

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**

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Paper No. 88-05

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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

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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.

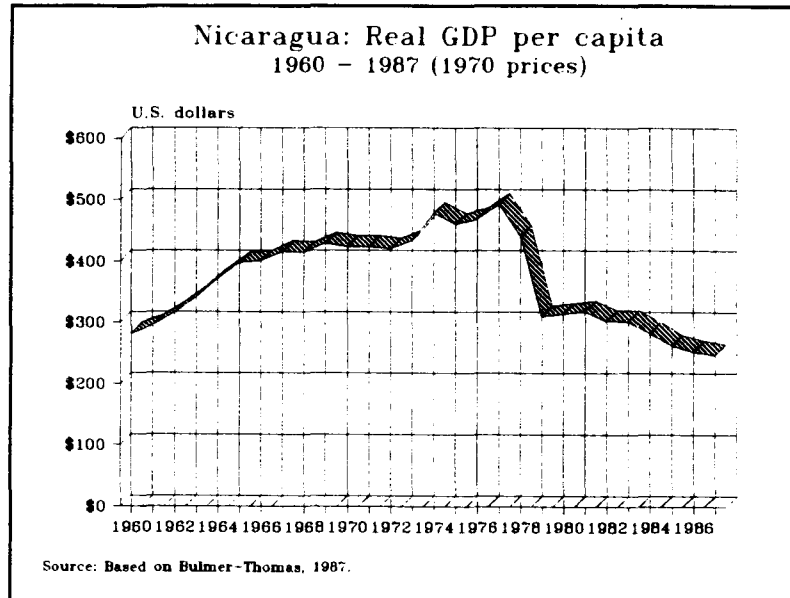
In order to understand the current policy dilemmas, however, it is important to put the Nicaraguan economy in proper focus. The paper will present a summary overview of the Nicaraguan economy from 1979 to 1987, including discussion of accomplishments, shortcomings, and the consequences of the war. It 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

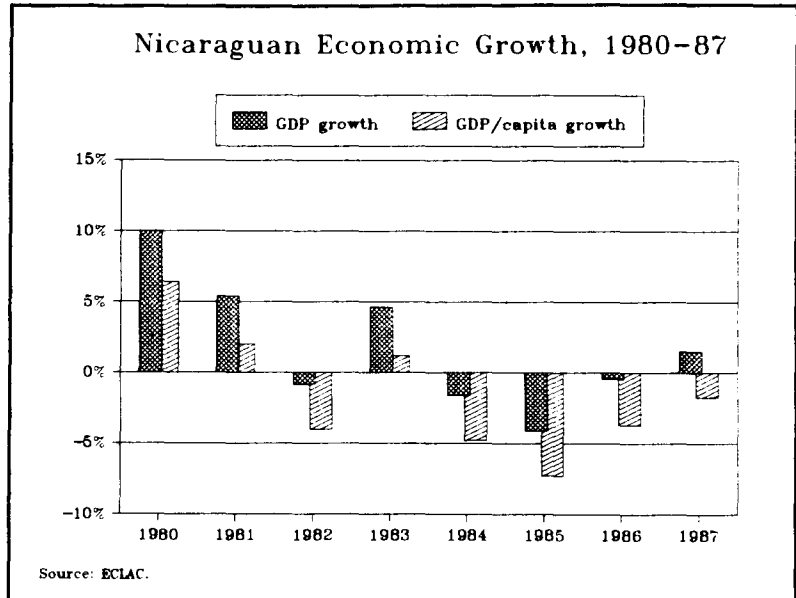
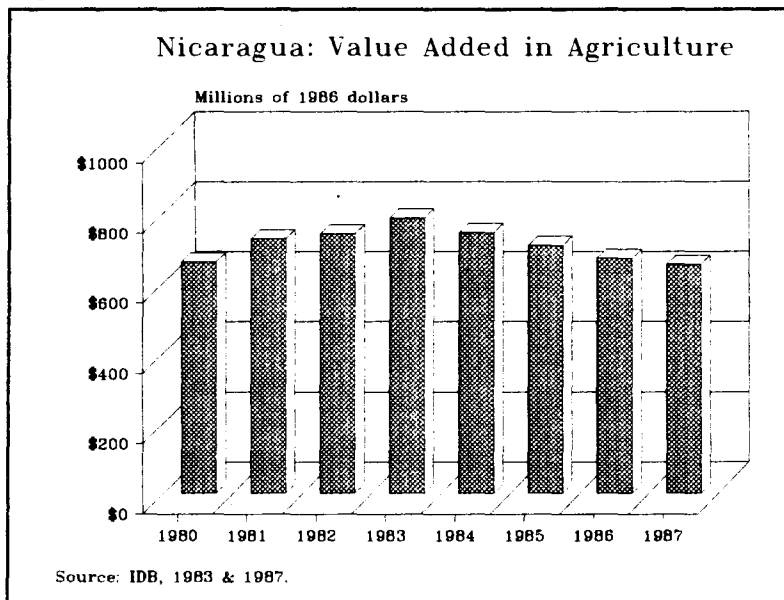


