

TEXAS PAPERS ON LATIN AMERICA

**Pre-publication working papers of the
Institute of Latin American Studies
University of Texas at Austin**

ISSN 0892-3507

**Nicaragua: The Economic Dilemmas
of Peace and Democracy in 1988**

Michael E. Conroy

**Institute of Latin American Studies
and Department of Economics
University of Texas at Austin**

Paper No. 88-05

Nicaragua: The Economic Dilemmas of Peace and Democracy

by Michael E. Conroy

September 15, 1988

Abstract

This paper explores the complex economic conditions that Nicaragua faces at the end of 1988. It focuses, in particular, on the policy dilemmas that the Nicaraguan government confronts as domestic economic conditions continue to deteriorate, as the prospects of continued war drag on, and as public opinion begins to associate economic problems more closely with the government and less closely with the war. The paper presents a summary of overall Nicaraguan economic performance since 1979, places it in the context of the broader Latin American economic crisis over the same period, and analyzes some of the principal characteristics of the economic model that has evolved under the Sandinista Front. Special attention is paid to the dramatic economic policy changes implemented in February and June 1988 and to the changing external assistance levels received by Nicaragua, especially the rapid increase and then decline in Soviet economic assistance. Two alternative scenarios for future economic policy are then explored, one under the assumption of continued war and economic isolation, the other under an assumption of a definitive cease fire in the war and economic reactivation with international assistance.

Nicaragua: The Economic Dilemmas of Peace and Democracy in 1988¹

by Michael E. Conroy

Department of Economics
and
Institute of Latin American Studies
The University of Texas at Austin

September 15, 1988

The year 1988 has been bittersweet for the Nicaraguan people. The temporary cease fire signed in the village of Sapoá on March 23rd has meant an effective end to the majority of the fighting in the war with the "contras," although sporadic violations of the cease fire have continued. The willingness of both "contra" leaders and the government to negotiate raised hopes repeatedly that a definitive cease fire was near and that peacetime reconciliation and reconstruction would soon begin. But the continuing failure of those negotiations to produce a resolution of the military conflict dashed those same hopes. And through it all, the economic situation has continued to deteriorate.

This paper will explore the complex economic conditions that Nicaragua faces at the end of 1988. It will focus, in particular, on the policy dilemmas that the Nicaraguan government confronts as the domestic economic conditions continue to deteriorate, as the prospects of continued war drag on, and as public opinion begins to associate economic problems more closely with the government and less closely with the war. Peace may be the most serious challenge that the Sandinista

¹ This paper was prepared for presentation at the "Conference on Nicaragua: Prospects for a Democratic Outcome," sponsored by the Orkand Corporation, October 12 and 13, 1988, Washington, D.C. It will also be presented at the VII Congreso Centroamericano de Sociología, October 10 -15, 1988, Guatemala City. The opinions expressed in this paper reflect solely those of the author and do not necessarily represent those of either the Orkand Corporation or the University of Texas.

Front has faced since 1979; for the latent demand for jobs, higher wages, and expanded social services is certain to burgeon as soon as there is a definitive cease fire. Peace with democracy presents a double challenge; for there are municipal elections to be scheduled and new presidential elections will be expected by 1990. And to enter those elections without dramatic improvements in economic conditions will threaten the support on which the Sandinista Front most clearly relies.

