

Page Denied

Next 1 Page(s) In Document Denied



**Directorate of
Intelligence**

Secret

25X1

Nicaragua: Compounding Economic Problems

25X1

An Intelligence Assessment

Secret

*ALA 86-10048
November 1986*

Copy 297

Page Denied



**Directorate of
Intelligence**

Secret



25X1

Nicaragua: Compounding Economic Problems



25X1

An Intelligence Assessment

This paper was prepared by [redacted] Office of
African and Latin American Analysis, with
contributions from [redacted]
[redacted] Office of Leadership Analysis. It
was coordinated with the National Intelligence
Council and the Directorate for Operations. [redacted]

25X1

25X1

25X1

Comments and queries are welcome and may be
directed to the Chief, Middle American-Caribbean
Division, ALA [redacted]

25X1

Reverse Blank

Secret

*ALA 86-10048
November 1986*

Secret

[Redacted]

25X1

Nicaragua: Compounding Economic Problems

[Redacted]

STAT

Key Judgments

Information available as of 15 October 1986 was used in this report.

The Nicaraguan economy, already in a tailspin because of Sandinista anti-private-sector policies and financial mismanagement, has been further strained during the last 18 months by the growing civil war, continuing problems related to the US trade embargo, and economic decision making based wholly on political concerns. Unprecedented consumer shortages and deteriorating public services now are combining to lower personal welfare. We estimate that, unless circumstances change fundamentally, real per capita GDP will continue to decline during 1986 and 1987, even taking into account the present trend of increasing Soviet aid. In this case, we believe Managua will have to rely even more on police-state tactics to try to short-circuit the growing potential for food riots or work disruptions.

[Redacted]

25X1

The effect of the economic slide on the Nicaraguan population is increasingly severe:

- Overall economic activity is now one-third below prerevolution levels.
- Export revenues are down two-thirds, and foreign debt has soared from \$1.5 billion in 1979 to \$6 billion.
- Recent agricultural harvests have been the worst this decade.
- Government officials expect consumer price inflation to hit 600 percent this year.
- Real wages and average personal income are about one-half pre-1979 levels, [Redacted]
- [Redacted] by mid-1986 shortages of basic foods were more serious than at any time since the revolution. [Redacted] many Nicaraguans have cut their diets to subsistence levels and that some are going hungry. [Redacted]

25X1

25X1

25X1

25X1

25X1

Sandinista efforts to consolidate political control and prosecute the war have become primary economic policy determinants, largely determining budget allocations, agricultural and industrial reforms, and commercial and foreign trade relations.

[Redacted]

25X1

[Redacted]

25X1

[Redacted]

25X1

[Redacted] the Sandinistas view the existence of

25X1

private enterprise as only a short-term tactical accommodation until the regime can establish full state controls.

[Redacted]

25X1

Secret

ALA 86-10048
November 1986

Secret



25X1

The slide in real GDP in 1987 could intensify if increased US aid to the insurgents requires a response by Managua that saps an additional share of the Sandinistas' limited managerial and budget resources. The military's share of the total budget already has risen from 25 percent in 1984 to some 60 percent in 1986, [redacted]. In our opinion, the more intense the armed rebellion, the more the Sandinistas will be encouraged to attack the remaining productive private sector, which is perceived by the regime as its political and philosophical enemy. [redacted]

25X1

25X1

External assistance provides a safety net but is unlikely to be sufficient to brake the economic slide. Some \$1 billion in Soviet Bloc economic aid during 1985 and thus far in 1986 has had no appreciable effect on the downturn. Given current Sandinista policies and likely increasing war costs, we calculate that for the next 18 months Soviet aid—even if continuing to grow at current rates—probably will only keep consumption at minimum levels. [redacted]

25X1

Public discontent over economic shortages is underscored by unprecedented consumer disturbances [redacted]

25X1

Since last June, the US Embassy has reported spontaneous, food-related disturbances in Managua, Leon, and San Juan del Sur [redacted]

25X1
25X1

[redacted] consumers are disgusted with shortages of foodstuffs and other goods that Nicaragua formerly exported. Moreover, [redacted] Nicaraguans blame government mismanagement and inappropriate policies rather than external forces for the dismal economic situation. [redacted]

