



Mr. D. Vikram Haksar  
Mission Chief for Nicaragua  
Western Hemisphere Department  
International Monetary Fund  
Washington, D.C.

July 25th, 2006

Dear Mr. Haksar,

In the first place, we would like to thank you for your letter dated June 19<sup>th</sup>, in which you answer the correspondence addressed to the IMF Managing Director by members and collaborators of both the Nicaraguan Civil Coordinator and Intermón Oxfam.

Therefore, we agree on the opportunity of maintaining dialogue with civil society in order to enable the implementation of effective measures aimed at achieving the Millennium Development Goals (MDGs). In view of this aim, please let us make some comments with regards to the most relevant topics in your letter.

#### About expenditure allocated to fight poverty

According to data from Budget Liquidation Reports of the Republic of Nicaragua and the Secretariat for Coordination and Strategy of the Presidency, from 2000 until 2004, the expenditure allocated to poverty reduction practically stagnated, barely increasing from 11.6% of GDP in 2000 to 11.7% of GDP in 2004, in spite of significant additional resources arising from:

- ? **External debt relief** (as a result of the HIPC Initiative), which released major fiscal resources previously allocated to service such debt, exceeding the annual average amount of 200 million dollars in recent years, and
- ? A considerable **increase in fiscal revenue** amounting to a total of nearly 300 million dollars between 2000 and 2005.

As you state in your letter, a change was registered in this trend in 2005 when expenditure allocated to poverty reduction was increased to 12.7% of GDP. On the one hand, this was due to an increase in the amount of budget transfers to municipalities and to a rise in the salaries of teachers and health workers, which still evidence a considerable shortfall. On the other hand, there is the subsidy granted to urban public transport and the subsidy granted to the private energy company, which was increased to 0.6% of GDP.

The IMF expressed its agreement with the increase of the latter subsidy but disagreed with the rise in municipal transfers and the salaries of teachers and health workers, even using this statement to justify the suspension of its program with Nicaragua. This position taken by the IMF failed to be understood, particularly when it was early known that annual fiscal revenues would allow to finance those increases, as indeed happened. Therefore, we are pleased to hear that the Fund acknowledges now that "these efforts are bearing fruit", as you point out in your letter.

From our point of view, we still consider that public expenditure allocated to fight poverty in Nicaragua is noticeably insufficient to achieve the fulfillment of MDGs. As a reference, per capita social expenditure in Honduras and Bolivia, countries with a development level similar to that of Nicaragua – and also members of the HIPC Initiative – double Nicaragua's expenditure, in spite of the fact that their levels of per capita external aid are inferior.

Likewise, we believe that as stipulated by international consensus, the funds released through the HIPC Initiative should not be used as a substitute but should be additional to the expenditure made with the country's own resources<sup>1</sup>. Also, a significant part of the increase in terms of fiscal revenue should have been allocated to the rise in resources aimed at fighting poverty. If this had taken place, the increase in social expenditure between 2000 and 2005 should have been enough to bridge the financial gap to achieve the MDGs and national goals in key areas such as education, health, nutrition, drinking water, sanitation, rural roads and housing.

Civil society has welcomed the efforts made by international financial institutions to mobilize funds for the fulfillment of MDGs, mainly through multilateral debt cancellation for HIPC countries such as Nicaragua. However, we believe that **IMF support and debt relief by international financial institutions should not be tied to conditionalities and restrictions on public spending that would indeed prevent the achievement of MDGs.**

#### About the salaries of teaching and health staff:

We should agree with you on the figures of salary increases for teaching and health staff registered in 2005. However, we still find it difficult to understand the reasons for the IMF opposition against this measure, since:

- ? The government of Nicaragua itself has acknowledged that in order to fulfil the health and education goals it will be necessary to overcome the huge salary shortfall in these areas and to have enough resources available so as to increase total wages thus recomposing them and hiring additional staff<sup>2</sup>. Along the same line, **the UNDP underscores that 86% of the increase in education spending should be allocated to payment of teachers' salaries and other ordinary spending**, since "if donors maintain the policy only to finance capital investments, the sector will be seriously affected by a lack of resources for vital ordinary spending"<sup>3</sup>.
- ? These increases do not represent absolute significant increases. They only appear to be significant from a percentual point of view since they are being applied to very low initial amounts. Nicaraguan teachers, for instance, continue to earn a salary that accounts for nearly half the mean salary of the Nicaraguan workforce<sup>4</sup>. This implies that instead of attracting the required qualified staff to

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<sup>1</sup> "...it was established that debt relief should reflect an additional spending to the efforts made by countries through their own allocation of resources to fight poverty. In this sense, HIPC relief should not be substituting domestic resources which were previously used for such purpose". ("Second Progress Report on the ERCERP", October 2003, page 33).

<sup>2</sup> "It has to be considered that the recomposition of the salary shortfall and the increase of total wages by an increased coverage of sectoral services, will be a key issue over the next few years in the progress towards social goals"... This would imply "a new order in the State salary policy, mainly regarding those sectors directly related to basic services (health, education and citizen security)". (Operative National Development Plan, Government of Nicaragua).

