As a result of that evaluation: (a) the procedures being used were found to be sound and certain adjustments were suggested, such as including centralized environmental monitoring in the new monitoring and evaluation system; (b) training activities were proposed to provide SISPADRU instruction to PNDR technical staff, the extension agencies and administrative agencies, contractors and construction supervisors in the departments where the program will be expanded; (c) the hiring of three additional technical officers was proposed to serve the departments that the program will cover, working as members of the staff of the DRDAs; (d) tracking of environmental monitoring of projects is being introduced into the monitoring and evaluation system; and (e) an environmental audit has been added to the plan for institutional strengthening of the PNDR.

- 5.7 The Operating Regulations contain the typology of activities and projects eligible for financing and their environmental evaluation requirements, including indications about management and maintenance.

- 5.8 The objective of the rural development policy that the program pursues is economic growth and reduction of poverty of the rural population in the target area. From the environmental standpoint, it aims for sustainable management of natural resources and recovery and protection of resources now being depleted.

D. Financial viability

- 5.9 Measures have been taken to guarantee the program's continuing institutional and financial viability, through a plan that increases the local counterpart funding to cover the program's administrative costs. Also, contributions from the beneficiary communities toward financing of the projects have been factored in and efforts will be made to increase their participation.

E. Economic viability

- 5.10 One factor given special consideration when analyzing the economic viability of the rural development support component was the makeup of the target population, which consists of small- and mid-size producers capable of generating surpluses. Because the program does not take an aid approach, the projects that the beneficiaries request have to be properly justified and evaluated.
- 5.11 In preparing the operation, a review was done of the results of the financing of the program's first phase. The review has an economic appraisal component for projects for which a feasibility study is officially required, as in the case of rural roads and infrastructure works, and an examination of the principal findings of the impact evaluation carried out as the operation was being prepared.

1. Methodological elements of the economic appraisal

- 5.12 For the review and in anticipation of the analysis of the portfolio planned for the second stage, the economic appraisal was made under conditions that would ascertain the soundness of the projects and their suitability as economically viable solutions. Projects of such varied origin, especially in the case of road projects, with differing climates and agroecological conditions in their impact areas, make it difficult to apply uniform guidelines; in principle, a variety of factors that could influence the parameters used have to be considered, such as the estimated maintenance cost or, on the income side, strategic positioning between points of strong marketing potential.
- 5.13 Given the foregoing, the parameters established were those that can be applied in the economic appraisal of both current projects and projects now in the pipeline. The parameters are considered conservative, inasmuch as they look only at the effect the projects have on the producers' income. The evaluation criteria for rural road rehabilitation projects were:
- a. The impact of an economic infrastructure work such as a rural road is immediate; its effect on income is predictable and is realized by lowering transport costs. Transport normally represents 10% of a product's market price; at the least, the project lowers this cost by 50%, thereby yielding a benefit equivalent to 5% of the value of output each year. This is a conservative assumption: indeed, in the pre-project situation it is sometimes impossible to get products to market at all in certain areas, or roads are impassable some months of the year.
 - b. Since a project's benefit is equivalent to a 5% increase in farmgate prices, there will be a corresponding response on the supply side. To conservatively estimate that response, a 0.2 supply elasticity has been assumed. According to econometric

evidence of this parameter in developing-agriculture settings, values for staple grains range from 0.2 to 0.5 (short-term response). Under this assumption, output would rise by 1%. The projections of the impact of investment outlays assume an increase in output of this magnitude in the first year after the works are placed in service, since evidence also suggests that the supply side responds quickly. Output then remains at this new level in each year of the analysis horizon.