25X1

25X1

In our view, any further economic deterioration would increase the potential for spontaneous antigovernment demonstrations and in time could present a major obstacle to the Sandinistas' efforts to extend political control. While the Sandinistas apparently are preparing to ride out what they presumably see as an almost inevitable economic decline, they run the risk that over time regime stability could in no small measure be determined by their response to mounting consumer distress. [redacted]


25X1

Secret

Secret



25X1

The growing economic plight, potentially reinforced by increased battle-field losses for the Sandinistas, will continue to erode popular confidence in the regime, and could eventually translate into increased popular support for the insurgents. On the basis of the Sandinistas' track record, we believe the regime will continue to respond to the compounding economic problems by tightening political, social, and economic controls. While these tactics are likely to encourage a considerable number of Nicaraguans to abandon their country, they are also likely to encourage others to join the armed opposition, especially if the insurgents can effectively use increased international support to build a "winners" image. 

25X1

Secret

25X1

Contents

	<i>Page</i>
Key Judgments	iii
Introduction	1
Restructuring the Economy	1
Creating a Socialist State	1
Shifting International Economic Linkages	1
The Sandinista Record	3
The Tailspin Worsens in 1986	5
Steep Production Declines	5
Growing External and Internal Deficits	6
New Distribution Controls	7
Consumer Shortages	9
Looking Down the Road	10
Poor Prospects for Policy Changes	10
Growing Managerial Problems	11
Agricultural Deterioration	11
The Soviet Safety Net	12
Implications for Sandinista Vulnerabilities	13
Appendixes	
A. Sandinista Economic Decision Making	15
B. Key Economic Policy Makers	17

SecretALA 86-10048
November 1986.

Secret

25X1

Figure 1



708818 (545340) 11-86

25X1

Secret

Secret
[redacted]

25X1

Nicaragua: Compounding Economic Problems [redacted]

25X1

Introduction

The Sandinistas are increasingly having to make tough economic policy decisions in order to meet competing priorities and keep the economy, which is nearly a shambles, afloat. Real per capita GDP has fallen sharply in recent years and inflation has skyrocketed. Despite increased shipments of staples from the Soviet Bloc, consumer supplies [redacted] have contracted to near subsistence levels. [redacted]

During the past several years—and particularly since Daniel Ortega's inauguration in January 1985—the Sandinistas have stepped up attacks against the private sector and taken firmer control of the economy, according to US Embassy and press reporting. [redacted] private-sector access to bank credits has continued to plummet. Land confiscations, authorized by a 1981 land reform decree, have picked up markedly since 1983 and increasingly have become politically motivated. [redacted]

25X1

25X1

25X1

25X1
25X1
25X1

This paper analyzes the causes, extent, and implications of the economic slide. It evaluates the policy priorities of the Sandinistas and their success in centralizing the economy and forging new international economic linkages. Looking forward, it evaluates the prospects for the economy in light of probable government initiatives and increasing internal and external pressures. The paper also assesses the effectiveness of Soviet Bloc financial support and the probable implications of the continuing economic decline for the potential vulnerabilities of the Sandinista regime. [redacted]

The net result has been the nearly complete centralization of state economic power.² Private-sector investment has virtually disappeared, causing Sandinista National Directorate member Bayardo Arce to comment publicly that "all investment projects in our country belong to the state. The bourgeoisie no longer invests, it subsists." Increasingly, anti-private-sector rhetoric and the repressive political climate created by the Sandinistas are causing business executives, managers, farmers, and professionals to abandon their careers and go into exile, according to press and US Embassy reporting. [redacted]

25X1

25X1

25X1

[redacted] the state—including government-directed cooperatives—now holds about 60 percent of all arable land and productive capital assets and produces about two-thirds of all GDP. Before the revolution, the state owned virtually no arable land or factories, and government services accounted for only 15 percent of GDP; for his part, former President Somoza personally owned about 10 percent of all arable land, and his farms and factories accounted for as much as 15 percent of all economic activity. [redacted]