Figure 3



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

	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.

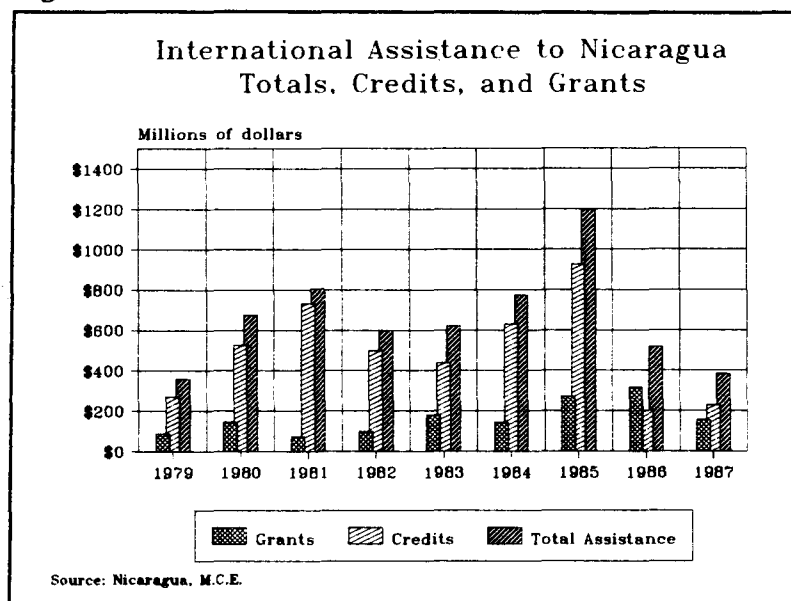
International Assistance

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

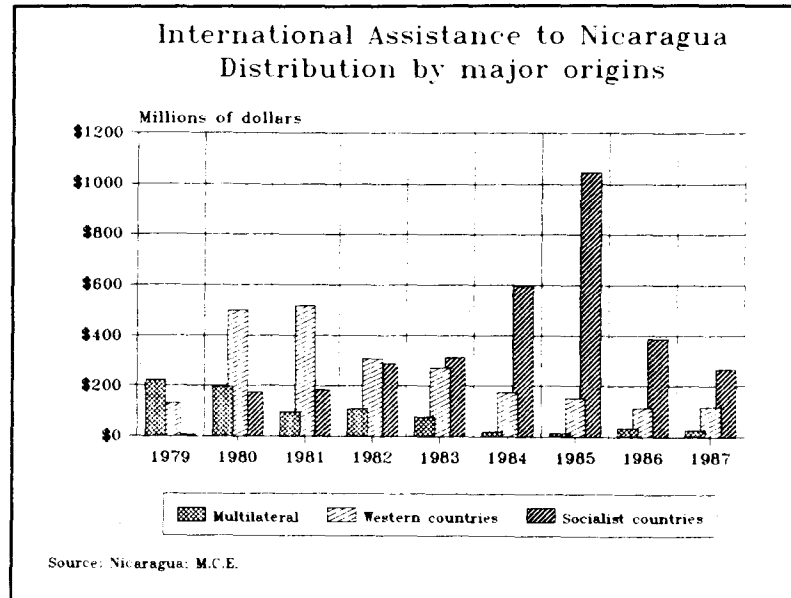
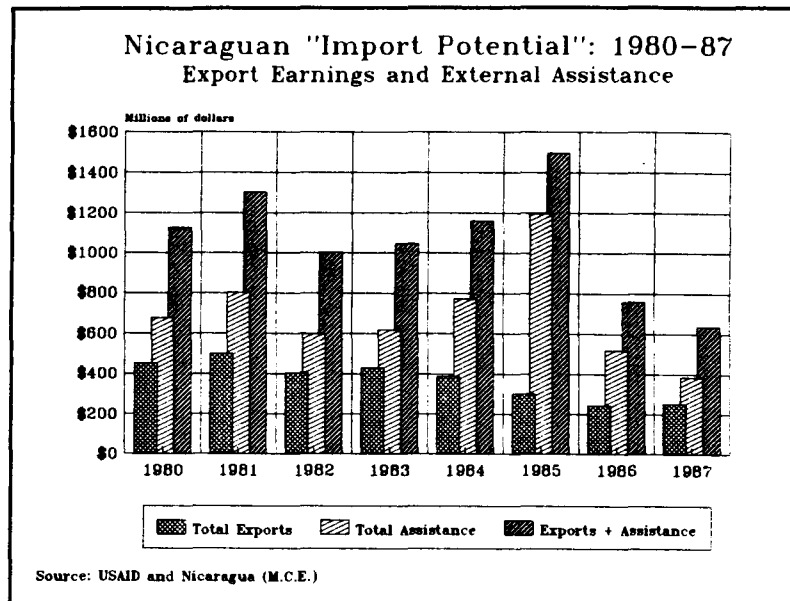