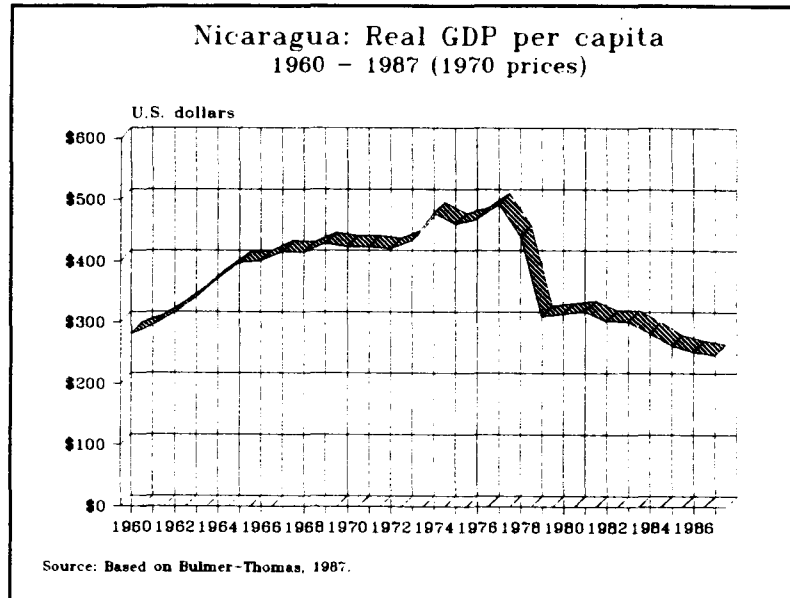
In order to understand the current policy dilemmas, however, it is important to put the Nicaraguan economy in proper focus. The paper will present a summary overview of the Nicaraguan economy from 1979 to 1987, including discussion of accomplishments, shortcomings, and the consequences of the war. It will then zero in on the specific problems of 1988, the policy responses embodied in the government's dramatic shifts in economic policy on February 14th and June 14th of this year and the potential impact of those new policies on both the fundamental economic problems and on political support for the government. The paper will close with a discussion of the alternative future roles of the Nicaraguan private sector, Western financial institutions, and other parties in future economic policies under two alternative scenarios: a) continuation of low-intensity warfare, and b) a definitive cease fire and the refocusing of political forces into the civilian arena.

The Nicaraguan Economy: 1980-87

It would be easy to select individual dimensions of the performance of the Nicaraguan economy since 1979 and to characterize that performance as "disastrous." The standard of living for the population as a whole, as measured by real GDP per capita and as illustrated in figure 1, fell by 1987 to a level below that of 1960. Gross domestic product fell, in per capita terms, by more than 14% in 1978, the last full year under the Somoza regime, and by more than 25% during

1979, the year of the overthrow of Somoza. From 1980 to 1987, the years for which the present government of Nicaragua can be held more fully responsible, growth was strong at first. But declines in the period from 1984 to 1987 has left GDP per capita at 17.2% below the 1980 level.² Total exports from Nicaragua have declined in value by 40%

Figure 1



over the same period. Shortages of imported goods have become acute throughout the country; and the production of domestically-produced goods that required imports (everything from clothing to medicines and beer) has also fallen dramatically. Average real wages, according to one source, fell by 1988 to less than 10% of 1981 levels.³ Figure 2 provides year-by-year indication of the changing growth rates. At the same time, price levels rose in Nicaragua at rapidly escalating rates: 32% per year from 1980 to 1984, 334% in 1985, 778% in 1986, and, some say, as

² Measurement of Nicaraguan economic performance since 1980 is fairer and more reasonable than beginning with either 1978 or 1979. To begin with 1978 levels would force the current government to be effectively responsible for economic performance in 1979, a year totally disrupted by the insurrection, where nearly a full year of economic output was lost. To begin with 1979 levels would credit the present government with the dramatic increases in output that occurred in 1980, when compared to 1979, that were, at least in part, a relatively natural "rebound" effect.

³ Central America Report, September 2, 1988; it is not clear whether these data refer to industrial wages, urban wages, or average wages nationwide.

much as 1500% in 1987.⁴ Nicaragua's external debt also increased at unparalleled rates, from \$961 million in 1979 to approximately \$7.2 billion in 1987.

This "easy" interpretation may, in fact, be simply facile. The reality of what has been happening is quite a bit more complex, and quite a bit more interesting. Agricul-