25X1

Restructuring the Economy

Creating a Socialist State

Despite lipservice to the importance of a "mixed economy," Sandinista policies since the revolution have moved Nicaragua inexorably toward a state-dominated socialist economy.¹ This goal was first identified just weeks after the Sandinistas took power when an internal document set government policy as the "elimination of the traitorous bourgeoisie . . . once the private sector ceases to be of value." By moving only gradually toward full state controls, the Sandinistas have been able to help maintain substantial access to official Western economic support while initially retaining many key technicians and managers. [redacted]

Shifting International Economic Linkages

At the same time that the Sandinistas have been working to centralize their economy, they have taken equally pronounced steps to redirect their foreign

25X1

² See appendixes A and B for a detailed examination of the economic decision making process and its key players [redacted]

STAT

25X1

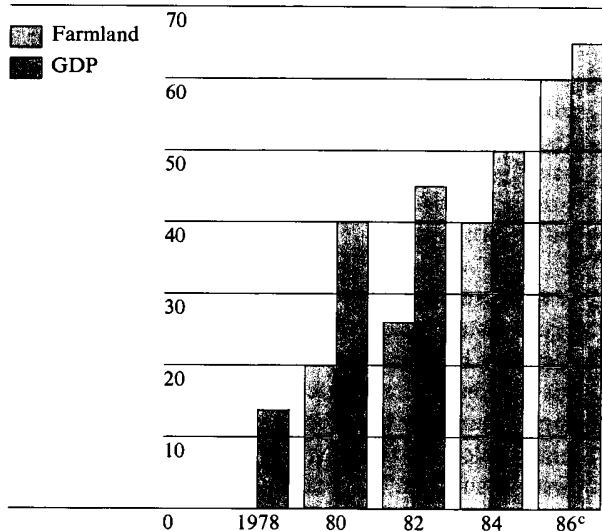
[redacted]

Secret

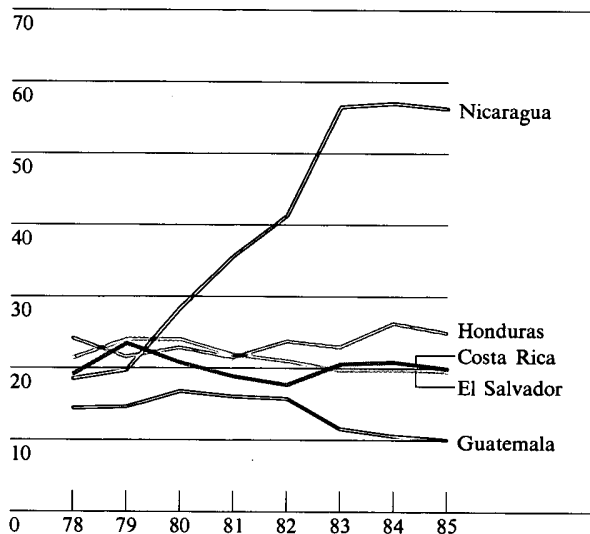
Figure 2
Nicaragua: Expanding Role of Public Sector, 1978-86

Percent

Public-Sector Share of Arable Farmland and GDP^a



Government Budget Expenditures^b



^aIncludes state-controlled cooperatives.

^bAs a percent of GDP.

^cProjected.

310655 11-86

25X1

economic relations away from the West and toward the Soviet Bloc. According to US Embassy reporting, Sandinista policy has consistently been to reduce trade with the United States as a matter of ideological principle.³ After the May 1985 trade embargo was announced, the Sandinistas redoubled their efforts to cut their economic reliance on the West. As a result, official trade data show that nonmilitary trade with the Bloc, which had been negligible before 1979, climbed to one-half of the total during 1985, and will very likely account for 75 percent of all trade during 1986.