Figure 6

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



the economic crisis of 1988. Nicaragua had exhausted, by the end of 1987, most of its possibilities for expanded trade credits, most of its possibilities for sustained external assistance, and most of its possibilities for increasing domestic production without further expansion of its drastically limited imports.

The Nicaraguan Economic Model.

Nicaragua developed, between 1979 and 1987, a new internal form for economic organization that is neither prototypical free-enterprise capitalism nor archetypal Marxist-Leninist central planning. There has been a propensity in the U.S. media (reinforced by administration opponents of the Nicaraguan government) to oversimplify what has actually evolved economically by leaping to conclusions on the basis of the rhetoric of some government officials, rather than looking at the policies actually implemented. The presence of a strong central government, dominated by a single political party, and engaged in a relatively rapid expansion of production in the public sector suggests central planning. But more than 80% of 1987 agricultural production came from private producers (and independent cooperatives); and more than 73% of 1984/85 agricultural exports originated in private farms, ranches, cotton gins and sugar plants.⁷

The model that has evolved is closer to that of Peru, Brazil, and Mexico than it is to Cuba, China, or Vietnam, although it differs from all of them.⁸ The Nicaraguan government, for example, redistributed large quantities of agricultural land, mostly land confiscated from the Somoza family and their closest

⁷ EIU Country Profile...1988-89, p. 18.

⁸ For further discussion of this issue, see "The Nicaraguan Experiment: Characteristics of a New Economic Model," by Manuel Pastor, Jr., and me, Chapter 11, pp. 207-225, in Crisis in Central America: Regional Dynamics and U.S. Policy in the 1980s (Boulder, Colorado: Westview Press, 1988).

business associates. Although some of the confiscated land went into large state farms, the majority of it has been distributed to fundamentally independent cooperatives and individual producers. By 1987, only 13% of productive land was state-owned, a reduction from the 19% state-held in 1985.⁹ The government has nationalized most international trade; and the surplus generated in exports and imports was expected to provide the revenue needed to finance public sector projects and to protect the standard of living of the poorest segments of the population. But at the same time the government negotiates continuously with private agricultural producers to make certain that the profit incentives built into government prices are adequate to stimulate continued production.¹⁰

The Nicaraguan model differs most from traditional Latin American development strategies in the attempts that have been made to subsidize and protect the standard of living of the poorest portions of the population. From 1979 to 1983 the urban poor benefitted from expanded public employment, dramatically increased health care services, quadrupling of educational opportunities, and the provision of large quantities of subsidized basic commodities, available through both neighborhood organization and workplace. The peasantry benefitted from the redistribution of nearly 20% of the total cultivable land mass of the country, from increased health and educational services in the countryside, and from credit and technical assistance for the expansion of both basic grain and export production.¹¹

⁹ Ibid.

¹⁰ It should surprise no one that under these conditions the producers are never fully satisfied (at least in public). The process of negotiation is continuous and cantankerous; any admission by producers that prices were fully satisfactory would bring immediate problems in future negotiations and pressure from labor unions for higher wages!

