Wilson Center
LATIN AMERICAN PROGRAM

Nicaraguan Tragedy:
From Consensus to Coercion

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Executive Summary

Over the past 25 years, the Nicaraguan economy has performed reasonably well, with rates of growth and of poverty reduction exceeding average rates of Latin America. Nicaragua's successful economic model was pursued both by "neo-liberal" administrations (1990–2006) and "leftist" Sandinistas (2007–present). The shared strategy featured a market-driven, business-friendly economy well integrated into global commercial and financial markets. Even during Sandinista rule, a constructive dialogue between business leaders and senior government officials engendered broad consensus on economic policies. For a moment in history, Nicaraguan society overcame what has arguably been the main obstacle to sustained socioeconomic progress in Central America: the bitter, self-defeating deadlocks dividing business and government and the consequent frequent discontinuities in public policies.

Nicaragua's expanding foreign exchange earnings have come from increasingly diverse export sectors: a multi-crop agriculture, livestock and agribusiness, gold mining, low-wage manufacturing in free trade zones, emerging international tourism, and rising remittances from Nicaraguans working abroad. The growth model also depended upon two important additional sources of international capital: generous assistance from multilateral development banks and, increasingly, private foreign investment. Until 2015, Venezuelan largesse helped fund social programs and public-sector investment while allowing the Sandinista government to avoid raising politically contentious taxes. The expanding economy benefited wide swaths of the Nicaraguan population, markedly reducing poverty and extreme poverty and growing the middle classes, even as many challenges remained.

However, in one critical respect, during the past decade Nicaragua regressed: its quality of democratic governance deteriorated. Whereas there was a broad consensus on economic matters, Nicaraguan society sharply fragmented on political governance issues. This contradiction proved unsustainable. Discarding the consensual decision-making model that had produced economic success, Sandinista President Daniel Ortega and his vice president and spouse Rosario Murillo reacted to widespread popular protests that erupted in April 2018 by protecting their ever-tightening autocratic grip with lethal force. The consequent collapse of consumer spending and business confidence has driven the economy into a tailspin.

The government's proposed pension reform was the immediate detonator of the 2018 crisis. In a deeper sense, however, the political crisis was the logical outcome of the contradictions between a largely private, market-driven economy, and the efforts by the Sandinista leadership to construct an autocratic, single-party political system. While the combination of private economies and autocratic politics may thrive in some Asian societies, there is not yet a successful, enduring example in the Western Hemisphere. Nicaragua is unlikely to prove an exception to the rule.

Today, Nicaragua is at a turning point. Governance capacities can catch up to economic performance, to construct a model of open, democratic capitalism with social inclusion. Alternatively, the country can regress into the dark abyss of political repression and economic misery.

Introduction

Above: Manufacturing premium, hand-rolled cigars, Estelí, © Richard Feinberg

Cover Photo: 2016 campaign banner featuring candidates Daniel Ortega and Rosario Murillo, Managua, © Richard Feinberg

Over the past 25 years, the Nicaraguan economy has performed reasonably well, with rates of growth and of poverty reduction exceeding average rates of Latin America and the Central American and Caribbean regions. Nicaragua's successful economic model was pursued both by "neo-liberal" administrations (1990–2006) and "leftist" Sandinistas (2007–present). The shared strategy combined macroeconomic stability with dynamic export-led growth. For a small country (a population of 6.5 million and a GDP of $14 billion), exports became increasingly well diversified across various agricultural crops (including coffee, sugar, and livestock), agro-industry, gold mining and fisheries, low-wage manufactures (predominantly apparel), and, in recent years, international tourism became an important earner of foreign exchange. In addition, the export of labor services generated rising remittances that helped lift many households out of poverty. Voting their confidence in Nicaragua's stable growth strategy, both foreign investors and multilateral development institutions issued glowing accounts and augmented their presence significantly.

On various well-publicized measures of business climate and international competitiveness, Nicaragua still fell far short as benchmarked against paragons such as Sweden, Switzerland, or Singapore.[1] But as measured against its own post-conflict starting point or against

1. For example, World Bank, *Doing Business 2019* (Washington, D.C.; World Bank, 2019), http://www.worldbank.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf; and World Economic Forum, *The Global Competitiveness Report 2017–2018* (Geneva: World Economic Forum, 2017), https://www.weforum.org/reports/the-global-competitiveness-report-2017-2018.

other Central American nations, Nicaragua's economic record was certainly respectable. However, in one important respect, during the past decade Nicaragua regressed: its quality of democratic governance deteriorated.[2] Whereas there was a broad consensus and a constructive policy dialogue between the private and public sectors on economic matters, Nicaraguan society sharply fragmented on political governance issues. This contradiction proved unsustainable. In April 2018 the simmering political divisions surfaced with a vengeance, as dissatisfied private citizens—civil society and private enterprise—voiced their protests in massive street demonstrations and general strikes. Discarding the consensual decision-making model that had produced economic success, Sandinista President Daniel Ortega reacted by protecting his ever-tightening autocratic grip with lethal force.

The consequent collapse of consumer spending and business confidence has driven the economy into a tailspin. As of this writing in February 2019, the strategic financial sector is fast bleeding deposits and its loan portfolio has deteriorated as non-performing loans are skyrocketing, yielding a liquidity risk in the short term and a solvency risk in the medium term. Absent a sustainable resolution of the political crisis, the economic outlook is depressingly bleak.

Nicaragua is at a turning point. Governance capacities can catch up to economic performance, to construct a model of open, democratic capitalism with social inclusion. Alternatively, the country can regress into the dark abyss of political repression and economic misery.

The Good Years (1990–2017): Economic Expansion with Social Inclusion

Stabilization and Recovery

By the early 1990s, after over a decade of protracted and costly civil wars and gross economic mismanagement, the Nicaraguan economy was in shambles. The transportation infrastructure—roads, seaports, airports—was badly damaged, electricity blackouts were commonplace, livestock had been slaughtered for household consumption, property relations had been upended, and many of the more educated professional classes had fled abroad. Moreover, imprudent macroeconomic policies during Sandinista rule (1979–1990) had led to hyperinflation and a debased currency, the depletion of the accumulated capital stock, and the destruction of business confidence. By 1993, economic output was around 60 percent lower than prior to the 1978–79 Sandinista revolution, leaving about half of Nicaraguans surviving in poverty.[3]

2. On democratic backsliding, see Richard E. Feinberg, "Nicaragua: From Revolution to Restoration," Brookings Institution, November 8, 2018, https://www.brookings.edu/wp-content/uploads/2018/11/FP_20181108_nicaragua.pdf.

3. World Bank, *Nicaragua: Paving the way to faster growth and inclusion. Systemic Country Diagnostic* (Washington, D.C.: World Bank, June 18, 2017), Report: 116484-NI, para 9, 36, and figure 3.1, 31.

Nicaragua is at a turning point. Governance capacities can catch up to economic performance, to construct a model of open, democratic capitalism with social inclusion. Alternatively, the country can regress into the dark abyss of political repression and economic misery.

Nicaraguans of nearly all political persuasions learned important economic lessons from the debacle of the 1980s. To this day, all governments have rejected the state socialism model, which had proved both economically and politically unsustainable. Instead, governments have opted for a market-driven, open-economy, business-friendly economic model well integrated into global commercial and financial markets.

The task of the first liberal democratic government of President Violeta Chamorro (1990–97) was to restore a semblance of economic normality. Recovery was inevitably slow. The state had to be reformatted, state enterprises divested, property rights reestablished, a business class reassembled. The government liberalized the trade and foreign exchange regimes and resumed relations with the international lending agencies.

During the 1980s, the Sandinistas had expropriated many properties, including businesses and private homes. In the famous *piñata* following their electoral loss in 1990, Sandinistas looted government property and claimed personal title to many of these lands and residences. However controversial, the *piñata* established a Sandinista propertied class, a new bourgeoisie, giving many once youthful revolutionaries a stake in a stable, business-oriented market economy. At the same time, an important early task of the government of Violeta Chamorro was the negotiation of claims by former property owners. Some properties were returned while in other cases claimants, especially U.S. citizens, were offered monetary compensation in the form of government bonds.[4] Prices of the expropriation bonds (*Bonos Para la Indemnización*, BPI) initially fell on secondary markets. But as all governments have honored the expropriation bonds, their prices have recovered. Together, the *piñata* and the claims settlement injected a certain stability into property relations, fulfilling a critical pre-condition for renewed business confidence and economic recovery. Both the Sandinista elites and the re-emerging private sector had stakes in property rights.

4. Richard E. Feinberg, "Nicaraguan Democracy and the Post-Conflict Resolution of Property Claims," 2014, unpublished manuscript.

Economic Expansion

Since 1990, the key features of the Nicaraguan growth model have been macroeconomic stability, an open economy driven by export-led growth, and gradual social inclusion of the middle and working classes.

Nicaraguan macroeconomic management is anchored in a crawling peg foreign exchange rate regime: the *córdoba*-dollar rate is constantly devalued to account for domestic inflation. This monetary adjustment mechanism has maintained the competitiveness of Nicaraguan exports in dollar terms and provided predictability to market participants. Indeed, the Nicaraguan economy today is a de facto dollarized economy: three-quarters of the deposits in the Nicaraguan banking system are denominated in dollars. Furthermore, authorities, whether "neo-liberal" or Sandinista, have maintained sound monetary and fiscal policies. Key variables such as fiscal balance, monetary expansion, current-account deficits, external debts, and levels of international reserves have been kept in line with prudent international norms, as repeatedly certified by annual staff reports of the International Monetary Fund (IMF, Box 1). "The Washington Consensus" remains alive and well in Nicaragua (and in much of Central America).[5]

The overall results of this consensual stability-cum-growth strategy have been impressive. From 1994 to 2017 Nicaragua's GDP grew by an average of 4 percent, accelerating toward 5 percent in recent years, and exceeding Latin American norms, albeit from a very low base. Per capita GDP rose from $653 in 1994 to $2,161 in 2017 (Figure 1). (Per capita growth rates lagged GDP growth rates due to the annual increases in population of around 1.5 percent.)