Managua's foreign aid linkages also have been dramatically altered since 1979. Immediately following the revolution, large amounts of concessional funding came in from all corners, including Cuba and the Soviet Bloc. During the period 1980-81, the West provided Nicaragua \$450 million per year in financial support compared with \$60 million from Cuba and the Soviet Bloc. During 1984-85, economic aid from the West slipped to \$240 million per year, while financial support from the East jumped to an annual rate of about \$400 million. By 1985-86, Cuba and the

25X1

25X1

Secret

2

Soviet Bloc were providing about three-fourths of all economic disbursements, while aid from Western sources continued to decline. [redacted]

The Sandinista Record

Since 1981, Nicaraguans have experienced a steady decline in living standards. Sandinista government statistics indicate that, by the end of 1985, overall economic activity was one-third below the prerevolutionary level. National accounts prepared by Managua show that about half of the falloff in economic activity resulted from a reduced output of goods, while the remainder was caused by the marked deterioration in services. The only economic sector to buck the trend was government activity, which expanded rapidly throughout the period. [redacted]

Agricultural output fell steadily, even according to government figures. Using official statistics to compare average export performance during 1984-85 with that of the 1975-78 period, we conclude that:

- Coffee and tobacco output fell 10 percent.
- Beef production fell by a little over 20 percent.
- Banana output was down by one-fourth.
- Cotton production dropped by one-half.
- The shrimp and lobster catch dropped 60 percent.
- Lumbering activities were down 70 percent.

Official figures indicate that farm output for the local market held relatively steady, because the Sandinistas kept prices paid to farmers for staples higher than export prices. Even if government figures are correct, however, population increases cut per capita production and consumption of corn, rice, and beans substantially during the same period. [redacted]

The other economic sectors also contracted sharply. Official figures show that industrial production fell 22 percent and mining output tumbled by more than half between 1977 and 1985. At the same time, economic activity in the service sector also fell sharply, despite an increase in government spending on military, health, education, and public services. In the transportation, financial, and commercial sectors, where state nationalizations hit services the hardest, economic activity fell by an average of 40 percent, [redacted]

Managua fared no better on the international side. During the 1970s, Nicaragua exported slightly more than it imported. In contrast, during 1980-85 it exported one-half the amount it imported. In dollar terms, the trade balance shifted from a small surplus during the 1970s to an aggregate \$2.4 billion deficit in 1980-85. Agricultural exports fell by one half and exports of other goods by 75 percent, according to official figures. While some of the drop was caused by lower prices for Nicaragua's commodities and the disruption of the Central American Common Market, national statistics suggest that the bulk of the loss resulted from lower sales volume caused by production shortfalls. [redacted]

25X1

25X1

25X1

Nicaragua's public budget record has been equally poor. Despite lipservice to the importance of controlling public expenditures, the budget deficit as a share of GDP rose from less than 5 percent before the revolution to one-third of GDP since 1982, [redacted]

25X1

[redacted] The deficits have been driven by the huge increase in public-sector spending; government expenditures as a share of GDP soared from less than 20 percent before the revolution to almost 60 percent since 1982. By comparison, government expenditures as a share of GDP in the Core Four Central American countries averaged about 20 percent during 1983-85. Government statistics also show that, while the Sandinistas financed a large share of the deficit with loans from the nationalized banking system, the bulk of the deficit was covered by printing new currency [redacted]

25X1

25X1

As a result of the skyrocketing money supply and huge foreign payments deficits, the foreign exchange value of the cordoba plunged. After being fixed at 10 cordobas to the dollar immediately following the revolution, the cordoba was first devalued in February 1985 when Managua reset its official exchange value at 28 to the dollar. A depreciated black-market rate had developed much earlier, however, and the cordoba traded at about 200 to the dollar on the streets at the time of the devaluation. By the end of last year, while officially still fixed at 28 to the dollar, the cordoba traded on black markets at 500 to the dollar. [redacted]