Figure 2

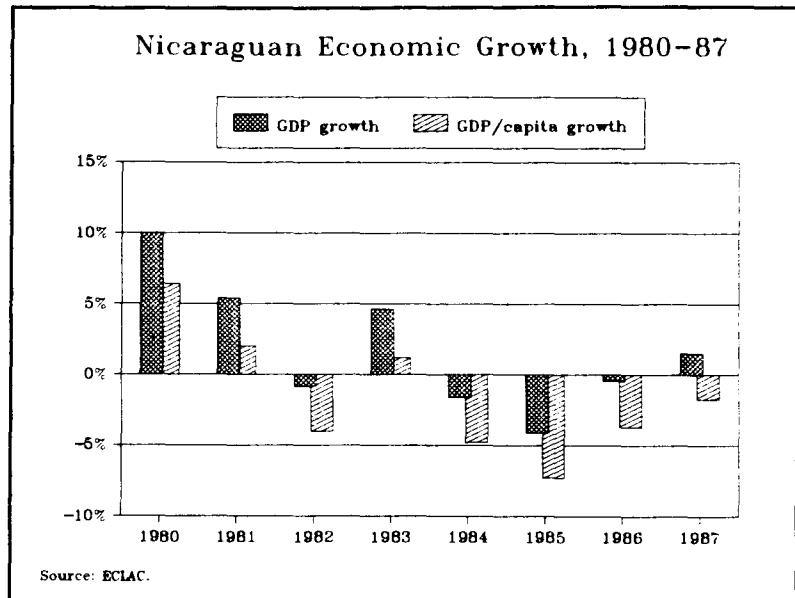
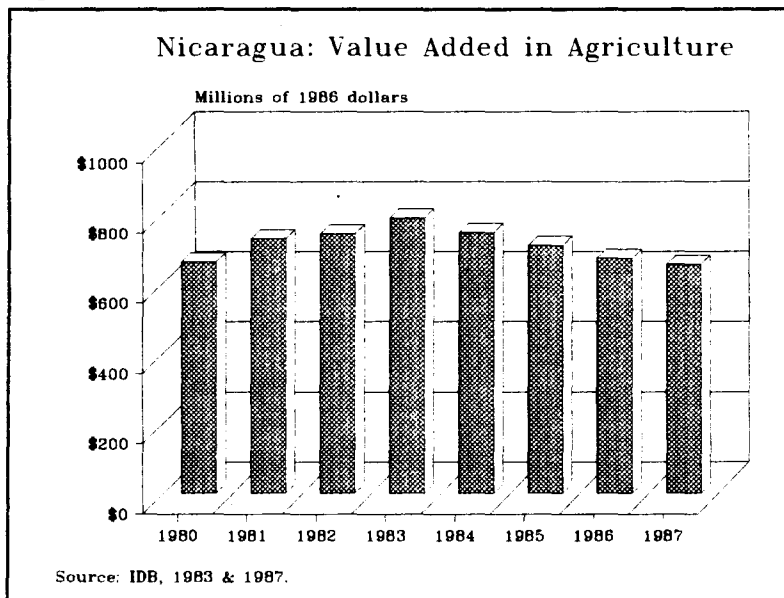


Figure 3



ture, the perennial mainstay of the Nicaraguan economy provided the principal impetus for growth from 1980 to 1983. It declined somewhat from 1984 to 1987 (15%), as shown in figure 3, but not by anywhere near the decline in exports; for the Nicaraguan government has pursued a deliberate policy of converting agricultural export acreage into basic grains production, as part of the "wartime survival" strategy.

⁴ For 1980 to 1986, taken from Juan Valverde, "La crisis y las distorsiones de la economía nicaraguense," *Boletín Socioeconómico* 8 (June-July 1988) p.7; 1987 level taken from *EIU Country Report: Nicaragua, Costa Rica, Panama* 3(1988).

For most of the years of recent economic decline, the decreases in exports have been offset by grants and credits, increasingly from the Eastern European countries, that permit the government to run substantial deficits. The accumulated debt from this process is the largest in Central America, but it has the lowest effective debt burden (15%-17% of export income) in all of Central America (less than half the burden of Costa Rica, El Salvador, or Panama in comparable years).⁵

Comparison with the Rest of Latin America

Direct comparison of the Nicaraguan economic performance with that of other countries in Central America and in the rest of Latin America suggests that Nicaraguan economic conditions over this period did not differ as greatly as the

separate statistics would seem to imply. GDP per capita was down by 5.5% for Latin America as a whole during the same period. Mexico and Venezuela incurred decreases of 10.5% and 20.0%, respectively. The decline in GDP per capita in Nicaragua was not even the greatest in the Central American region. Table I demonstrates that Nicaragua's overall economic performance was, in some significant measures, better than that of Guatemala and comparable to that of El Salvador and Honduras. There was no comparable problem, however, with respect to the rate of inflation.

Table I

Recent Economic Indicators Nicaragua, Central America, and Other Latin American Nations		
	GDP Growth 1980-87	GDP/capita Growth 1980-87
Latin America	10.7%	-5.5%
Nicaragua	4.5%	-17.2%
Mexico	6.8%	-10.5%
Venezuela	-2.6%	-20.0%
Costa Rica	8.7%	-9.5%
El Salvador	-6.8%	-14.5%
Guatemala	-3.1%	-20.5%
Honduras	9.6%	-14.5%

Source: ECLAC, Preliminary Overview...1987

⁵ EIU Country Profile 1988-89: Nicaragua, Costa Rica, and Panama (April 1988), p.27. The "passive default" that EIU sees embodied in this low debt burden may hinder further credits, but it is an effective strategy under the circumstances; the low burden also reflects the relatively generous effective terms obtained from the Eastern European creditors.