- c. The mere fact that farms gain access to markets has an impact on the use that stands to be made of currently idle or underutilized land. For purposes of the appraisal this effect was quantified at 1% of the production area in the project's area of influence, as from the date of the project's completion.
 - d. Also factored in was the consideration that the effect of a works project is not confined to farming *per se*; it has an impact on every quarter of economic activity in the rural environment. This multiplier effect was put at about 70% of income imputed from the increase in value of output.
 - e. Adjustment factors for the economic appraisal were determined on the basis of international averages; for the shadow price of labor the typical range is from 0.5 to 1.0 of the wage. For conditions in Nicaragua, even without estimating the labor supply and demand curve, the 0.70 factor bespeaks the seasonal nature of labor and relative migratory facility. As for foreign exchange, the market does not have any significant restrictions as regards the market price of foreign currency, so that the financial price can be considered equal to the shadow price.
 - f. The economic appraisal took price-subsidization mechanisms into account, though their influence is minimal for the following reasons: (i) price bands have been eliminated; and, in any event, they did not distort prices, since by virtue of the design of the system itself they had zero effect, on average, on the pricing structure; (ii) the agriculture sector had scant access to the previous export-incentive system, which mainly benefited manufacturers; and (iii) there is a more broadbased subsidy of 1.5% under the new export-incentive policy, but its effect is slight.
- 5.14 These projects are known to generate additional benefits through other effects. However, conservative assumptions had to be used to arrive at a robust minimum estimate of their probable results.
2. Economic evaluation of the component as a whole
- 5.15 The parameters and adjustment factors described above were used to do the appraisal, and the weighting was computed on the basis of

the total costs of the projects, adding in, as key data, the program's administrative costs and the total amount spent on investments. With that, the minimum economic internal rate of return (EIRR) of the program is 19.8%. While the high-end estimate is 33.8%, the more likely estimate of 27.8% is a conservative measurement of the benefits, because (as was noted above), the assumptions used to compute the EIRR of each project were conservative.

- 5.16 The favorable economic evaluation of the projects examined reinforces the conclusion that they meet all the eligibility criteria established by the program, as described in the Operating Regulations. One important consideration is that the program's impact will generate various indirect benefits and positive effects that are difficult to quantify. In fact, information compiled during the impact evaluation done in September 1997 reveals that the projects conducted during the first stage have had a marked impact on the local economy, which would suggest that similar impacts can be expected from the pending projects.

3. Demand targeting

- 5.17 The program is broad in scope, not just in terms of the type of actions but the target groups as well. The PNDR will have an impact on 91 municipalities in the central and Pacific regions, where 1.32 million people live (73% of the country's rural population). Of these, 75%, i.e. 985,000 people, are poor. The following is a brief description of the types of rural producers in the PNDR's area of influence:

- a. **Wage earners** account for 43.7% of the rural population and work as farmhands.
- b. **Small farmers** represent 41% of the rural population with farms of up to 25 *manzanas* (17.5 hectares); they account for 76.29% of the holdings in the program's area of influence. They are agrarian reform beneficiaries with thinly capitalized operations who use mainly family labor and very occasionally labor from outside the family group; they produce mainly for self-consumption but have the potential to generate a surplus. These are poor *campesinos* with growth potential and generate 17% of employment in the rural sector.
- c. **Mid-size producers** represent 10.5% of the rural population and have farms ranging in size from 25 to 100 *manzanas* (17.5 to 70 hectares), owning 17.3% of the holdings in the program's area of influence. They have the potential to hire additional labor and have somewhat diversified production structures that equip them to sell on the market, in modest volumes. They account for 39% of employment in the rural sector and 50% of the net foreign exchange earnings.

- d. **Large landowners** account for 4.9% of the rural population and 6.58% of the farms in the program's area of influence. They are located mainly in the coffee and cattle regions and have good access to land. Their farms are over 100 *manzanas* (over 70 hectares) and the landowners themselves are well integrated into the market economy and are net employers of rural labor.