25X1

25X1

25X1

25X1

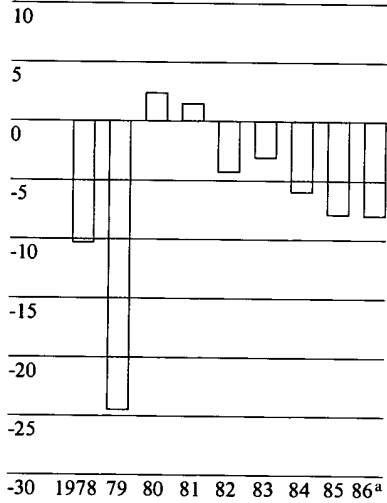
25X1

Secret

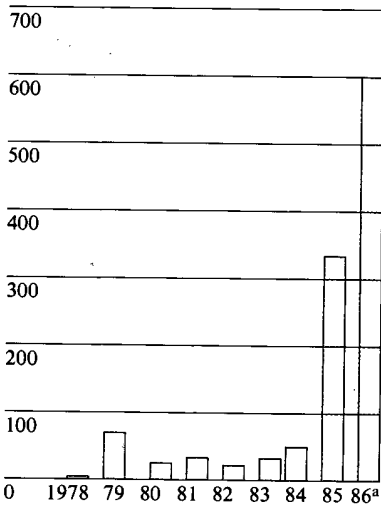
Figure 3
Nicaragua: Economic Indicators, 1978-86

Note scale change

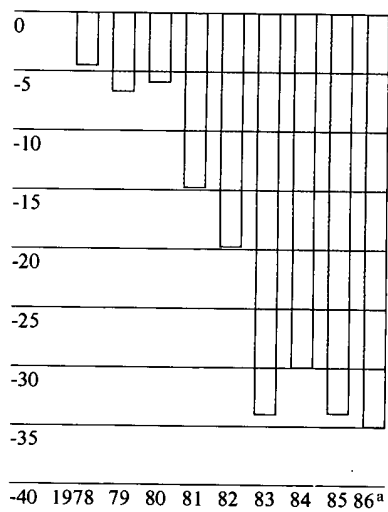
Real Per Capita GDP Growth Percent



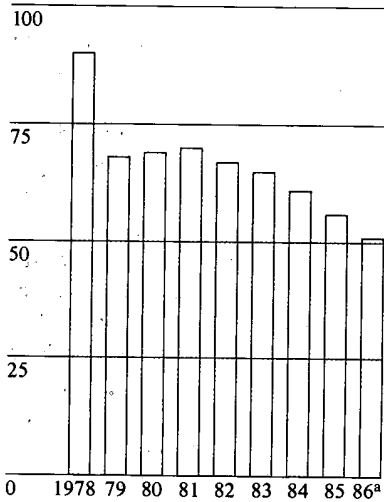
Consumer Price Inflation Percent



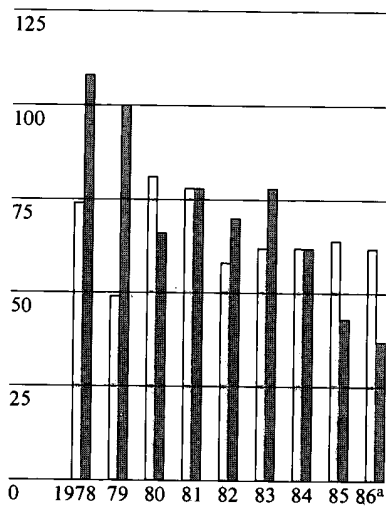
Budget Deficit as a Share of GDP Percent



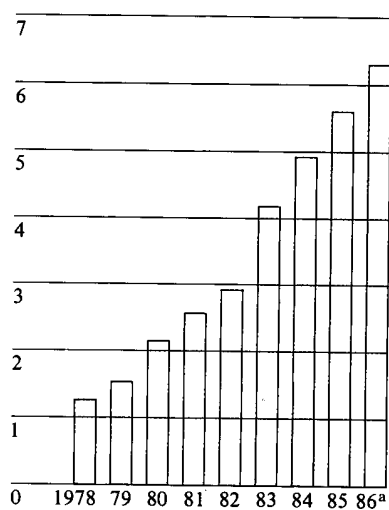
Per Capita Income Index: 1977=100



Export/Import Volumes Index: 1977=100



External Public Debt Billion US \$



^aProjected.