The IMF estimated that Nicaragua had seemingly approached its growth frontier of 4.5 percent.[6] An acceleration of growth would require the relaxation of stubborn structural obstacles (such as high transportation costs due to spotty infrastructure, low labor productivity attributable in part to under-performing education systems, expensive and at times unreliable energy, and various other institutional deficiencies).

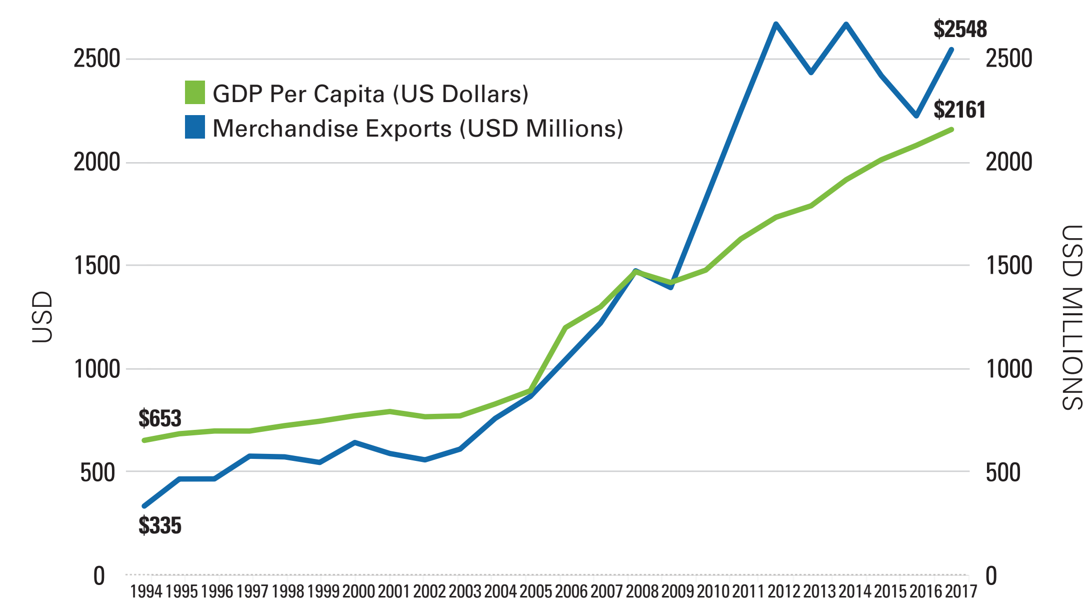
Diversification of Exports

As befits a nation of its size, Nicaragua is a highly open economy, one of the most open in Latin America. As one measure, during the last five years (2013–17) the total trade

5. "The Washington Consensus" refers to the basic conditions for an open, market-driven economy, as advocated in the 1990s by the IMF and World Bank and described in John Williamson (ed.), *Latin American Adjustment: How Much has Happened?* (Washington, D.C.: Peterson Institute for International Economics, 1990).

6. IMF, "Nicaragua 2017 Article IV Consultation" (Washington, D.C.: IMF, June 2017), Country Report no.17/173, Box 1, 8, www.imf.org/en/Publications/CR/Issues/2017/06/27/Nicaragua-2017-Article-IV-Consultation-Press-Release-andStaff-Report-45008.

Figure 1. GDP and Export Growth 1994–2017



Note: Does not include free trade zone exports
Source: Nicaraguan Central Bank (BCN) External Sector https://www.bcn.gob.ni/estadisticas/anuario_estadistico/index.php

(exports and imports) to GDP ratio averaged 105 percent; in 2017 imports (merchandise goods and services) alone accounted for nearly 60 percent of GDP.

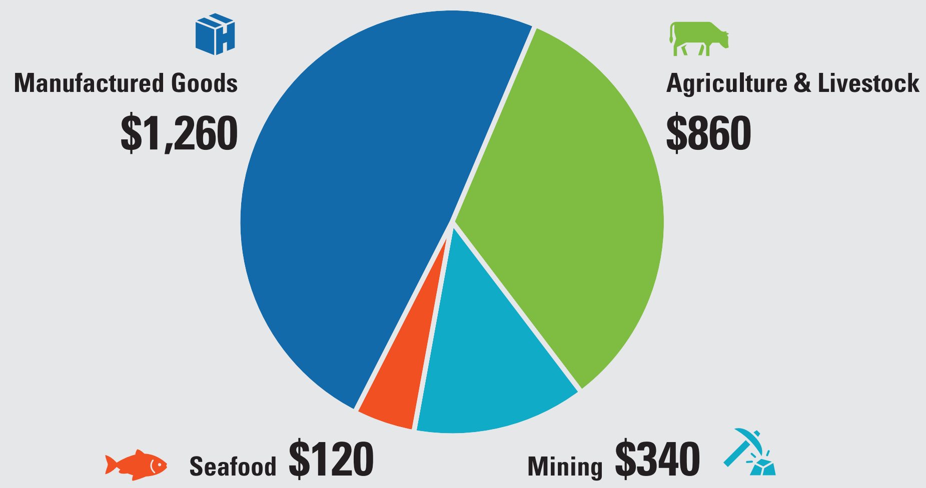
Trade has been a preeminent driver of growth. Merchandise exports have risen from $335 million in 1994 to over $2.5 billion in 2017 (Figure 1). While volatility in the international economy (commodity prices and total demand) has caused fluctuations in Nicaraguan export earnings, the overall trend has been decidedly upward sloping.

In many respects, Nicaragua remains primarily an agricultural economy. Agriculture and livestock account for 17 percent of national production and 30 percent of the labor force.[7] In addition, much of what is coded as "industry" is in fact the processing of agricultural inputs and outputs (agro-industry or agribusiness).

Nicaragua has abundant land and varied climates and topography. In proportion to the country's size, Nicaraguan agricultural and agro-industry exports present a diversified picture (Figures 2, 3). Nicaragua does not suffer from the monoculture economy that

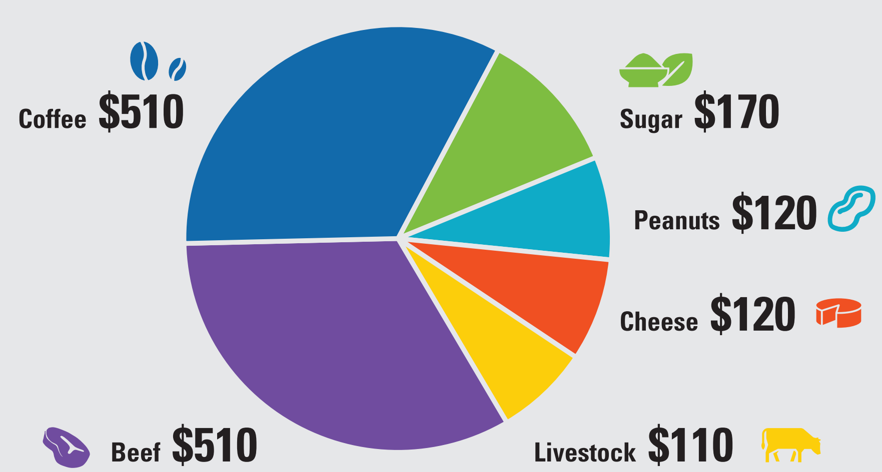
7. World Bank, *Agriculture in Nicaragua: Performance, Challenges and Options* (Washington, D.C.: World Bank, 2015), 8, http://documents.worldbank.org/curated/en/532131485440242670/pdf/102989-WP-P152101-Box394848B-OUO-9.pdf.

Figure 2. Exports by Sector 2017 (USD millions)



Note: Does not include free trade zone exports
Source: Nicaraguan Central Bank (BCN) External Sector https://www.bcn.gob.ni/estadisticas/anuario_estadistico/index.php

Figure 3. Agricultural and Agro-industry Exports 2017 (USD millions)



Note: Does not include free trade zone exports
Source: Nicaraguan Central Bank (BCN) External Sector https://www.bcn.gob.ni/estadisticas/anuario_estadistico/index.php

plagues and periodically destabilizes too many developing countries. Nicaragua's agricultural and agro-industrial exports are scattered among a variety of products, led by coffee ($510 million), beef ($510 million), sugar ($170 million), cheese ($120 million), peanuts ($120 million), livestock ($110 million), beverages and rum ($60 million), and tobacco ($40 million). Among high-end consumers, Nicaraguan hand-rolled cigars, single-origin coffee beans, and aged rum have attained the status of premium brands. Seafood, including lobsters and shrimp, account for another $120 million in export earnings. While fluctuations in the international prices of coffee, beef, and sugar (and of oil imports) are risk factors for the Nicaraguan economy, the diversity of agricultural exports provides relative stability to merchandise revenues.

Among the nation's economic partners, the United States weighs most heavily, especially if free trade zone exports are taken into account and even more so if tourism and remittances are considered.

Extending beyond its traditional agricultural and agro-business exports, Nicaragua innovated in four other dynamic export sectors. As will be discussed below, by 2016 the free trade zones (foreign-owned *maquiladora* or light manufacturing firms attracted by competitive wages) were adding net exports of $400 million (Figure 4). Gold mines opened by international investors (led by Canada's B2Gold Corp) emerged as another earner of hard currency ($330 million by 2017). Further, as Nicaraguan society stabilized, tourism took off, generating over $800 million in revenues by 2017 (Figure 6). Even more consequential, labor services became Nicaragua's single strongest export: remittances from overseas workers approached $1.4 billion annually (Figure 7), equivalent to 55 percent of total merchandise exports and 10 percent of GDP. Adding these four additional export earners to traditional merchandise exports, in 2017 Nicaragua earned a hefty $5.1 billion in export revenues (Figure 9).

Free Trade Zones (FTZs)

The National Free Zone Commission (CNZF) manages the free trade zone system, which is actually a set of regulatory and tax mechanisms governing disperse manufacturing and agro-industrial locations. At under $1 per hour, FTZ wages are the lowest in Central America.[8] During Sandinista rule, the CNZF joined with factory management and trade unions to negotiate annual wage and benefit packages, maintaining labor peace and a steady supply of semi-skilled predominantly female labor.