5.18 The general characteristics and size of farms are shown below:

GENERAL CHARACTERISTICS AND SIZE OF FARMS, 1997						
DEPARTMENT	Farm size (manzanas)					
	1 - 4.9 (subsistence)	5 - 24.9 (small farms producing surpluses)	25 - 99.9 (mid-size)	100 - 499.9 (large)	500 + (very large)	Total
Nueva Segovia	12,065	8,304	3,070	460	24	23,923
Madriz	11,388	5,657	1,463	257	37	18,802
Estelí	17,382	5,769	2,867	531	37	26,586
Managua	9,050	5,325	1,582	558	118	16,633
Granada	7,992	1,645	319	186	48	10,190
Carazo	7,655	3,192	757	227	30	11,861
Rivas	10,516	3,760	1,150	441	93	15,960
ZC West	4,099	1,847	6,835	2,923	148	15,852
Boaco	11,067	3,855	3,194	1,571	117	19,804
Chontales	2,514	2,629	4,559	2,269	192	12,163
Jinotega	9,783	11,946	4,597	1,264	58	27,648
Matagalpa	14,344	16,836	9,540	3,508	323	44,551
Río San Juan	665	986	2,789	907	83	5,430
Total farms/producers	118,520	71,751	42,722	15,102	1,308	249,403
Percentages	47.52%	28.77%	17.13%	6.06%	0.52%	
NOTE: 1 manzana = 0.7 hectares						

- 5.19 In size terms, 76.29% of the holdings in departments covered in the program are small (farms between 1 and 25 manzanas); 17.13% are mid-size holdings.

NICARAGUA
FOOD AND AGRICULTURAL REVITALIZATION PROGRAM
LOGICAL FRAMEWORK

SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS/RISKS
Contributed to a sustainable productivity in the food and sector and helped reduce poverty.	<ul style="list-style-type: none"> - An increase in employment and income in the rural sector. - Better income distribution. 	<ul style="list-style-type: none"> - Findings of existing household surveys, which are repeated at intervals. - Results of an analysis of special surveys conducted before and after the program, in selected communities. 	<ul style="list-style-type: none"> - A favorable macroeconomic climate and sound sectoral policies. - Targeting improved rural production, physical and human capital is a key strategy for increasing productivity in the food and agriculture sector.
Programs made and activities carried out have increased agrifood productivity and income of small- and mid-size producers in the area covered by the program.	<ul style="list-style-type: none"> - An increase in the real agricultural and food product in the program area, both per hectare and per beneficiary. - Increase in the total real value-added in program areas. 	<ul style="list-style-type: none"> - Program monitoring and mid-term evaluation - Findings of the surveys conducted - Price and market information - Interviews with producers 	<ul style="list-style-type: none"> - The program's mechanisms are effective for achieving its goals. - The training activities and the extension foster additional investments in the sector, improve producers' management skills and have a synergistic effect on the productive process.
DEVELOPMENT SUPPORT Programs transferring resources and implementing productive projects is ongoing.	<ul style="list-style-type: none"> - Investments channeled through the program - Projects carried out and operating - Coordination with other rural development programs 	<ul style="list-style-type: none"> - Management reports - Bank supervision - Evaluation - Auditing - Impact studies 	<ul style="list-style-type: none"> - An adequate institutional framework is maintained. - Decentralization and community participation are successfully promoted. - The capacity for institutional management is improved.
Programs executed that have had their results Organizations stronger in project management and implementation. Increased institutional capacity for analyzing and carrying out	<ul style="list-style-type: none"> - Number of persons benefitted - Number of projects executed - Number of small farms capitalized - Amount of resources invested - Kilometers of rural roads rehabilitated - Number of training and technology transfer activities carried out - Hectares of woodlands replanted - Communal irrigation systems developed - Marketing units established - Productive diversification achieved 	<ul style="list-style-type: none"> - Analysis of statistical samples - Bank supervision - Audit reports - Program evaluation 	<ul style="list-style-type: none"> - The identification, ranking, preparation and implementation of investments function properly and improve productivity. - Efficient mechanisms are devised to enable the PNDR, communities, governments, and outreach and implementation agencies to coordinate with each other.

Original signed
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PROPOSED RESOLUTION

NICARAGUA. LOAN ___/SF-NI TO THE REPUBLICA DE NICARAGUA
(Program for Productive Agriculture Sector Reactivation)

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, to cooperate in the financing of a Program for Productive Agriculture Sector Reactivation. Such loan will be for the amount of up to US\$40,000,000 or its equivalent in other currencies, except that of Nicaragua, which are part of the resources of the Bank's Fund for Special Operations, and will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.