□ Import
 ■ Export

310556 11-86

25X1

Secret

Secret

As the money supply surged and consumer shortages increased, inflationary pressures mounted. By mid-1984, the government, citing growing budget deficits and the need to curb black-market speculation, began boosting official prices for food staples. From December 1984 through December 1985, official consumer prices jumped 334 percent, according to government statistics. Meanwhile, food prices soared 387 percent, housing prices 219 percent, and clothing prices 142 percent, according to the same sources. [redacted]

Average real wages also fell steadily. The Sandinistas gave workers a 40-percent wage hike when they took power—despite an inflation rate of 70 percent—then virtually froze wages during the next several years. Our analysis of official statistics between 1979 and 1984 shows that the average real wage fell by half and the minimum wage by slightly more. During 1985, three wage adjustments were not enough to keep up with inflation, and IMF statistics show that average real wages fell by another 20 percent. [redacted]

The Tailspin Worsens in 1986

The Sandinistas' economic problems have continued to mount this year. According to official estimates, recent agricultural harvests have been the worst so far this decade. New licensing regulations and punitive taxes have made economic activities increasingly difficult for independent businessmen, according to press and US Embassy sources. Moreover, production shortfalls and the US embargo are undermining Nicaragua's import capacity. In these circumstances, consumer price inflation has continued to soar, and, by mid-1986, government officials were acknowledging that consumer shortages and living standards were the worst since the revolution. [redacted]

Steep Production Declines

The agricultural sector, where key harvests are already in for 1986, is taking its worst pounding since the major disruptions caused by the Sandinista revolution. Overall, we project that agriculture—which accounts for one-fourth of Nicaragua's GDP, nearly half of its employment, and the bulk of its exports—will probably fall by an additional 15 to 20 percent this year. The coffee harvest, which alone accounts for

20 percent of agricultural production, appears to be among the hardest hit. Statistics from INCAFE, the state coffee-trading monopoly, indicate this year's coffee harvest fell to 35,000 tons, one-third below last year's, and about 40 percent below pre-1979 levels. Private producers have told Embassy officials that the harvest actually was no better than 25,000 tons. [redacted]

25X1

Other export crops have not fared much better. Private producers say this year's cotton harvest, which accounts for about 15 percent of all farm output, was one-third below last year's and 60 percent below pre-1979 levels. Recent government reports forecast further declines in banana and sugar production. [redacted]

25X1

25X1

25X1

25X1

Harvests of foods for local consumption are also down sharply, according to Nicaraguan agricultural experts. Food distribution officials report the winter rice harvest was only half that expected, and early indications are that the summer crop was also poor. Meanwhile, official sources indicate that the crucial corn and bean harvests also have been highly disappointing. While providing no details, President Ortega stated in his 19 July speech celebrating the seventh anniversary of the revolution that the current corn harvest was "poor" and that consumer rations would have to be cut. [redacted]

25X1

25X1

Government officials cite bad weather and shortages of manpower and imported inputs for the declines, but, according to US Embassy reporting, private growers place more blame on government controls, the lack of credit, and civil war disruptions. For almost every crop, most private producers say that price and marketing regulations preclude acceptable profits. Various reports indicate that government mismanagement—including inadequate field maintenance, untimely and inappropriate planting, and improper handling—have also been important factors in the decline. Significantly, Sandinista officials had claimed during the coffee harvest that increased security had effectively blunted insurgent attempts to disrupt the harvest. [redacted]