Buoyed by the U.S.-Central America Free Trade Agreement (CAFTA-DR) of 2005, the free trade zone system expanded rapidly. By 2017, the leading textile and apparel sector was

8. IMF, "Nicaragua 2017," para 28, 16.

providing around 70,000 jobs[9] of a total of FTZ employment approaching 120,000 (Figure 4), and nearly 60 percent of the $2.6 billion in FTZ exports. In factories primarily owned by Asian investors from South Korea and Taiwan, Nicaraguan women cut and sewed basic garments for sale to major brands. The final consumer in this global supply chain most often resides in the United States. Other FTZ manufactures include automotive wire harnesses, medical devices, footwear, and some electronic equipment assembly. In the agribusiness sector, some 50 companies generate around 17,500 jobs, in the processing of cigars, shrimp, vegetable oils, organic honey, and wooden furniture.

Authorities, whether "neo-liberal" or Sandinista, have maintained sound monetary and fiscal policies.

Of note, since 2011 Nicaragua has been an active participant in the Better World program, a joint project of the International Labor Organization and International Finance Corporation of the World Bank Group, to improve working conditions for the labor force in the apparel factories.[10] The Better Work program seeks a consensus among the major stakeholders (the government, labor unions, factories, and purchasing brands), to enhance rights awareness and industry competitiveness. The Nicaraguan program engages 31 factories (60% of the total), 38,000 workers, and 15 international brands.

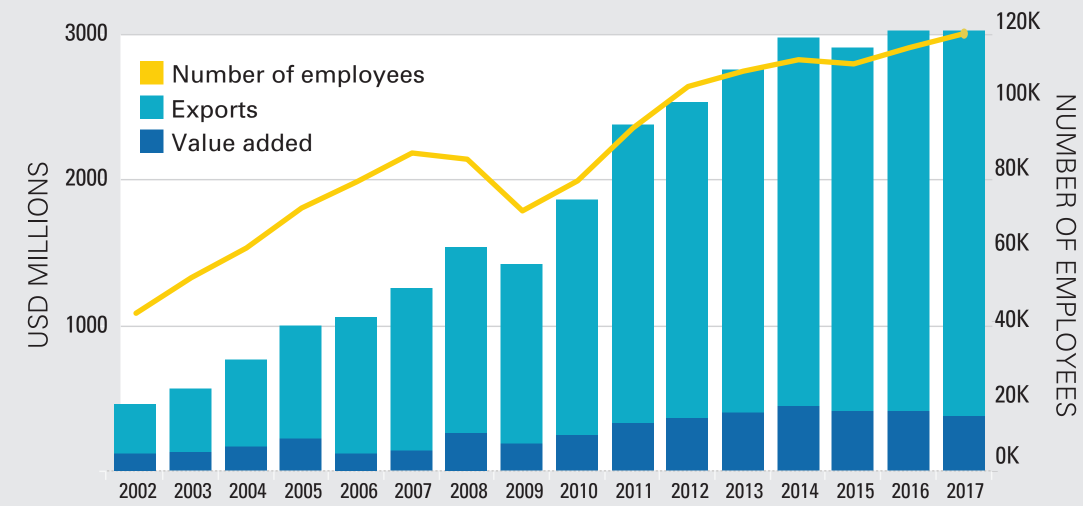
Trading Partners

Among the nation's economic partners (Figure 5), the United States weighs most heavily, especially if free trade zone exports are taken into account and even more so if tourism and remittances are considered. The United States absorbs 40 percent of merchandise exports (plus 71% of free trade zone exports).[11] Nicaragua is a charter member of CAFTA-DR. Despite some initial misgivings, the Sandinista government has remained within the regional agreement, and has aggressively taken advantage of its provisions that facilitate access to the U.S. market of light manufactures, especially textiles and apparel.

Among other trading partners, Central America absorbs just under a quarter of Nicaragua's exports. Regional commercial integration has been a dream since independence from Spain in the early nineteenth century and CAFTA-DR did reduce barriers to regional exchange. While there has been some progress toward regional integration, a number of stubborn obstacles remain, including time-consuming customs

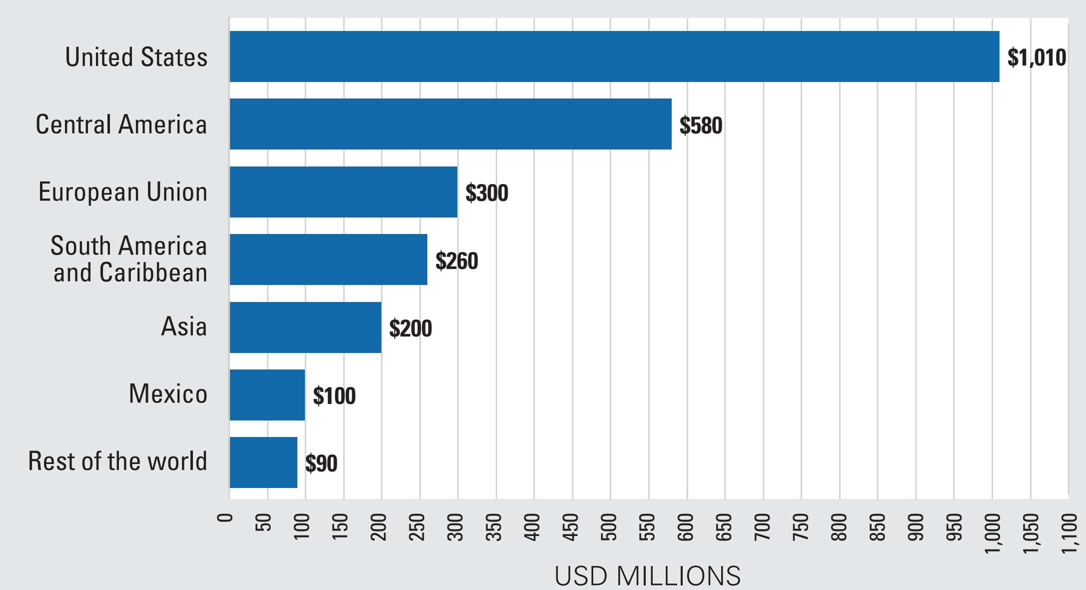
9. CNZF, "Investment Sectors," http://cnzf.gob.ni/en/investment-sectors.
10. See https://betterwork.org/home/better-work-nicaragua/.
11. IMF, "Nicaragua 2017," Appendix 1, 39. Adding free trade zone exports and merchandise exports, direct exports to the U.S. totaled 52 percent (2016).

Figure 4. Free Trade Zone Expansion 2002–2017



Note: As of 2005, other direct employees were incorporated to each company count. As of 2006, a methodological change was employed in the calculation of free trade zone exports.
Source: Nicaraguan Central Bank (BCN) https://www.bcn.gob.ni/estadisticas/sector_real/produccion/1-18.htm

Figure 5. Exports by Destination 2017



Note: Does not include free trade zone exports.
Source: Nicaraguan Central Bank (BCN) External Sector https://www.bcn.gob.ni/estadisticas/anuario_estadistico/index.php

procedures and woefully inadequate and costly transportation networks.[12] Uneven GDP growth in the Northern Triangle (El Salvador, Guatemala, Honduras) has also slowed export expansion as have intermittent border tensions between Nicaragua and neighboring Costa Rica.

Additional export markets include the European Union (12%), South America and the Caribbean (10%), and Asia (8%). Despite its size and proximity, Mexico absorbs only 4 percent of Nicaraguan exports. Mexico's new president, Andrés Manuel López Obrador, has pledged to bolster Mexican economic ties to Central America. Leading Mexican firms, including Telmex and Cemex, have been active in Nicaragua, but to date Mexican governments have not been willing to expend significant resources in Central America.

Nicaragua Becomes a Tourism Destination

As Nicaragua earned a reputation for stability, low crime, competitive prices, and a cordial welcome, the country slowly emerged as a tourism destination. Surfers and backpackers along with wealthier visitors, retirees and their families, and cruise ship passengers, came in increasing numbers to enjoy the Pacific Ocean beaches, colonial-era towns, and adventure tourism. The number of tourism establishments jumped from 406 in 2007 to 1,237 in 2017, and the number of rooms from 6,233 to 16,226.[13] International visitors surged from 978,000 in 2007 to 1,959,000 in 2017 (of whom 606,000 arrived via air, mostly from North America, with their much higher per-day expenditures). Tourism revenues doubled from 2012 to 2017, reaching $840 million (Figure 6). Tourism became another significant foreign exchange earner within the nation's diversifying export platform of goods and services.

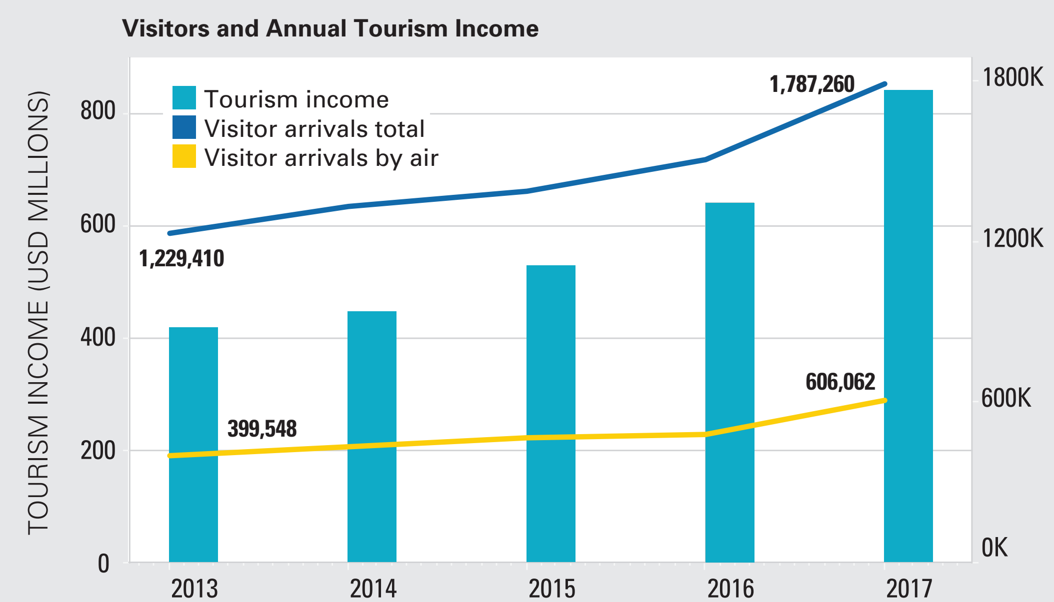
While Managua boasted the presence of international hotel chains operating business and leisure hotels, many tourism establishments were smaller, domestic offerings, following the enormously successful tourism model of neighboring Costa Rica. Smaller domestic establishments were more likely to generate backward linkages into the national economy, purchasing local farm products and local manufactures such as custom furniture. In Nicaragua, many family-owned establishments offered a sustainable option for environmentally-conscious travelers. Tourism also fueled the wider hospitality-related industries including restaurants and bars, car rentals, and tour operators.