¹¹ For profiles of these programs, including questions about their relative efficiency and organization, see my edited volume, Nicaragua: Profiles of the Revolutionary Public Sector (Boulder CO: Westview Press, 1987). As of August 1988 the government announced that the

One of the early responses to attempts by the government to restrain money wage increases, substituting increased social services for increased salaries, was the rapid creation of an expanded "informal" sector comprising a wide range of activities from black-market speculation in subsidized basic commodities, grey-market merchandising of imported commodities, and myriad cottage-based industries producing goods and services in short supply. Some reports have suggested that up to 60% of the labor force engaged in some informal sector activity by 1987. The government has had a profound ambivalence toward this portion of the population. At times they have been criticized by officials as "apron-wearing speculators"; at other times government-backed research institutions have lauded the wealth of basic services they provide.¹² The economic policies adopted in February and June of 1988 had completely opposite effects on their activities.

Since 1983 government policy has sought to shield both the poor and the relatively wealthy producers from the full effects of the war. Expansion of the money supply to expand the economy, burgeoning government expenditures without significant increases in taxes, reliance upon the "inflation tax" to keep deficits below otherwise intolerable levels, and a wide variety of direct, albeit sometimes chaotic, measures to counter momentary imbalances have characterized the economic policies of a government single-mindedly determined to win the war, even at the cost of severe longer term economic consequences.

"fundamental transformation" undertaken through agrarian reform "had been completed." An estimated 887,600 hectares had been distributed to 112,000 families. [Central America Report, XV(August 12, 1988)31.

¹²Central America Report, September 2, 1988, citing a new study by the Instituto Nacional de Investigación Económica y Social.

The model that has evolved is so far from the free-wheeling free-trade and free-market policies followed prior to the overthrow of Somoza that it is not surprising that much of the private sector (and the middle class that had been supported by it) resent the new policies, new institutions, and new directions.¹³ Whether this model will be sustainable under the inherited economic conditions, under continuing war, or under a definitive cease fire and a period of reconstruction is unclear. It is clear that it has been the propensity of the government to turn to the public sector to fill gaps left by inadequate private sector performance in recent years. Whether the private sector will emerge from the wartime economy reinvigorated or defeated is one of the most important economic questions facing the Nicaraguan economic experiment.

The Economic Impact of the War

Nicaraguans recognize, perhaps more clearly than most in the U.S., that the principal objective of the "contra" war has been economic: to damage the economy directly and indirectly until the government loses capability for responding to the crisis and loses credibility with its supporters. There is no doubt that the economic damage from the war has been severe. Public government estimates range from \$1.5 billion to more than \$4 billion (the equivalent of nearly three years of GDP).

The single greatest cost of the war has been the shift of resources out of directly productive activities and into government services, both military and social, in support of the war. Figure 7 illustrates the expansion of government expenditures in 1983 that corresponded to the rapid expansion of the Sandinista army, the militias, and the reserve forces to counter the outbreak of the war. By

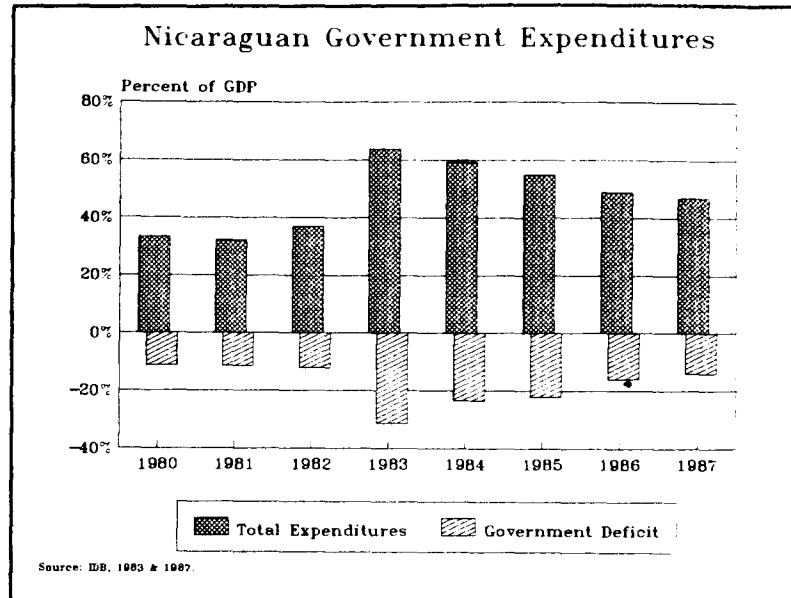
¹³This is not to suggest that the private sector has been monolithically opposed to the regime or to many of the economic policies; the strong -- but critical -- support of the members of the National Farmers and Cattlemen's Union (UNAG) is an important counterexample. Nor does it suggest that relations between either urban workers or peasants and the government has been free of tension.

