The Development of Economic Policy in Nicaragua: 1979 to 1985

The extremely complex dynamics associated with the transformation of a primarily agrarian and feudal society to a modern industrial one without the "necessary preconditions" for revolution left the Sandanista government with many dilemmas and countless problems in formulating economic policy subject to a future based on a mixed economy. However no analysis of Nicaragua can ignore entirely the profound effects that U.S. attempts at destablization of the state had on the near "Wartime economy".

In common with most other underdeveloped countries (LDC's), Nicaraguan "economic development" was based on agro-exports and therefore hampered by its vulnerability to commodity price fluctuations, trade deficits, and consequent balance of payments problems. Industrialisation was not encouraged and where it existed, it supplied mainly the domestic market and used a high import content in its produce. The Somoza dictatorship (which had spanned over 50 years) was corrupt to such an extent that even multi-national corporations (MNC's) were forced to support (initially) the Sandinista revolution, in the hope that the new government might not be so greedy! Prior to the revolution of 1979 Nicaragua was one of the poorest and most unjust societies in Latin America. Its life expectancy rate at 53 yrs was the lowest in Latin America, and 15 yrs lower than its "next door neighbour" Costa Rica! 75% of the population lived in rural areas and an 1973 estimate put at 66% the the level of the people who were under-nourished. Although the Somoza dictatorship borrowed quite heavily (1.3bn) very little of the money was used to improve the lot of the small producer, who dominated as a percentage of the economically active population (EAP). However a World Bank mission in 1952 reported that "The concentration of income in a relatively small part of the population should be a favourable basis for increased industrial production, through private capital formation". Dualism in its extreme perhaps!

However this was not to be and during the 70's worldwide inflationary pressures, fluctuations in agro-export prices and the growing foreign debt brought industrial production to a standstill. In 1979 these pressures amongst others lead to a popular revoloution lead by the Sandinista's (FSLN party), and the overthrow of the Somoza dictatorship, coupled with full confiscation of all their holdings, land, factories and wealth. During this upheaval there was a huge flight of capital , total disruption of trade, food and foreign exchange shortages and the almost total abandonment of the productive facilities in the economy.

Nicaragua's growth pattern fits in very well in the dependency perspective of economic development in LDC's. The direction and composition of its output has been shaped by the needs of the core countries and most of its output is non-processed agro-exports. like many other peripheral LDC's, Nicaragua's dependency was not directly enforced but was internally perpetuated by the extraordinarily rich elite who benefited greatly from the support of the core countries politically, economically and sometimes militarily, when the need arose. Any industrialisation that did occur in Nicaragua was poorly integrated with other indigenous producers and therefore was totally dependant on its raw material or technical imports, from the core country. However the new regime did not try to break the links to the core countries, but it did attempt to sway the balance a little in Nicaraguas favour.

Bearing in mind that the private sector in Nicaragua accounts for over 50% (58% in 1989) of GDP it was accepted that no attempt to socialize the entire means of production would be attempted, and that private investors should be guaranteed that confiscation of their property would not take place. The objectives to be aimed for were all to be a basis for, "initiating the process of transition". More specifically they were

1. To reactivate production/distribution with the aim of satisfying the basic needs of the population.

2. To build and maintain a level of "national unity" amongst workers and small producers, professionals and "patriotic entrepreneurs".

3. To establish and maintain macroeconomic and external sector balances.

Although the government had no direct control over the private sector it did have considerable influence through its 100% ownership of the banking system and its very strict control over currency movements.

The initial economic policy developed in 1979 focused mainly on development through agro-industry. Although the government was aware of the danger of over dependence on agricultural exports, it had to admit that realistically in the medium term it, at least agriculture would provide the basis for industrial development, through increased output and vertical integration. As regards banking the government operated a policy of a fixed exchange rate for the Cordoba, which was intended to help indigenous industry import its necessary inputs, it also had the advantage of keeping the inherited national debt (in dollars) at a realistic if not affordable level.

The nationalised banks also extended a very generous credit policy to small and large producers alike, which in effect were charged "negative interest rates" at the level of inflation prevailing. This credit policy did not discriminate in favour of the public sector , and indeed in the period 1980-82 54% of all credit was made available to private producers, including many huge ranchers and plantationists. However most of this credit was directed to private agricultural interests and not the industrial sector which was still reluctant to invest even at low interest rates.