12. United Nations Economic Commission for Latin America and the Caribbean (ECLAC), *Desarrollo, integración e igualdad: La respuesta de Centroamérica a la crisis de la globalización* (Santiago, Chile: CEPAL, 2018), Section IV, 65–96, https://repositorio.cepal.org/bitstream/handle/11362/44191/1/S1800904_es.pdf.

13. Instituto Nicaragüense de Turismo (INTUR), *Boletín de Estadísticas de Turismo*, various years, https://www.intur.gob.ni/wp-content/uploads/2018/06/Bolet%C3%ADn-de-Estadisticas-de-Turismo-de-Nicaragua-A%C3%B1o-2017-Web.pdf.

Beachfront seafood restaurants, San Juan del Sur, © Richard Feinberg

Figure 6. International Tourism Takes Off



Source: National Tourism Institute (INTUR) https://www.intur.gob.ni/wp-content/uploads/2018/06/Bolet%C3%ADn-de-Estadisticas-de-Turismo-de-Nicaragua-A%C3%B1o-2017-Web.pdf

Incomes Earned Abroad by Labor Services

The severe political instability of the late 1970s and 1980s drove many Nicaraguans to seek safety and opportunity elsewhere. Reflecting the turn of political events, Nicaraguans departed in waves, initially consisting of families associated with the Somoza dynasty, followed by business owners and professionals displaced by the Sandinistas, and finally common folks fleeing the violence of the *contra* war. Other migrants routinely crossed the southern border to Costa Rica to find seasonal work. By 2017, these emigrés were sending nearly $1.4 billion annually in remittances to families and friends in Nicaragua (Figure 7). Of these, some 300,000 Nicaraguans residing in the United States accounted for 55 percent of the total, with Nicaraguans in Costa Rica and Spain providing 20 percent and 10 percent, respectively. The export of labor had become the single largest earner of foreign exchange by far, well surpassing all agricultural and livestock exports combined, and worker remittances were growing more rapidly.

For many Nicaraguan households (and for many families elsewhere in Central America and the Caribbean), remittances make the difference between living in extreme poverty or poverty, between poverty and joining the emerging middle classes. At around 10 percent of GDP, remittances have enhanced consumer spending, driving the visible expansion of shiny new shopping malls in Managua catering to middle and working-class lifestyles.

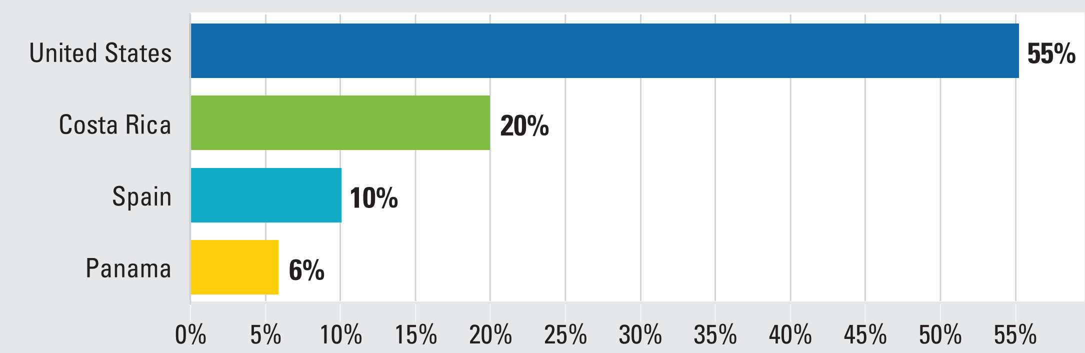
Official Assistance and Foreign Investment

Thus, Nicaragua's foreign exchange earnings have come from diverse export sectors: agriculture, livestock and agribusiness, gold mining and fisheries, low-wage manufacturing in FTZs, international tourism, and remittances from Nicaraguans working abroad. The open, market-driven growth model also depended upon two important additional sources of international capital: development assistance and, increasingly, private foreign investment.

In comparison to the size of the Nicaraguan economy, foreign assistance agencies (official grants and loans) have been extraordinarily generous, funding significant portions of the annual foreign exchange gaps and of public-sector spending and investment. By way of testimony, the Inter-American Bank (IDB) calculated that official cooperation had represented almost 20 percent of GDP during the five-year period from 2007 to 2011.[14] However, the relative weights of the sources of official finance have varied over time (Figure 8). In recent years, bilateral assistance declined as the United States and some European governments objected to Sandinista practices (flawed elections, harassment of non-governmental organizations, restrictive anti-abortion regulations) or had decided to redirect their foreign assistance programs toward the low-income countries of sub-Saharan Africa and Asia. Nevertheless, the growing enthusiasm of the multilateral

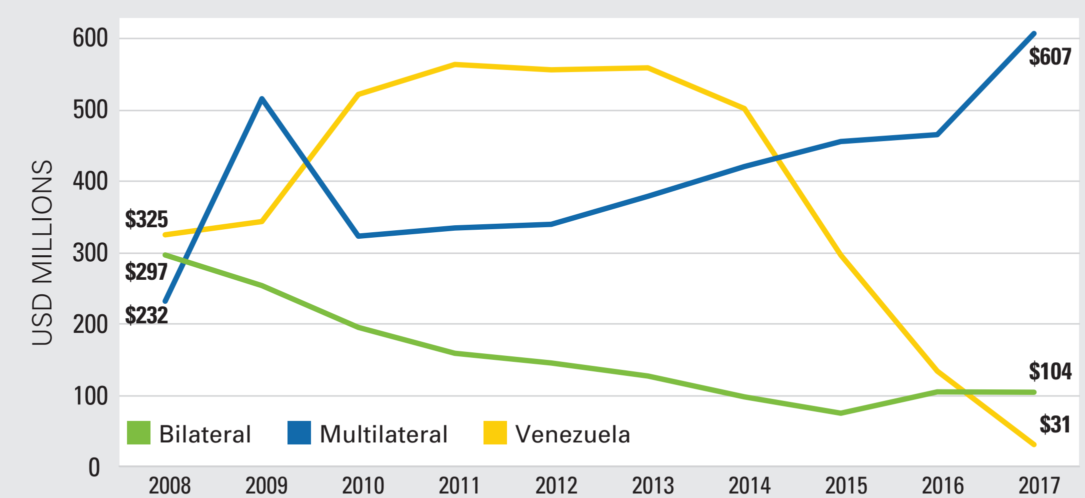
14. IDB, *Nicaragua: IDB Country Strategy 2012–2017* (Washington, D.C.: IDB, October 2012), annex IV, 3.

Figure 7. Worker Remittances by Source 2017



Source: Nicaraguan Central Bank (BCN) https://www.bcn.gob.ni/publicaciones/periodicidad/trimestral/remesas/2017/Remesas_4.pdf

Figure 8. Official Grants and Loans to Nicaragua 2008–2017



Source: Nicaraguan Central Bank (BCN) https://www.bcn.gob.ni/publicaciones/periodicidad/semestral/cooperacion/ICOE_1.pdf development institutions (primarily the IDB, the World Bank, and the Central American Bank for Economic Integration) more than compensated for this bilateral withdrawal. By 2017, while bilateral assistance had fallen to $104 million, multilateral loans and grants had soared to $607 million (Figure 8). As Nicaragua's leading multilateral partner, the IDB approved $1.4 billion in loans and disbursed $1.1 billion from 2013 to 2017, accounting for 51 percent of the country's external public debt during those five years.[15]

Foreign Direct Investment (FDI) Surges

As the Nicaraguan economy grew and gained a reputation for political stability, low street crime, and a reasonably attractive business climate, FDI inflows surged from 4 percent of GDP between 2001–7 to nearly 7 percent of GDP on average between 2008 and 2016. Averaging $852 million during 2015–17, FDI made important contributions to Nicaragua's savings and investment. Foreign investors favored the export-oriented apparel industry, gold and silver mining, domestic commerce (shopping malls), energy, and telecommunications. The dominant sources of FDI, also well diversified, were Central America, the United States, and Mexico (20.5%, 17.8%, and 16.2%, respectively).[16]

Venezuelan Largesse

With the advent of the Sandinista government, the Venezuela of Hugo Chávez became a major source of international finance. In the eight years from 2008 to 2015, Venezuelan loans and grants totaled $3.7 billion, nearly $460 million per year (Figure 8).[17] Venezuelan largesse helped fund social programs and public-sector investment, while allowing the Sandinista government to avoid raising politically contentious taxes. Ironically, financial flows from Venezuela (where *chavistas* fostered polarization) facilitated Nicaragua's consensual political economy model, providing the liquidity that make it easier to satisfy simultaneously a wide range of constituencies.

The death of Chávez and the collapse of the Venezuelan economy had a major impact on Nicaragua's economic and political fortunes. During 2016–17, the rising inflows in project-oriented multilateral development finance, FDI, international tourism, and remittances stoked GDP growth but did not directly fill government coffers with the readily available budget support that Venezuela had so generously provided (Figures 8, 9). As financial flows from Venezuela diminished precipitously, the Sandinista government felt obliged to reduce state subsidies for such public utilities as electricity and transportation, directly hurting its core constituencies.

The loss of this felicitous liquidity was a factor behind the 2018 political explosion and, arguably, the government's violent response. The immediate spark that ignited the popular insurrection was the government's announcement of austerity adjustments to pension fund premiums and benefits. The decision by the government to revert from consensus-building to forceful coercion may be explained in part by the loss of the large Venezuelan subsidy: the government was no longer able to purchase social peace through financial instruments.