1987 62% of government expenditures (30.3% of GDP) was required for defense. The roots of the 1987-88 inflationary crisis lay there.

The additional economic consequences of the war are numerous: direct damage to critical facilities, reduced agricultural production because of the relocation of producers out of the areas being attacked,¹⁴ increasing

scarcity of human resources for directly productive activities as the "best and the brightest" are recruited into war-related activities, and disruption of investment decisions in the predominantly private crucial agricultural sectors when the "contras" target all new investment (from vehicles to structures) for selective attack.¹⁵ The social consequences have also been damaging. The reallocation of government resources to defense undermined the budgets of most other ministries; as a result health, education, social security, and housing programs were all reduced.¹⁶ And the targeting by the "contras" of schools, government health clinics, and social service employees in the field had devastating direct

Figure 7



¹⁴ Acreage planted increased by 44% in the Spring of 1988, despite severe credit restrictions; the principal cause for the increase appears to be the cease fire that permits literally tens of thousands of farmers to return to the hills and plant.

¹⁵ For an expanded treatment of this subject, see my "Economic Aggression as an Instrument of Low-Intensity Warfare," in Thomas W. Walker, editor, Reagan versus the Sandinistas: The Undeclared War on Nicaragua (Boulder CO: Westview Press, 1987), pp. 57-79.

¹⁶ Cf. Harvey Williams, "The Social Impact in Nicaragua," in Walker, op.cit., Reagan versus the Sandinistas..., pp.247-264.

impacts on the delivery of government services, especially in the more remote areas where the conflict was greatest.

The peace prospects created by Sapoá have not alleviated the economic costs of the war significantly. No fundamental demobilization will be possible until there is a definitive cease fire and the removal and relocation of the "contra" forces or their disarming and re-incorporation. The reduction in the number of ambushes, firefights, and casualties has been a great relief. And the maintenance of full military readiness under the reduced levels of conflict is both difficult to motivate and expensive.

The development model pursued by the Nicaraguan government, to this date, is one that is peculiarly vulnerable to the kinds of economic damage that the "contra" war has wrought. That Nicaragua has managed to fight a counterinsurgency of the magnitude that has been necessary while sustaining as much domestically-oriented economic production as it has, may be viewed, in the kaleidoscope of history, as a remarkable accomplishment. The evolution of the economic model has been buffeted by international market conditions, by internal production problems (including the danger, uncertainty, and other damages brought by the "contra" war), by outside direct and indirect pressures from allies, and by disapproving noises from analysts in the Socialist bloc of countries. What was clearest in early 1988 was that it was in crisis, a level of crisis that required profound remedies.

The Austerity Measures of 1988

New economic austerity policies introduced in 1988 have diminished the most important dimensions that separated Nicaraguan economic policy from that of Peru, Mexico, or Nicaragua's Central American neighbors. The austerity measures were hailed by the Nicaraguan business community, lessened the

subsidies to those goods by raising their prices, and set much of the economy free from earlier attempts to control prices and wages. "For the first time since the 1979 insurrection," according to one group generally supportive of the government, "the Nicaraguan government has begun a program of economic reforms that does not include steps to protect the poor, the social base of the Sandinistas, from its harshest effects."¹⁷ It is to the analysis of these policies that we must now turn.

On February 14th, 1988, the government announced a set of economic measures that had surprising breadth and profundity. They included:¹⁸

- ◆ complete remonetization, introducing a new cordoba equal to 1000 of the old currency; with provisions that required conversion within one week, documentation of the origin of all large amounts of cash, and the temporary freezing of large savings accounts after conversion to the new currency;
- ◆ unification of all exchange rates into a single, drastically devalued (3000%) new cordoba at the rate of 10 to the dollar;
- ◆ an increase in minimum wages of 100% to 300%;
- ◆ increased prices and new price controls on 46 basic commodities and a call for popular action to monitor compliance with the new controls;
- ◆ a 10% cut in government budgets and the reorganization of more than 40 government ministries, agencies, and institutions into 8 super-ministries; and
- ◆ reduction of government employment by more than 8,000 jobs.

The policies were modeled on the "heterodox shock" treatments that Brazil and Argentina pioneered in 1985 and 1986 as means to halt rampant inflation. It

¹⁷Central American Historical Institute Update, 7(July 12, 1988)23: 1.