The government efforts to restrict the consumption of non-essential goods and increase the consumption of basic goods and public services, led to a policy of restriction of imports of luxury goods and widespread subsidisation and rationing of basic-goods. Coupled with this price strategy the government implemented an incomes restraint strategy. The reasoning behind this was the knowledge that increase in nominal wages only served to increase the price level to the disadvantage of the majority and that increasing the supply of "wage goods" was the best way to improve income distribution. Policy for industrial development was more long term in nature and included among its objectives , a strategy of emphasis on production of basic consumer goods, basic inputs for agriculture, construction, national defence and transportation. In short, industry was encouraged to increase its technology and trade linkages with agriculture and other indigenous industries in order to achieve greater integration and more "value added" in the economy, and in doing so lessen its dependence on imports.

During the years after the first Economic plan, many problems developed and many of those that were there already exacerbated. The government's attempt to restrict imports was partially successful with a dramatic fall in consumer good imports, however there was still a huge demand for raw materials and inputs that were vital for most of the priority industries. The government was forced to restrict foreign exchange to only the most pressing of needs. This hit private industry particularly hard as it relied to such an extent on foreign inputs. A related problem was the continued existence of low levels of integration between industries. This has been a major contributor to the persistence of low levels of productivity in the industrial workforce which has been estimated in dollar terms as $10,000 per worker per year in output (max.). Other non-economic factors have contributed to this lack of productivity in industry including the departure from the country of many technically qualified people and the lack of administrative experience and knowledge on the part of managerial and technical staff.

The government policy of wage containment and widespread subsidies of basic goods also had counter productive results. The difficulties encountered by the state in exercising control over the market place allowed speculation and wide spread arbitrary price increases for manufactured goods which mushroomed into a massive black market. Conversely agro-producers affected by these price increases for manufactured goods sought higher prices for their produce by selling their subsidised (but rationed) produce at much higher prices in the black market.The wage containment policy led to more migration from rural to urban areas, where incomers became involved in diverse informal activities, which were more lucrative than agricultural work. This in turn led to a scarcity of workers for the harvests.

A scarcity of foreign currency began to appear in 1981. The needs to raise foreign exchange through a policy of export encouragement coupled with import restrictions were not met. Instead the maintenance of a deliberately overvalued Cordoba became an insurmountable obstacle to increasing exports, just as it became a permanent stimulus to the demand for imports. This overvaluation was reflected in the huge black market for foreign currency where the exchange rate for the U.S. dollar was more than 50 times the offical rate in 1985. This difference in exchange rates for export revenue and import purchase also resulted in financial losses for the Central bank that were covered by more paper money issues. Also the strong demand for dollars by the private sector for consumption purposes which could not be supplied by the government led to even more contraband imports, smuggling and a more profitable black market. The generous credit policy and the low price of imported supplies (due to the overvalued Cordoba) could not compensate for the decline in profits resulting from the overvalued Cordoba.

The new economic policy announced in 1985 was aimed to overcome the failings of the original one and at the same time reverse the trends in the parasitic economy that were fast gaining ground. In 1982 alone it was estimated that over 30,000 workers went into "self-employment" in the informal sector. This new economic policy included some very unpopular measures, and some were almost monetarist in nature. Huge spending reductions were announced, subsidies were eliminated on many basic food items, a freeze on public employment in administration was announced and government investment in capital projects was sharply cut down. Resources were to be assigned to priority areas of production in most cases and stimulants in the form of changes in prices, wages and exchange rates were all part of the new policy. New producer prices and wage increases were aimed at concentrating capital and labour in the productive sector and resources previously directed towards health, education and housing were to be diverted towards production and also, it must be said, the increased need for more defense against invasion. The new foreign exchange policy involved devaluing the Cordoba to 1/3 of its previous level although this meant little difference in the huge gap between offical and black market exchange rates which still remained. Different rates of exchange were established for different activities. These new rates were not going to improve things in the long run as seen by the bias towards consumption expenditure on imports. However compensatory measures in regard to wage increases (100% for agro-workers) were hoped to keep purchasing power at an equivalent level. These policies aimed at increasing production while allowing for wage/ price increases through direct distribution of goods to workers.

In fact the government policy of gradual reductions in the exchange rate have not prevented this. In 1989 Nicaragua had the world's highest inflation at 30,000%. This has been accompanied by a sharp decrease in the living standards of the people. However, economically, now as in 1984 Nicaraguas main hopes (and a source of most of its problems) rest outside its frontiers.It is a small impoverished country still struggling for survival against exploitation. Peace in the region is a necessary but not sufficent condition for economic growth and stability. Great gains have been made since 1979 which have benefited most Nicaraguans, hopefully these gains will be built upon by the new administration and not destroyed by a return to the old order.

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