Figure 9. Balance of Payments 2017—Key Indicators

Key indicators (USD millions)	
Merchandise Exports	2,548.3
Merchandise Exports (Free Trade Zone)	2,638.1
Merchandise Imports	5,661.4
Merchandise Imports (Free Trade Zone)	1,643.9
Merchandise Trade Balance	**-2,118.9**
Remittances	1,390.8
Foreign Direct Investment	816.2
Loans and Grants	742.4
Tourism Revenue	840.1
International Reserves	**2,757.8**

Sources: Nicaraguan Central Bank (BCN) External Sector and Main Macroeconomic Indicators, https://www.bcn.gob.ni/estadisticas/anuario_estadistico/index.php; National Tourism Institute (INTUR), https://www.intur.gob.ni/wp-content uploads/2018/06/Bolet%C3%ADn-de-Estadisticas-de-Turismo-de-Nicaragua-A%C3%B1o-2017-Web.pdf

The death of Chávez and the collapse of the Venezuelan economy had a major impact on Nicaragua's economic and political fortunes.

15. IDB, *Country Program Evaluation: Nicaragua 2013–2017,* Executive Summary, Office of Evaluation and Supervision, April 2018.
16. IMF, "Nicaragua 2017." Figures are for the years 2012–16.
17. On Venezuelan capital flows, see "Informe de Cooperación Oficial Externa 2017," Central Bank of Nicaragua, 2018, Table 1, 15, https://www.bcn.gob.ni/publicaciones/periodicidad/semestral/cooperacion/ICOE_2.pdf; IMF, "2017 Article IV Consultations," 42-44 and Table 7; Enrique Sáenz, "La Gestión económica: Despilfarro de oportunidades?" in Edmundo Jarquín, 209-65; Carlos F. Chamorro, "The right to know about Albanisa," *El Confidencial*, April 14, 2016, https://confidencial.com.ni/the-right-to-know-about-albanisa; and Arturo Cruz, *How to Understand the Nicaragua Crisis*, Latin American Program, Wilson Center, December 12, 2018, https://www.wilsoncenter.org/publication/how-to-understand-the-nicaraguan-crisis.

BOX 1: Contributions and Shortcomings of the IFIs

Over the past two decades, the international financial institutions (IFIs)—IMF, World Bank, and Inter-American Development Bank—have been deeply engaged in the Nicaraguan economy. They added value in many areas, including funding for basic infrastructure, energy, and poverty alleviation, and provided technical assistance to upgrade the organizational capacities of financial authorities and other institutions. By providing a well-earned "seal of approval" for government macroeconomic policies, the IFIs also encouraged private investors, both international and domestic, to view Nicaragua as a welcoming business climate.

At the same time, and with the advantage of hindsight, the IFIs fell short in three critical respects, regarding the inter-related matters of official corruption, data shortcomings, and political risk:

Not confronting corruption. IFI reports made occasional references to corruption, noting the concerns of the domestic private sector as relayed to IFI missions and Nicaragua's rather poor ratings on international transparency indices. The IMF repeatedly expressed concern about financial flows from Venezuela that were not fully accounted for in official reporting. But the IFIs did not dwell on the inter-related transparency and corruption problems and did not condition their financial support on significant anti-corruption reforms. In its 2018 country program evaluation, the IDB mentioned "corruption" only once, in a footnote. The IFIs did not foresee how official corruption and cronyism were badly eroding checks and balances in the political system and threatening regime legitimacy.

Suggesting that such shortcomings are of a more general nature, on April 6, 2018, the IMF adopted a new framework on governance and corruption: "The Framework is designed to promote more systematic, effective, candid, and evenhanded engagement with member countries regarding governance vulnerabilities, including corruption…."[18]

Reliance on unreliable official statistics. IFI teams sometimes invest the resources and time to generate their own primary data but more often rely on statistics provided by member governments. Yet when the IFIs reprint such national data, it takes on a greater authenticity. In Nicaragua, data on the banking system is widely viewed as reliable but data on social sector variables, including poverty rates, may be less so. In its 2017 staff report, the IMF warned about the need "to improve the timeliness, quality, and reliability of statistics."[19] Nevertheless, the IFIs continued to circulate official Nicaraguan statistics about which they themselves were skeptical.

18. IMF, "IMF Executive Board Approves New Framework for Enhanced Engagement on Governance" (Press Release 18/142), April 22, 2018, https://www.imf.org/en/News/Articles/2018/04/21/pr18142-imf-board-approves-new-framework-for-enhanced-engagement-on-governance.

19. IMF, "Nicaragua 2017," para 30, page 17.

Underweighting political risk. IMF reports on Nicaragua devote extensive space and analysis to risk assessment, focusing primarily upon financial flows and external debts and on global variables such as growth rates, interest rates, and energy prices. Sorely missing was an awareness of the domestic political risk variables that in 2018 proved determinant.

As inter-governmental institutions, IFIs inherently shy away from political criticisms of member states. Nevertheless, bypassing such variables can badly distort economic analysis and result in faulty predictions.

When Nicaragua exploded in mid-2018, visiting IMF staff at last had to recognize the centrality of politics to economics, releasing this statement:

> The main challenge for 2019 and beyond is to preserve macroeconomic and financial stability. Addressing medium-term fiscal challenges and undertaking structural reforms—which are unavoidable to safeguard fiscal sustainability—*require obtaining broad support*. Policies to restore private sector confidence and to prevent the creation of negative feedback loops resulting from lower activity and employment, deterioration in asset quality, credit contraction, and deposit outflows are essential to promote economic recovery and offset an increase in poverty.[20] (Emphasis by the author)

The IFIs did not foresee how official corruption and cronyism were badly eroding checks and balances in the political system and threatening regime legitimacy.

20. IMF, "IMF Staff Concludes Visit to Nicaragua," October 31, 2018, https://www.imf.org/en/News/Articles/2018/10/31/pr18402-imf-staff-concludes-visit-to-nicaragua.

Shared Prosperity

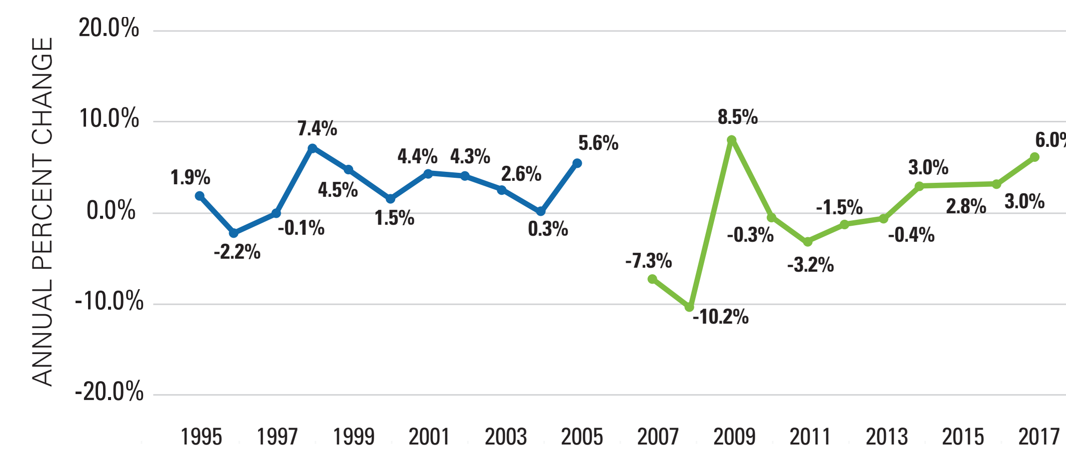
The post-1990 growth model benefited wide swaths of the Nicaraguan population. Poverty declined markedly and social indicators (such as life expectancy, child mortality, years of schooling, access to potable water, and electricity) measurably improved, even as many challenges remain.[21] The poverty rate declined from 48 percent in 2005 to 30 percent in 2014, extreme poverty fell by half, from 17 percent to 8 percent, and the 2016 household survey indicated that the trends in poverty reduction were continuing.[22] During those years, Nicaragua's rates of poverty reduction were generally in line with Latin American averages but significantly more pronounced than in Central America as a whole.[23] In Nicaragua, poor households benefited from growing employment, rising remittances, and reductions in fertility rates (fewer dependents per wage earner). Also impactful were Sandinista government social programs, including the provision to poor households of farm animals and tin roofs, and for school children free shoes, backpacks, and lunches. Well-maintained and secure recreational facilities improved the quality of life in poorer neighborhoods.

At the same time, the middle class expanded significantly, rising from 11 percent in 2005 to 18 percent by 2014 (the latest official statistics) and surely continued to expand through 2017.[24] What were once marginal, squatter barrios gradually upgraded to respectable, stable neighborhoods supplied by basic services. Middle-class communities and shopping centers in Managua and in the more prosperous provincial towns visibly expanded. Some rural areas benefited from higher commodity prices (and the extra revenues earned from premium coffee beans). Furthermore, the wealthy also enjoyed the economic expansion. As one indicator, the rates of return on equity in the banking system approached 30 percent per year (2013–17).[25] At the new luxury resort of Mukul on the Pacific coast, well-heeled Nicaraguans snapped up private villas at over $350,000 each.

In relation to the rest of Latin America, income distribution in Nicaragua, as measured by the Gini coefficient, is relatively egalitarian. Nicaragua's Gini coefficient improved slightly in recent years, falling from 0.49 (2005) to 0.466 (2014), comparing favorably to the Latin American average of 0.514 (lower coefficients indicate less inequality).[26]

21. IMF, "Nicaragua 2017," Table 11, and "Nicaragua: Millennium Development Goals, 1990–2015," 38.
22. For poverty indicators and definitions, see World Bank, *Nicaragua: Paving the way to faster growth*, especially sections 2 and 4. On issues regarding poverty measurement and the quality of official data, see Box 2.1, 12. On 2016 trends, see World Bank, *Country Partnership Framework for Nicaragua for the Period FY18 – FY22* (Washington, D.C.: World Bank, February 12, 2018, Report No. 123026-NI), 1.
23. By 2014, Nicaraguan poverty rates were much lower than in neighboring Guatemala and Honduras and slightly higher than El Salvador. World Bank, *Paving the way to faster growth*, Figure 2.13, 23.
24. The middle class being defined as individuals with an income between US$10–50 per day in 2005 purchasing power parity. World Bank, *Paving the way to faster growth*, para 19, 23.
25. ECLAC, *Desarrollo, integración e igualdad*, Cuadro III.2, 63.
26. World Bank, *Paving the way to faster growth*, Figure 2.19, 29.