¹⁸Latin American Economic Report, 88-02 (February 29, 1988), p.16.

was the intent of these policies to correct for many of the fundamental imbalances that existed in the prices of imported goods, to both raise and freeze prices and wages, and to stimulate additional production. Production for export was the priority goal, and the devaluation was expected to provide strong new incentives. The remonetization also served to reduce the money supply by nearly 15%, and to undermine currency speculators and blackmarketeers, as well as destroying the value of the currency carried in the hills by the "contras."¹⁹

The short term impact was significant reduction in the rate of inflation (relative to the hyperinflation of the weeks preceding the measures), as the "campaign against speculation" brought rapid public attention to price speculators. The subsequent impact was to reduce the availability of many of the goods previously produced by small-scale entrepreneurs; this then worsened the rate of inflation. The measures were generally taken to be anti-business, for the reduction in money supply reduced the availability of credit; and the popular mobilization against price increases discouraged production under conditions when input prices continued to rise or where imported components were now dramatically more expensive than they had been. Popular support for the measures, however, was widespread. They reinforced the confidence of the broad bases of the government's support that the government was capable of taking the harsh steps needed and that the steps would contain at least token recognition of the plight of wage earners and poor farmers.

By early June, however, continued shortages of foreign exchange had forced the black market exchange rate up to 100-to-1; prices for basic commodities (even through the subsidized "secure channel") had risen by more than 600%; and the political mobilization against price increases had fizzled. Work stoppages, union-

¹⁹See "The New Economic Package -- Will a Popular Model Emerge?," *Envio*, 7 (September 1988)86.

led demonstrations, and hunger strikes protested the gap between earnings and the minimum cost of living.

On June 14th the government announced another far-reaching set of economic measures. The new measures were designed to transfer resources from domestic consumption to export promotion, deliberately reducing domestic demand by cutting income levels even further. The specific measures included:

- ◆ devaluation of the new cordoba from 10-to-1 dollar to 80-to-1, and the indexing of the exchange rate to the rate of inflation;
- ◆ lifting of all price controls from the majority of goods and services, and the elimination of most of the remaining subsidies from goods distributed through the "secure channel" (partial subsidies were returned for government workers and the army in July in lieu of money wage increases);
- ◆ increases in prices for the goods still controlled: gasoline by 12 times, inter-urban transportation by 6 times, basic grains by two times, etc.;
- ◆ freeing of virtually all wages from the standardized national wage scale, permitting industries to pay in proportion to productivity levels;
- ◆ reduction of the flow of credit to large state enterprises and increases in the availability of credit for private producers, with credit rationing to the most productive enterprises, and new credit limits set at 70% of demonstrable financial need (rather than 100%);
- ◆ establishment of positive real rates of interest on savings and credit through automatic adjustment for price inflation.

The Nicaraguan private sector, shocked by the February measures, was generally supportive of the June policies. And this was only one of many bases for concern and suspicion on the part of representatives of the "popular sectors." Unlike the February measures, the June policies offered little hope for the majority of wage earners to protect themselves from price increases on the limited set of controlled goods or from the expected price increases from goods that were

no longer controlled. The Economics Minister was forced to admit that average individual worker wages would then cover only 48% of the "minimum market basket" for a family.²⁰ Other data from normally sympathetic sources suggested that the average worker's wage would cover as little as 7% of the minimum basket.²¹ The last of the pricing mechanisms that had protected the Nicaraguan population from the full brunt of the region-wide crisis had been dismantled. Price levels were now expected to approach international levels for many domestically produced goods, and inflationary pressures were expected to abate as domestic production responded to the new price incentives.

The policies enacted in February had direct and negative impacts on large portions of the informal sector. Fixed prices and zealous monitoring of them removed much of the incentive for informal sector activities. The identification of informal sector producers as part of the "speculators" against which there should be "popular mobilization" created one of the strongest social criticisms of them that had been issued to date. The loss of the informal sector production contributed directly and rapidly to the inflation that followed the implementation of the policies.

The policies enacted in June, however, had direct and positive impacts on the informal sector. In the first place, the liberalizing of wages is expected to reduce the incentives for people to move out of formal sector jobs and into the informal sector. As wages rise in other jobs, the least productive part of the informal sector may be expected to contract. But of even greater importance is the freeing of prices for the goods and services that are produced by those who continue to produce on a small scale. Although the credit mechanisms, linking of wages to

²⁰Central American Historical Institute Update, 7(July 12, 1988)23, p.2.