The origins of these economic declines have been studied extensively, including in the work of the Kissinger Commission. The Nicaraguan economy, as well as the rest of the Central American economies, is driven primarily by export earnings. When Nicaragua's exports have expanded in the past, the economic conditions for the nation as a whole have generally risen. When prices or production have fallen, times have become very difficult. The insurrections in Nicaragua and El Salvador may have precipitated the economic

declines in the region as a whole during the early 1980s, and the counter-revolutionary war in Nicaragua deepened and prolonged the decline. But most economists are in agreement that, as noted by Zuvekas (a leading USAID analyst of the region), "the depth and duration of the economic crisis for the region as a whole has been determined primarily by external economic events."⁶ Falling prices for Central America's principal exports (coffee, sugar, cattle, and cotton), high interest rates on debt accumulated in the 1970s to counter increases in petroleum costs, and dramatic reductions in the availability of the international commercial bank lending that had facilitated growth during the 1970s, all affected Nicaragua as well as the other nations in the region. Table II illustrates the

Table II

Indices of 1987 Export Volumes, Prices, and Earnings: Nicaragua, Central America, and Other Latin American Nations

(1980 = 100)

	Volume	Prices	Earnings
Latin America	132	74	99
Nicaragua	73	83	60
Mexico	197	66	131
Venezuela	81	67	54
Costa Rica	138	85	117
El Salvador	72	76	54
Guatemala	76	82	64
Honduras	116	86	100

Source: ECLAC, Preliminary Overview...1987.

⁶ Clarence Zuvekas, Jr., "Central America's Foreign Trade and Balance of Payments; The Outlook for 1988-2000," a paper presented at the "Symposium on the Future of the Central American Economies," The University of Texas at Austin, April 20-21, 1988; forthcoming in my edited volume, Transformation or Continuing Crisis: The Future of the Central American Economies.

problem faced in the export market. Only Costa Rica, from among the five traditional Central American nations, managed to increase its export earnings during the 1980-87 period; but Costa Rica had to increase production by 38% to obtain a 17% increase in export earnings. Nicaragua experienced a 40% decline in export earnings over that period, the combined effect of a 17% decline in prices for its exports and 27% reduction in the volume of goods produced and exported. By comparison, El Salvador incurred a greater drop in both volume and prices and, consequently, a greater reduction in export earnings.

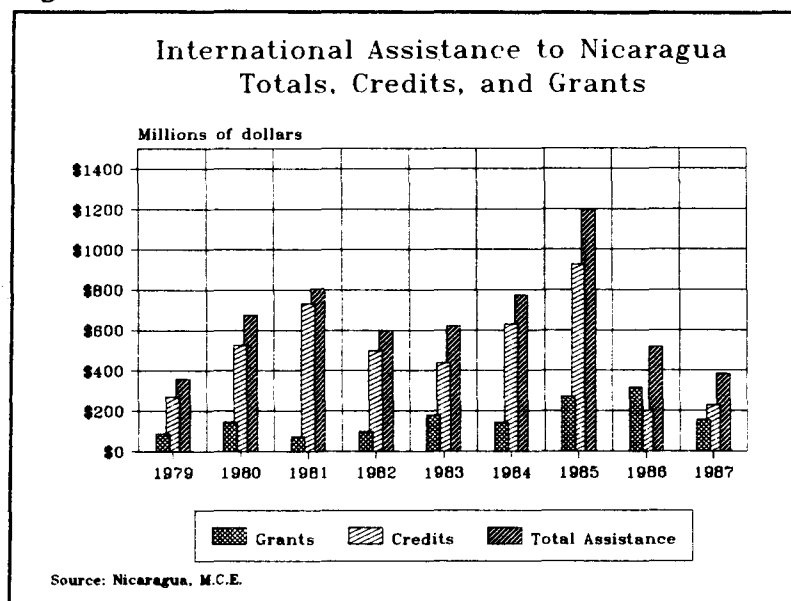
International Assistance

Nicaraguan economic performance would have been considerably worse, given the export conditions it faced, were it not for extensive international assistance that it received from 1979 through 1987.