Figure 10. Average Real Wages 1994–2017



Note: Ministry of Labor (MITRAB) survey aimed at companies with more than 20 employees affiliated to the Social Security system. Average January–November 2017. For the period 1994–2005 (1994 cordobas) and 2006–2017 (2006 cordobas). From 2006 wages deflated by methodological note, see webpage.
Source: Nicaraguan Central Bank (BCN) Employment and Wages https://www.bcn.gob.ni/estadisticas/anuario_estadistico/index.php

Nevertheless, average real (adjusted for inflation) wages in the formal private sector experienced only modest gains at best. From 1994 to 2005, average real wages rose about 2.75 percent per year but only about 0.4 percent annually from 2006 to 2017, and with sharp annual variations (Figure 10). Interestingly, workers' wages gained more during the "neo-liberal" era than under Sandinista rule. There were, however, important variations across sectors. From 2006 to 2016, real wages actually declined in agriculture and commerce, were stagnant in manufacturing, but rose markedly in mining and construction.[27] Labor market conditions best explain the general trends. Swelled by population growth, the labor supply was constantly expanding even as labor productivity remained low due to deficient education and training programs and, in many smaller firms, due to the lack of capital and technology.

Notwithstanding the slow growth in real wages, household income and consumption could be more buoyant. As mentioned earlier, household welfare benefited from rising remittances, various government assistance programs and consumption subsidies, and falling fertility rates. Moreover, GDP growth had opened jobs in the more efficient formal sector, as workers transited out of the sprawling low-productivity underworlds of micro-firms and the self-employed.

27. The Central Bank of Nicaragua (BCN) and the Ministry of Labor (MITRAB), Table III – 12, "Real wage index of the private sector by economic activity."

Overall, the gains in poverty alleviation and upward mobility into the middle classes were impressive but the margins were slight and thus vulnerable to adverse shocks. The government's ruthless response to the political upheaval that began in April 2018 and the resulting economic implosion was just such a negative disturbance.

Private Sector Investment and Advice

As private market capitalism took hold following the 1990 elections, returning investors joined those intrepid business owners who had weathered the 1980s, the newly-minted Sandinista economic elites, and other local emerging entrepreneurs. Over time, foreign investors joined in the economic recovery. After the sell-off of 1980-era state-owned enterprises, government ownership was largely limited to public utilities (until Venezuelan loans and investments clouded the picture). The expanding private sector became the hegemonic driver of investment and growth. As the growth cycle matured, of the 33 percent ratio of investments to GDP, some 26 percent were attributable to private investment, the remaining 7 percent to public investment (Figure 11).

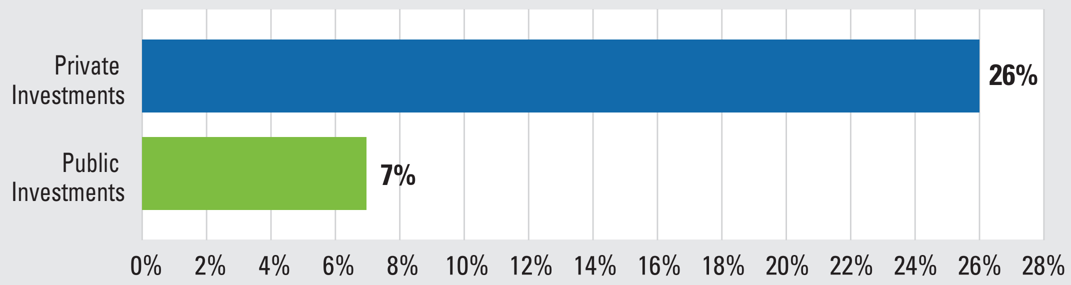
In addition, the organized private sector routinely maintained a fluid dialogue with the public sector. During the Ortega era (at least until 2017), the *Consejo Superior de la Empresa Privada* (COSEP, Superior Council of Private Enterprise) and other elite business associations held regular meetings on economic matters with senior representatives of the executive branch to find common ground. COSEP made its influence felt on innumerable economic initiatives that became laws and regulations, including on taxation and regulatory reforms, government procurement, property rights, competition policies, and international commerce and investment. These open, efficient channels for public–private policy dialogue and consensual decision-making improved the business climate, stimulated investments, and created jobs.

For a moment in history, Nicaraguan society overcame what has arguably been the main obstacle to sustained socioeconomic progress in Central America: the bitter, self-defeating deadlocks dividing business and government and the consequent frequent discontinuities in public policies.

Critics have accused the COSEP-government dialogue—as personalized in COSEP's president, José Adán Aguerri, and Sandinista economics czar and former *comandante*, Bayardo Arce—of circumventing the legislature and the political parties and thereby undermining governance institutions. These critics have the causality reversed. Rather, it was the capture of the legislature by the Sandinista Party, in combination with the fragmented and corrupt traditional parties, that compelled the private sector to seek a more effective mechanism for interchange with the executive branch. Nor could the private sector rely upon the courts, also badly compromised by the backroom deals of Ortega and the traditional political parties and packed with Sandinista party loyalists. In these circumstances, the COSEP–government dialogue was the solution, not the

Business participation in the national strike of September 7, 2018, © Richard Feinberg

Figure 11. Investments by Private and Public Sectors 2015–2017 (Percent of GDP)



Source: Nicaraguan Central Bank (BCN) Real Sector https://www.bcn.gob.ni/estadisticas/anuario_estadistico/index.php

For a moment in history, Nicaraguan society overcame what has arguably been the main obstacle to sustained socioeconomic progress in Central America: the bitter, self-defeating deadlocks dividing business and government and the consequent frequent discontinuities in public policies.

problem. Similarly, charges that COSEP was guilty of enabling centralized authority miss the mark; on the contrary, COSEP input into economic decision-making fortified market mechanisms and a private sector independent of state power. COSEP also used its access to senior officials to raise their concerns about the declining quality of governance, even as business lacked much leverage on matters outside of the strictly economic realm. As the quality of governance deteriorated, the business-government dialogue withered until its decisive demise in April 2018.

At its zenith, the corporate-government consensual decision-making model generated economic growth with modest social inclusion, giving voice and results to corporate boards and to residents of middle and working-class neighborhoods as represented by the Sandinista Party while also ameliorating rural poverty. Critics were correct, however, to recognize that the model relied overly on the skills and good will of just a few individuals (as well as upon the largesse of external donors). It also lacked the solid institutionality that could survive in the face of the overweening personal ambitions of powerful political caudillos and, eventually, of broad social upheaval.

Political Breakdown and Consumer Strike

The 2016 presidential contest deepened apprehensions regarding political stability. Running for his third consecutive term, Ortega had appointed his wife, Rosario Murillo, as his vice president and presumptive heir. In the 2016 elections, the government blocked international observation, accusations of electoral manipulation were commonplace, and voter abstention was on the rise. The ruling couple's emissaries had begun to talk of their upcoming two-term 10-year rule, a lifetime in politics.

Just as ominous, power within the executive branch and ruling Sandinista Party was becoming ever more centralized, with day-to-day operations firmly in the hands of Vice President Murillo. While well organized and hardworking, Murillo seemingly lacked the political skills of her husband. She surrounded herself with younger, less-informed loyalists. In the dialogue with the private sector, Murillo and her team were less inclined to consider other viewpoints. Rather, as one business participant recalled, "Murillo's idea of dialogue is, 'We talk, you listen.'"

For years, the IMF and World Bank had been warning of an impending liquidity crisis in the social security system, as liabilities outpaced contributions. In its June 2017 report, the IMF flatly stated: "The government, labor unions, and the private sector should arrive at a mutually agreeable solution as a matter of priority, as delaying the reforms will lead to a worsening of the situation and will increase the costs of reform."[28] Urging gradualism, the IMF suggested several reform packages, all intended to trim expenditures and boost revenues.

But no consensus was forthcoming. One important area of disagreement: the private sector demanded administrative reforms to address the allegations of mismanagement, corruption, and featherbedding in the social security bureaucracy. Without consensus with the private sector and without sufficiently preparing the public, in mid-April 2018 the government forged ahead alone and announced its own reform package. Public protests ensued: for some households living at the edge of poverty, even minor fiscal adjustments presented an existential threat. The government responded with disproportionate force, the civil protests rapidly spread, street barricades blocked commerce, and violence dramatically intensified, leaving hundreds of protesters shot dead and thousands wounded. The government then effectively banned anti-government demonstrations and assaulted opposition media. Under new "anti-terrorism" laws, hundreds were incarcerated as political prisoners.

Private sector leaders were shocked at the government's extensive use of police and armed gangs or *turbas* (composed of Sandinista Youth, retired police and military, and petty criminals) to repress peaceful demonstrations with deadly force. The children of many leading figures, including those of business executives as well as of high-ranking public officials, had taken part in the demonstrations, whose aims had quickly escalated from securing social security benefits to the removal of the Ortega-Murillo government via early elections.

In late May, prominent business leaders published an open letter to President Ortega:

> Paraphrasing your own words, there is no space in Nicaragua for the violence that has spilled so much of the blood of our brothers throughout our history. For this reason, we consider it most urgent to implement necessary reforms that allow for elections to be advanced in an orderly manner with a reformed Supreme Electoral Council, both dates to be determined in a national dialogue among representatives of your government and the Civic Alliance for Justice and Democracy.[29] (author's translation)

28. IMF, "Nicaragua 2017," para 20, 13.

29. José Adán Aguerri @jaguerrich, Twitter post, Twitter, May 30, 2018, 3:04 p.m., https://twitter.com/jaguerrich/status/1001917291460743170.