²¹"The New Economic Package...", Envio, September 1988.

productivity, and export incentives will favor larger and more export oriented producers over the informal sector, the new policies represent, at least implicitly, a new attitude toward this portion of the economy.

The new measures were criticized as too little and too late. They had come after most of the annual planting decisions had been made and the time for planting had passed. They were criticized, both inside Nicaragua and outside, as representing a dramatic departure from the revolution's fundamental commitments, averting away from previous goals of "increased popular consumption and privileged access to basic goods in the countryside."²² It is expected that the policies will "transfer resources from internal consumption to export," "transfer income from workers, consumers, campesinos and small producers... to the public financial sector, which will then pass it on to the agro-industrial and agro-export sectors," and "accelerate the fall of real salaries, transferring resources to those who control capital."²³

The Economics Minister, Alejandro Martínez Cuenca, responded to many of these concerns in a lengthy published interview.²⁴ He noted that the principal obstacles to the efficient development of the export sector was "distorted prices," "credit giveaways," and the resulting inefficiencies. The context was explicit, he suggested: "the economy is the Aquiles' heel of the revolution" in time of war. The measures have been required "in order to contain inflation, to stimulate a recovery in production, to make the national economy function in time of war and

²²Central America Report, July 8, 1988.

²³"The New Economic Package...", Envío, September 1988, p.15.

²⁴"Medidas para domar una economía desbocada," Pensamiento Propio, VI (July-August 1988) 52, pp.19-23.

in circumstances where... international support has not been what we wanted it to be."

When asked whether the impact of the measures was likely to undermine "the political and social base of the revolution, Martínez Cuenca responded that elimination of price controls on basic commodities would benefit the peasantry directly, that the elimination of wage controls would lead to higher wages for urban workers, and that the greatest negative impact would likely fall on salaried workers. He then suggested that it was the deliberate intention of that dimension of the policies to encourage the shift of workers into agricultural production and to more productive industry and to discourage the continuation of underemployment in low productivity government jobs. He concluded:

"Everyone is going to have to pay a little; everyone is going to have to pay a part of the [costs of] adjustment. There is no such thing as an operation that doesn't hurt; but what we have to look for is that the pain is relatively equally distributed so that it isn't concentrated in one single part of the body. And that's what is happening."²⁵

Early returns from the implementation of the new policies suggest that they have not been a panacea. Reports in July suggested that the annual rate of inflation had fallen to 300%, one fifth of the 1987 level.²⁶ The new cordoba continued to be devalued, reaching 350 to the dollar by mid-August. Agriculture appeared headed for a bumper year, both because of the expanded planting permitted by the cease fire and because of an abundance of rain. The dollar shortage remained critical, reflecting the low levels of exports, the lack of hard currency in aid from the Socialist Bloc and the sharp reduction in Socialist Bloc support; domestic production of generic medicinal products was reduced to half

²⁵*Ibid.*, p.25.

²⁶*Central America Report*, July 8, 1988.

for lack of foreign exchange to purchase imported components, but replacement medicine had been sought and obtained from Eastern Europe.²⁷

Alternative Scenarios for Nicaragua's Economic Future

The economic austerity package of 1988, taken as a whole, represents a set of policies that may be instructive with respect to future economic policy of the regime. It constitutes a "return to basics" focused on smaller-scale production units, new incentives for export production, internationally "realistic" prices, positive real interest rates as credit-rationing mechanisms, and a relaxation of controls over most prices and wages. The government has clearly exhausted its ability to protect its social and political base from the full economic consequences of the broader Latin American economic crisis or of the war.

When faced with the alternative of further expansion of the state into directly productive activities and further expansion of state controls or the restoration of economic incentives for private-sector production, the government has turned, after vacillating, decisively toward the private sector.²⁸ The ability and willingness of the government to take sweeping measures in this direction also serves to demonstrate that it is capable of moving forcefully in the opposite direction as well. If these measures do not result in further tempering of inflation and reactivation of the private production, the political pressure to return to greater state participation may prove overwhelming.

²⁷Central America Report, September 9, 1988.

²⁸The nationalization of the Ingenio San Antonio, the largest sugar mill in Nicaragua (and in all of Central America), appears to have been little more than a historical footnote to this process. The mill had long been recognized as a site of considerable labor/management strife (cf. Scott Whiteford and Terry Hoops, "Labor Organization and Participation in the Mixed Economy: The Case of Sugar Production," Chapter 7, pp. 171-199, in my edited volume, Nicaragua: Profiles..., op.cit.). It had become the least efficient of the large sugar mills in the country, 30% less than comparable mills, and it had undergone a 50% reduction in production from some of the nations largest tracts of sugar plantings (7000 hectares). See Central America Report, July 29, 1988.