<sup>3</sup> <http://www.undp.org/rblac/mdg/Informe-metas-Nicaragua.pdf>

<sup>4</sup> According to figures from the Central Bank of Nicaragua, the mean salary for the country's workforce is 255 dollars, while teachers' wages amount to 120 dollars, that is to say, 47% of the mean salary ([www.bcn.gob.ni](http://www.bcn.gob.ni))

this profession, it is necessary to hire poorly qualified staff which thus results in a poor quality education.

- ? It is widespread knowledge that this situation results in a “brain drain” and emigration which neither promotes the development of the country nor regional stability.

On the other hand, we cannot stop being astonished at the fact that the IMF considers that adapting the salaries of teachers and health staff to decent living standards is a risk factor with regards to competitiveness with foreign investors<sup>5</sup>. The fact that increasing the salaries of these public servants would lead to an improvement of labor conditions should be regarded as a favorable factor for the attraction of investors looking for what the ECLAC has labelled as “true competitiveness”, thus taking some distance from old harmful practices such as the race towards minimum labor conditions as a way to attract investors.

#### About “budget constraints”:

With regards to the so-called “budget constraints” you refer to in your letter and that in your opinion “do not allow to focus expenditure”, it is just worth remembering that both budget transfers to municipalities and the allocation of a budget percentage to public universities as well as the respective municipal and university autonomy, are provided for in the Political Constitution of the Republic of Nicaragua and therefore international institutions are expected to respect them.

An international organization like the IMF cannot impose the **modification of constitutional frameworks** on poor and small countries, since this would represent an unprecedented act in the history of international relations which will be hardly resulting in the creation of a sense of ownership with regards to decisions made, and will most probably create resistance.

With respect to your concern about the use of municipal resources, Nicaraguan people are the ones who are most interested in achieving this goal through adequate means. To help to improve the performance of local authorities and the use of public funds, it will be necessary to strengthen the accountability of municipalities before both the corresponding State bodies and citizens.

On the other hand, to ensure maximum political and economic effectiveness in this process, in our opinion, it is still necessary to establish mechanisms – or strengthen already existing ones – in order to broaden, guarantee and institutionalize the participation of citizens in the making of policies and local programs and also in monitoring the local operation of the public sector.

#### Key obstacles to the achievement of MDGs:

In any case, we consider that the Nicaraguan economy is suffering from other still more pressing and fundamental fiscal problems, which turn into the obstacles determining the impossibility to reach MDGs.

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<sup>5</sup>“(…) increasing public sector compensation risks having a negative effect on competitiveness. (...) As the government remains an important formal sector employer, growth in real public sector compensation far in excess of the private sector risks eventually putting pressure on labor costs in the formal sector. This would pose risks to the competitiveness of the formal export sector, and undermine Nicaragua’s attractiveness as an investment location, with respect to neighboring countries” (IMF Country Report n° 06/173, May 2006).

The Nicaraguan population bears one of the most regressive tax systems in the region, to the point that it significantly increases inequality as pointed out in IDB<sup>6</sup> studies and as recently confirmed by ECLAC<sup>7</sup>. The massive tax exemptions result in substantial losses to the State, thus reducing its capacity to make essential investments in human capital. Furthermore, on certain occasions, the public expenditure itself becomes concentrated in high-income population groups.

On the other hand, Nicaragua's burdensome domestic debt absorbs much more resources (three times more in 2003 and 2004) than those allocated to universities, Supreme Court and transfers to the 154 municipalities offering services to the country's 5.1 million inhabitants. Domestic debt service, which during the pre-HIPC period was very reduced, has currently reached disproportionate levels that exceed the levels of external debt service during such period, and has absorbed resources released through the HIPC from external debt payment.

We have reached the conclusion that Nicaragua will fail to achieve MDGs and national goals provided some progress is made towards a deep restructuring of the domestic debt and reforms to the tax system are implemented in order to turn it into a more efficient – in terms of its capacity to provide the State with more adequate resources for the fulfillment of its obligations -, and far less regressive system.

We would like to reiterate our opinion that these are key issues affecting all Nicaraguan citizens and therefore, they should be part of an open and transparent discussion process at country level, with broad democratic participation and full access to all the information required, which would open the possibility to enhance the decisions to be made as well as the design of policies, giving due consideration to different policy perspectives, approaches, dimensions and options.

The sole fact of making the country's key decisions through democratic and deliberative processes will contribute to the sense of ownership and joint responsibility that is essential for the long-term sustainability of any policy.

It would be desirable that IMF Programs that currently constrain the whole framework of economic and social policies in the least developed countries would be strongly modified so as to be mainly aimed at supporting these countries by all available means in order to achieve the fulfillment of the Millennium Development Goals, unanimously agreed upon by all Heads of State that are members of the United Nations.

Sincerely yours,



Ariane Arpa  
General Director  
Intermón Oxfam



Georgina Muñoz  
National Link  
Civil Coordinator

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<sup>6</sup> See, "Panorama Tributario de los Países Centro Americanos y Opciones de Reforma. Manuel R. Agosin - Alberto Barreix - Roberto Machado - Juan Carlos Gómez-Sabaini.

<sup>7</sup> "In this context it is not surprising...that the tax system contributes to further increase the already concentrated income in three countries (Nicaragua, El Salvador and Honduras)", Retos de la política fiscal en América Central, CEPAL, 2006.