In another stunning development, private sector organizations joined several one-day anti-government general strikes called by other civic organizations. The public–private sector dialogue was suspended. The consensual decision-making model that had built business confidence and contributed to years of economic stability and expansion was shattered. Autocratic coercion and popular resistance had replaced consensus-building, throwing Nicaragua's political economy into profound crisis.

The pension reform, in substance and process, was the immediate detonator of the crisis. In the deeper sense, the political crisis was the logical outcome of the contradictions between a largely private, market-driven economy, embedded in a culture of individualism and student rebelliousness, and the efforts by the Sandinista leadership to construct an autocratic, single-party political system.[30] While the combination of private economies and autocratic politics may thrive in some Asian societies, there is not yet a successful, enduring example in the Western Hemisphere. Nicaragua is unlikely to prove an exception to the rule.

Economy in Freefall

The impact of this national political conflagration on the economy was immediate and immense. The initial trigger was the contraction in consumption, the result of the street roadblocks curtaining commerce and the nighttime curfew. A general contractionary spiral ensued: businesses reacted to declining sales by laying off workers, which further reduced household consumption. As businesses contracted and the general outlook turned gloomy, banks tightened credit… which caused businesses to contract further… placing investment plans on hold… further contracting spending and employment. In reaction to alarming media reports of the civil strife, foreign investors delayed expenditures and international tourism plummeted, devastating the hospitality sector. Real estate prices nosedived and construction projects were suspended. Reflecting the decline in economic activity, tax revenues fell short of projections, forcing a pro-cyclical fiscal contraction. Tens of thousands of mostly young people, including many educated professionals, fled the violence and government repression to safe havens in Costa Rica. In addition, the United States determined to block lending by international financial institutions (Box 2).The Nicaraguan economy descended into a dark, downward spiral (Figure 12).

By the end of 2018, the economy had contracted by about 4 percent (versus the earlier projections of 4.5 percent positive growth, hence an 8 percent reversal), unemployment had increased by some 140,000, and many at-risk Nicaraguans were falling back into

30. On the social origins of the April 2018 explosion, see "Interview with Jaime Wheelock: La crisis de Abril: Naturaleza y Alcances" (Managua: *Cultura de Paz,* November 2018); and Arturo Cruz, *How to Understand the Nicaragua Crisis.*

Figure 12. Downward Economic Spiral

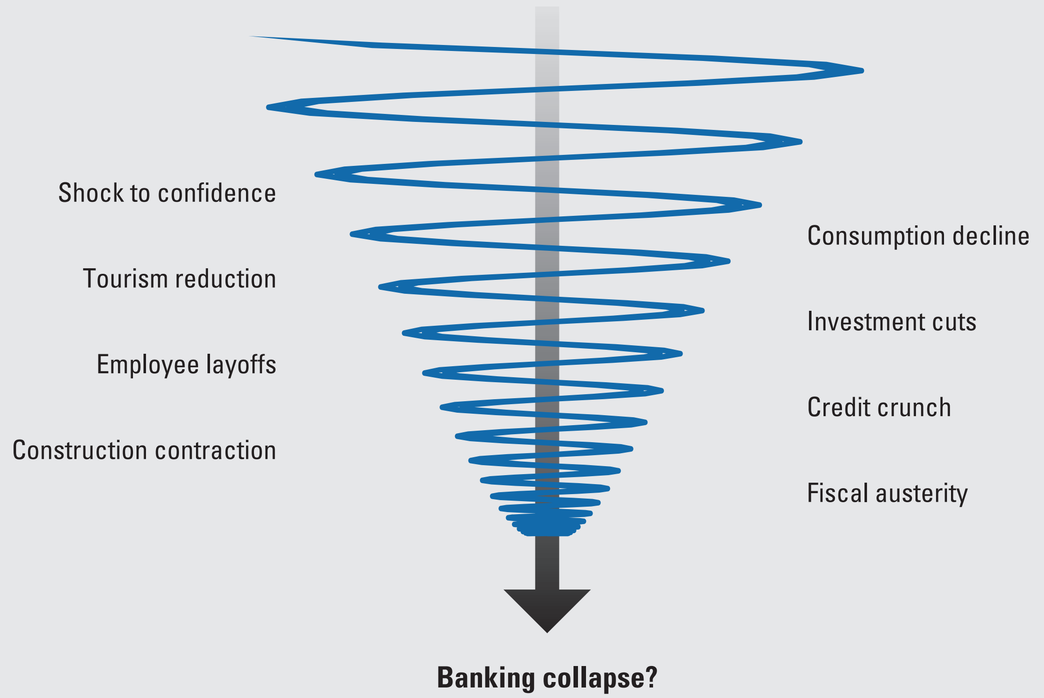
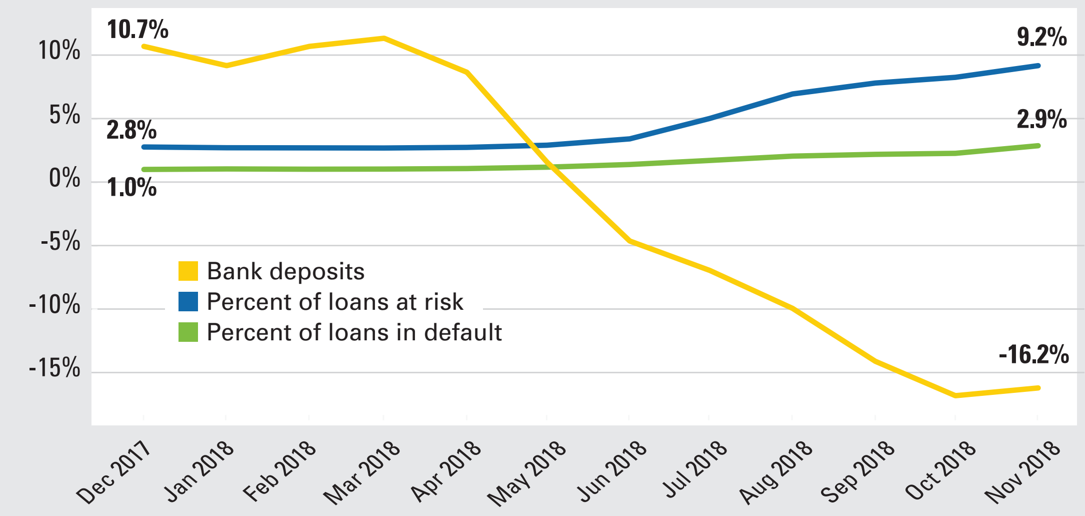


Figure 13. Banking Implosion



Sources: Nicaraguan Central Bank (BCN) https://www.bcn.gob.ni/estadisticas/monetario_financiero/financiero/depositos/5-1.htm; Superintendence of Banks and Other Financial Institutions (SIBOIF) http://superintendencia.gob.ni/infomes/indicadores-financieros

Street protest in Granada, Nicaragua, May 29, 2018, © Riderfoot, Shutterstock

By the end of 2018, the economy had contracted by about 4 percent (versus the earlier projections of 4.5 percent positive growth, hence an 8 percent reversal), unemployment had increased by some 140,000, and many at-risk Nicaraguans were falling back into poverty

poverty.[31] Moreover, the financial sector was contracting ominously. A leading economic policy institute projected that 2019 could witness a further 7 to 11 percent decline in economic activity, absent a political settlement and taking into account impending U.S. economic sanctions.[32]

Pre-crisis, the IMF had judged the Nicaraguan banking system to be "solid" and "robust," with levels of capitalization and liquidity well in excess of international standards, appropriate to the higher level of country risk.[33] These precautionary practices provided some cushion against the shocks of mid-2018. Short of cash and increasingly anxious about the future, businesses and households began to withdraw deposits, which by year-end had fallen by as much as a quarter (Figure 13). Non-performing loans rose sharply, even as banks scrambled to reschedule loans past due to avoid having to classify them as in arrears, thus deferring the corresponding loan-loss reserves. In effect, bankers watched as profits plummeted and capital they had accumulated over many years was suddenly at risk.

Throughout the Managua business community, talk spread that financial collapse was inevitable if current trends persisted for much longer. Bankruptcies could occur through various transmission mechanisms. Continual withdrawal of deposits could lead to a liquidity crisis, whereby banks could not meet their obligations and be forced to close their doors or seek new ownership. Alternatively, loan losses and declining profits could eat away at bank capital, creating a solvency crisis.

A financial collapse could also be prompted by country-level shocks. Foreign exchange reserves have been declining, although not yet precipitously. Should reserves suddenly plummet, the central bank would be unable to sustain the exchange-rate regime and would be forced into taking drastic measures such as a maxi-devaluation or restrictions on dollar-denominated assets, measures that could force widespread defaults across firms. Alternatively, a full-blown loss of confidence could cause a run on the banks. So far, deposit withdrawals proceeded gradually but in light of the tense political stalemate, an explosive exponential deposit withdrawal loomed as a credible threat. The official deposit insurance scheme only held reserves to cope with the collapse of a smaller financial institution, which by itself could set off a full-blown panic. Speculation was rampant as to how the authorities might react to systemic collapse: bank holidays, asset freezes, interventions, expropriations reminiscent of the 1980s.

31. COSEP and FUNIDES, "Monitoreo de las actividades económicas de Nicaragua," December 2018, http://funides.com/publicaciones/indicadores-mensuales/311-monitoreo-de-las-actividades-economicas.

32. FUNIDES, *Informe de Coyuntura 2018* (Managua: FUNIDES, January 2019).

33. IMF, "Nicaragua 2017," paragraph 10, 6.

BOX 2: U.S. Economic Sanctions: Impacts and Strategy

In December 2018, the U.S. Congress passed the "Nicaragua Human Rights and Anti-Corruption Act of 2018."[34] The legislation instructed U.S. representatives to the IFIs to vote against loans to Nicaragua (unless the assistance promoted democracy or benefited basic human needs). The legislation also authorized sanctions against Nicaraguan individuals engaged in human rights violations or corruption, as also enunciated by a strongly worded Executive Order issued by the Trump administration.[35] While largely codifying executive branch policies already underway, the "Nica Act"—passed unanimously by the U.S. Congress—signaled very broad repudiation of the government of Daniel Ortega.