The length of time that the government will be able to adhere to this course would seem to depend on two factors: resolution of the war and the availability of additional international assistance. And those two factors were linked.

The United Nations has proposed and approved preferential allocation to Central America of basic development support funds, up to \$4.3 billion over the next three years. The European Economic Community has also proposed contributing up to \$2 billion over the next five years to Central American reconstruction and reactivation.²⁹ And the Central American governments, working through regional organizations such as the Central American Bank for Economic Integration, have proposed other programs.³⁰ All of these programs are at least partially contingent upon compliance with the peace process (or peace processes) underway in the region.

Scenario 1: Continuation of the War. The lack of a definitive cease fire will continue to be a major economic burden on Nicaragua; indeed, it now appears that the principal gain for the "contras," now greatly weakened and badly divided, from refusing to sign a definitive cease fire is the continuing damage that they can afflict upon the economy by not signing. Given the now-admitted elimination of any possibility for additional military support from the present U.S. administration, and little prospect for future military support from the U.S. no matter who wins the November elections, this presents a continuing temptation to the

²⁹Cf. E.V.K. FitzGerald, "The Economic Problems and Prospect of Central America: A View from Europe," forthcoming in my Transformation or Continuing Crisis: The Economic Future of Central America, op.cit.

³⁰Cf. Luis René Caceres, "Central American Programs and Proposals for Economic Reactivation," forthcoming in my Transformation of Continuing Crisis..., op.cit.

Nicaraguan government to bring a decisive end to the conflict so that demobilization and reconstruction can begin.

Continuation of the war will decrease the potential positive impact of the recent policy measures that favored the private sector; it will provide further incentive for another reversal in economic policy, potentially targeted on the largest, potentially most productive, and most vulnerable land holdings in the central region of the country. Further declines in urban living standards, especially in Managua, if not matched by renewed availability of agricultural lands may tempt the government to nationalize and redistribute the majority of the larger farms in the central region that have been untouched to this date.

Continuation of the war will lessen the likelihood that Nicaragua will be able to turn to Western sources for development assistance, both because of the worsened prospects for renegotiating outstanding indebtedness and because the continuing, war-related domestic tension will make support for Nicaragua politically more difficult for Western governments. The only alternative will be to meet the conditions implicitly imposed upon further Socialist Bloc assistance, a modification of the fundamental economic model away from reliance on the private sector, away from subsidies to the production of the largest and wealthiest producers, and toward a reorganization of the state along lines more consistent with Eastern European experience. Even under *perestroika* it is inconceivable that further Socialist Bloc support will come to a multi-party, pluralistic, private-sector-dominated Nicaragua.

Scenario 2: Definitive Cease Fire and Economic Reactivation. Nicaragua has surprised many, among supporters and opponents alike, with the flexibility with which it has entered into negotiations with the "contras." That process, as open and as well monitored (presently by the Cardinal Archbishop of Managua

and the Secretary General of the O.A.S.) as one might hope for, has brought agreement on most of the original demands raised by "contra" leadership. The transference of the full process of opposition to the Sandinista Party to civil, rather than military, political processes must be seen as an immensely complicated and delicate process, even by those who believe that processes in Nicaragua have been far more democratic than the opposition, both civil and military, would admit.

The magnitude and timeliness of Western international assistance will, again, play a crucial role. If Nicaragua is expected to resolve all of the political difficulties that will come from a cease fire, disarming of the "contras," demobilization of the military reserves, and reactivation of the economy without substantial new, timely, and flexible international assistance, the probability of successful transition to a peaceful, open, predominantly private-sector economic system is, under present economic conditions, very small. Recent economic policy changes, however, suggest that Nicaragua will be willing to accept and will be able to utilize new assistance that might be predicated upon continuation of the reduction of the central government deficit, maintenance of "realistic" prices and interest rates, and continued resurgence of the private sector.

This would not necessarily represent abandonment of the first principles of the revolution, the commitment to expanded social services, redistribution of land and income, diversification of trade and external assistance, and a commitment to working class and the peasantry. It would, however, represent a continuation of the triumph of pragmatism over dogmatism that most observers now recognize has been a hallmark of the survival of the Nicaraguan revolution.