In general, Nicaragua received a total of nearly \$6.0 billion dollars in credits and donations from July 1979 through December 1987. This support, an average

of \$670 million per year, includes everything from trade credits to donations from the World Council of Churches. The distribution across the period since 1979, however, is far from even. Figure 4 illustrates that distribution. Nicaragua received the greatest amount of international assistance in 1985, the year in which the U.S. imposed the complete trade embargo. The majority of the \$1.1 billion received that year

Figure 4



was in the form of trade credits from the Soviet Union (\$664 million).

Soviet economic assistance to Nicaragua has been demonstrably opportunistic. It has fluctuated widely from year to year. There was no Soviet assistance prior to 1981 (except a \$400,000 donation). The total division across major sources of funding may be seen in Figure 5.

Soviet economic aid (including oil) exceeded \$100 million in only two years, 1984 and 1985; and those two years account for fully 67% of the \$1.6 billion that it has donated. In most other years, Soviet economic contributions have been in the range of \$50 million to \$70 million per year. Total assistance from Socialist countries has amounted to 55% of the \$6 billion eight-year total, has been more evenly divided across the years, but has failed to maintain Nicaragua's crucial ability to import needed goods, especially in 1986 and 1987 (see below). There is ample evidence, albeit largely anecdotal, that the Soviet Union and the other Eastern European countries have limited their contributions to Nicaragua out of disagreement with the fundamental model that has evolved. This "short leash" was "yanked" in 1986, when promised oil shipments of 500,000 tons were suddenly reduced to 300,000 tons. And although cordial commentary pervades public relations with Socialist Bloc countries and support totalling about \$300 million per year for 1988 and 1989 has been announced, the reduction in Socialist Bloc assistance may be the most important dimension underlying the crises of 1987 and 1988.

Figure 5

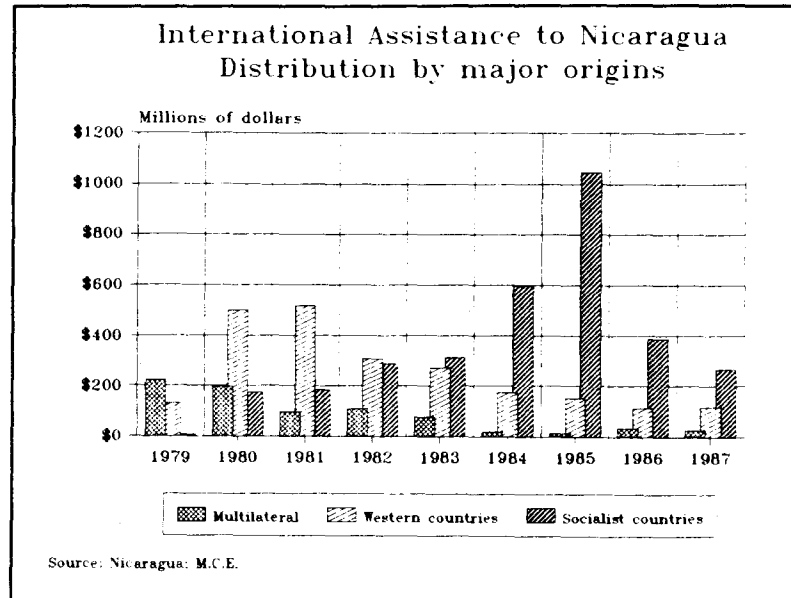


Figure 6

Western countries, including Western Europe, the U.S., Canada, and other Latin American countries contributed the largest shares of Nicaragua's external assistance until 1983. If multilateral contributions, dominated by the World Bank and the Interamerican Development Bank, are added to the "Western" con-

tribution, it was not until 1984 that Socialist countries contributed a majority of total external assistance. Western nations and the multilateral institutions have provided 43% of Nicaragua's total assistance over this period, most of it in the early years, prior to U.S. intervention in the World Bank and the Inter-American Development Bank to block further aid.

Nicaragua's external assistance fell greatly after 1985, to less than \$520 million in 1986 and only \$385 million in 1987. If we ignore the fact that much international assistance is tied to the purchase of specific sets of commodities or products from specific countries, the sum of total exports and total international assistance provides a comprehensive measure of Nicaragua's ability, from year to year, to purchase the vast array of imported goods needed for both agricultural and industrial production. This "import potential" is shown in figure 6. Nicaragua's import potential fell in 1986 to less than 80% of the 1982 level, the worst previous year. By 1987 it fell to nearly 60% of that level, and less than 40% of the peak year, 1985. That may be the single most important measure of the origins of