The punitive measures are aimed at two distinct targets: first, individuals in the Sandinista leadership, and second, the wider national economy and society. Sanctions targeted against individuals (whether levied under Specially Designated Nationals or Global Magnitsky authorities) seek to compel these individuals and other senior officials to reevaluate their ties to the Ortega-Murillo regime. The broader U.S. sanctions against IFI lending threaten the economy as a whole, intending to undercut Ortega's political base. If sustained, however, these broader sanctions will inevitably bring suffering to the average Nicaraguan citizen.[36]

As a small, highly open economy, Nicaragua is vulnerable, whether those ties are cut by economic agents responding to market signals and loss of business confidence or by purposeful official sanctions. To finance vital imports, Nicaragua relies on assistance from the international financial institutions and FDI, and both sources were very much at risk in the current polarized political environment (Figure 9). International tourism fell sharply in the second half of 2018.

Many Nicaraguans cheered when the U.S. government imposed individual sanctions against Rosario Murillo. Many Nicaraguans may also willingly accept some short-term economic pain if it helps to bring about a political solution; a CID-Gallup poll taken in the midst of the crisis found that 63 percent of interviewees considered human rights more important than the economy. But there is alarm at casual statements by the Nicaraguan government warning of its intention to resist "imperialist aggression," even at the cost of returning to a rural "rice and beans" subsistence economy.

34. "Nicaragua Human Rights and Anticorruption Act of 2018," H.R. 1918, 115th Congress (2018), https://www.congress.gov/bill/115th-congress/house-bill/1918/text.

35. The White House, "Executive Order on Blocking the Property of Certain Persons Contributing to the Situation in Nicaragua," November 27, 2018, https://www.whitehouse.gov/presidential-actions/executive-order-blocking-property-certain-persons-contributing-situation-nicaragua/.

36. FUNIDES estimated that if the economic crisis continues throughout 2019, around 1.2 million persons are at risk of falling into poverty if they lose their jobs or their incomes decrease. FUNIDES, "Projección de la actividad económica para 2019," press note, October 18, 2018, http://funides.com/noticias/439-proyeccion-de-la-actividad-economica-para-2019/.

The effectiveness of the sanctions strategy hinges upon several key judgments: that Ortega's seemingly firm hold on the Sandinista leadership and on the security forces can be shaken; that Ortega and the Sandinista leadership will respond rationally to spreading popular discontent; and that the political opposition can seize upon any emerging divisions to increase its own bargaining power. Only time will tell.

Conversely, countrywide economic sanctions can backfire. The "sanctions paradox" works as follows: in a world of declining economic activity, the gap widens between regime loyalists with access to official jobs,[37] social programs, and other perks and the rest of exposed society. As this insider-outsider gap widens, regime cohesion could actually tighten, bolstering insider resistance to regime change. This "sanctions paradox" may help to explain the surprising resilience of the *chavista* regime in Venezuela.

Additional linkages that in the extreme might be severed between the U.S. economy and Nicaragua include U.S. imports, which account for 40 percent of Nicaraguan merchandise exports as well as 70 percent of exports from Nicaragua's free trade zones (primarily apparel); and 55 percent of total annual remittances (or about $800 million). However, U.S. sanctions against worker remittances and merchandise exports (especially in the labor-intensive apparel sector) would directly damage middle-class and poor households.

Many Nicaraguans cheered when the U.S. government imposed individual sanctions against Rosario Murillo.
Many Nicaraguans may also willingly accept some short-term economic pain if it helps to bring about a political solution.

37. Under the second phase of Sandinista rule, dating from Daniel Ortega's reelection in 2006, central government employment rose from 61,000 in 2007 to 108,000 in 2017. See Nicaraguan Ministry of Finance and Public Credit, Table III-4, "Employment in the Central Government," Excel spreadsheet.

Back from the Brink: Reestablishing Consensus

Pre-crisis, there seemed to be widespread agreement on many of the key challenges facing the Nicaraguan economy. Infrastructure (roads, seaports, airports) and energy generation, despite important strides, required further investments. Public education was under-performing and demanded greater attention.[38] To raise agricultural productivity, smaller farms needed more irrigation, advanced technologies and technical assistance, better storage and distribution systems, and easier access to bank credit. Export-oriented industry could add value and raise wages through workforce training and superior management skills. The promising tourism sector could earn more dollars per visitor if supported by a more accessible transportation grid, even as Nicaragua continues to build its brand of small-scale, domestically-owned tourism.

Nicaragua is living proof that economic growth is not sustainable without a functioning consensus on political institutions.

As a developing economy, Nicaragua naturally faces many other challenges, but the economic model designed over the previous 25 years had laid a solid foundation. The keys to future success included sustained macroeconomic discipline, export-led growth, an increasingly diversified export platform, and an openness to foreign investment and multilateral finance. A reasonably equitable distribution of the fruits of growth could be achieved by combining strong job creation, progressive fiscal policies, and targeted, efficient government assistance programs. In the private sector, a more highly educated and trained work force would justify a fairer sharing of productivity gains.

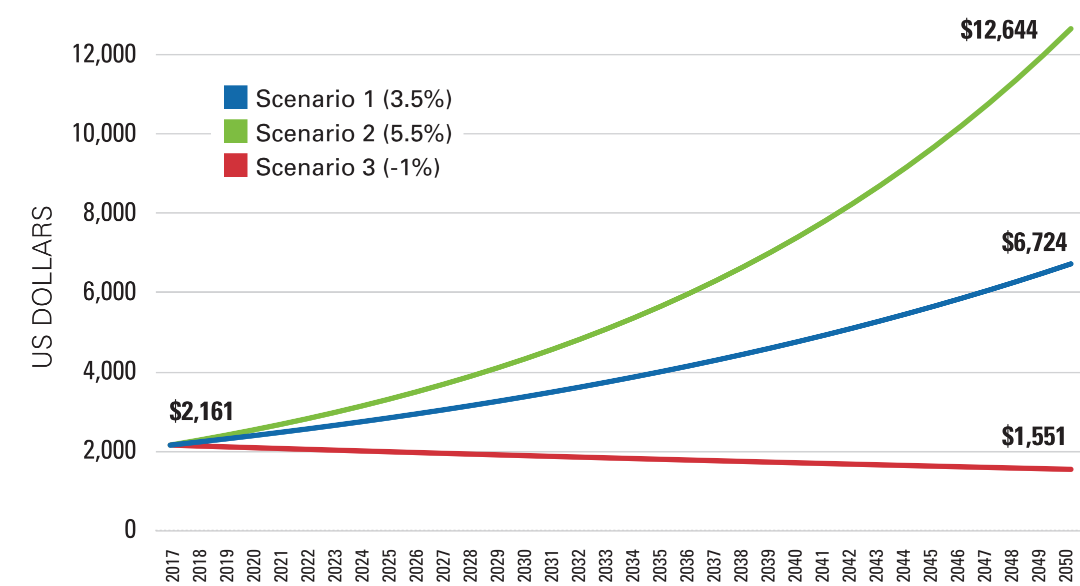
However, events had revealed that there was one critical issue, or set of issues, where there was no consensus: the reform of public-sector institutions. The old mindset that sought to manipulate public office for private and partisan gain had not disappeared. The proper relationships between public and private sectors and between the state apparatus and leading political parties were in contention. Also in dispute were the independence of the judiciary and the integrity of the electoral process. Hence, the profound political crisis. Nicaragua is living proof that economic growth is not sustainable without a functioning consensus on political institutions. As the World Bank presciently remarked in February 2018:

> The required acceleration of economic growth can only be achieved in close dialogue and collaboration between the public and private sectors, both in terms of the strategic direction and combination of resources.[39]

38. Nicaraguan students performed poorly on international tests, even in relation to other Central American nations. ECLAC, *Desarrollo, integración e igualdad*, Table VI.2, 119. See also: FUNIDES, *La Calidad de la Educación en Nicaragua, 2017* (Managua: FUNIDES, 2017), http://funides.com/publicaciones/informe-y-estudios/180-la-calidad-de-la-educacion-en-nicaragua/.

39. World Bank, *Country Partnership Framework*, 1.

Figure 14. Growth Scenarios 2020–2050 (Per Capita Income)



Nicaragua today desperately needs a political solution credible enough to restore confidence to financial markets, investors, and consumers.[40] The most pressing political issues are reform of the electoral system and the date for elections as well as a return of civil liberties and freedom for political prisoners. More comprehensive governance reforms must follow. Initially, economic recovery is likely to proceed slowly, as the nation recuperates from the severe trauma of violent confrontation and as economic actors wait to see if the new political accords are sustainable. During this transition, the international financial institutions can mount a concerted, quick-disbursing stabilization package that sets the conditions for renewed growth.

Once stability has been re-established, the nation can build upon its earlier economic successes, while correcting deficiencies. Looking forward, Nicaragua has already demonstrated that it can attain growth rates of 4–5 percent per year which if sustained could triple per capita GDP from the 2017 level of $2,161 to some $6,700 by 2050 (Figure 14). Further, if the nation could address critical bottlenecks to growth, it can aspire to even higher rates of per capita income. At a sustained GDP growth rate of 7 percent a year, in a generation each Nicaraguan could enjoy a per capita GDP six times the current amount, or some $12,600—in an economy more firmly embedded in stronger political institutions.

40. For the outlines of a political soft landing, see Feinberg, "Nicaragua: Revolution and Restoration," 15–16.

About the Authors

Richard E. Feinberg, a professor at the University of California, San Diego, has travelled frequently to Nicaragua over the last 15 years and has spoken, in informal conversations and more structured interviews, with many of the principal figures in business, political, and academic circles. His most recent visit was in December 2018. While serving with the State Department's Policy Planning Staff, he met with General Anastasio "Tacho" Somoza in 1978 and while serving with the National Security Council traveled with First Lady Hillary Rodham Clinton to Managua in 1995. Feinberg joined the Carter Center elections observation mission delegation in 2006 and attended the subsequent 2007 inauguration of Daniel Ortega Saavedra.

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Volcan Concepcion, Lago Cocibolca (Lake Nicaragua), © Richard Feinberg

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