25X1

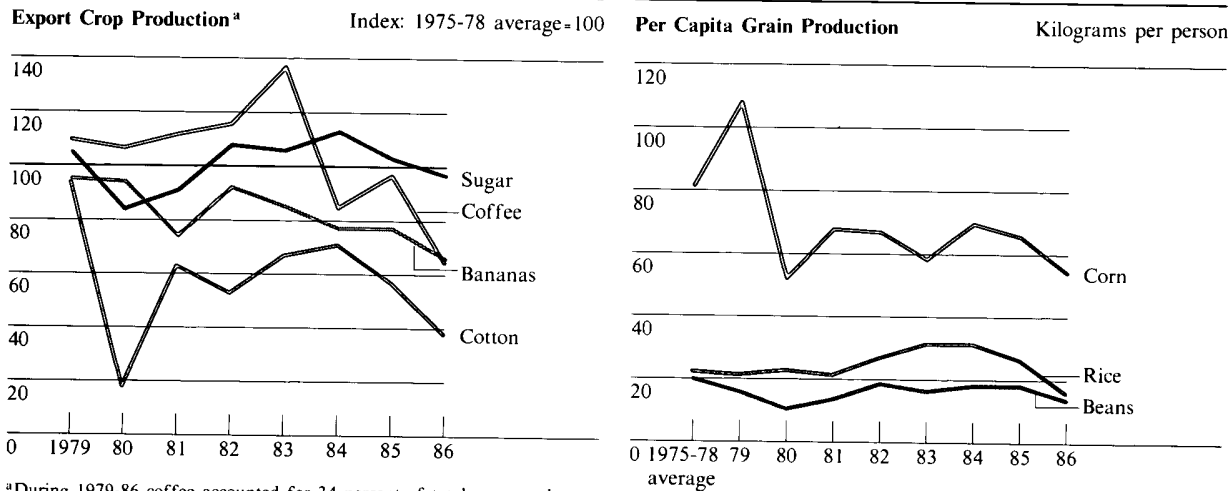
25X1

Secret

Secret

Figure 4
Nicaragua: Agricultural Production

Note scale change



310657 11-86

25X1

While information on 1986 industrial activity is still sketchy, it appears that output has continued to fall. Anecdotal reporting, including various censored stories from the now shutdown independent newspaper *La Prensa*, indicates that capacity at numerous factories has declined sharply this year. Among the firms apparently hardest hit are food-processing plants and processors of chemicals and wood products, largely because raw material shortages—caused by depressed agricultural production and import constraints—have been the worst for those products. Moreover, although government plans originally projected increases in various state-owned and -operated concerns, severe budget constraints caused President Ortega to order sharp across-the-board cutbacks at midyear.

that many professionals who have seen their practices disrupted by new Sandinista controls, as well as engineers and technicians unable to make a living without resorting to contraband activities, are leaving the country. The US Embassy notes that a comparison of Nicaragua's trade statistics with partner data indicates that, despite tough foreign exchange controls, tens of millions of dollars are being sent out of the country by private persons and by government officials using false invoicing techniques.

25X1

Growing External and Internal Deficits

Depressed economic activity is further undermining Nicaragua's international accounts. Recent official Nicaraguan projections indicate that exports will amount to 30 percent of imports and that the trade deficit will exceed \$600 million this year. When debt principal is added to Nicaragua's current international

25X1
25X1

These conditions are made worse by the continued flight of capital and human resources. During the past year, press and US Embassy reports have indicated

Secret

Secret

Impact of the US Trade Embargo

Direct losses attributable to the embargo since its inception in May 1985 have reached \$75 million, according to Nicaraguan figures and our own analysis. Increased Soviet Bloc assistance, however, has more than offset lost foreign exchange, and Managua is mostly affected by lack of access to vital spare parts. The effect of the embargo is likely to decline with time as the regime establishes new export markets, replaces US-made equipment, and improves circumvention efforts. [redacted]

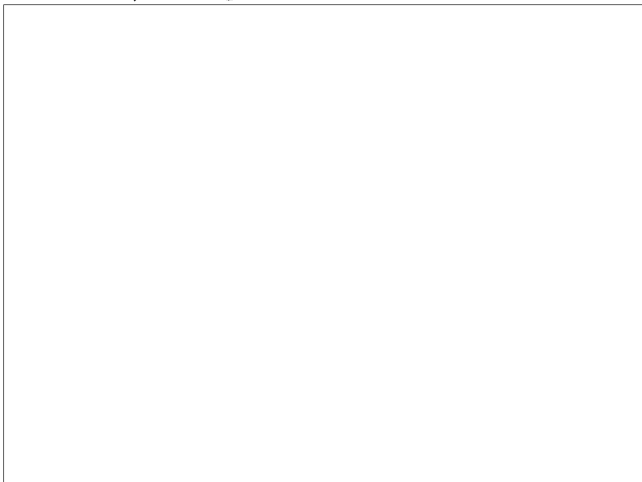
Export losses have driven Nicaragua's hard currency earnings to less than half 1984 levels, and denial of critical imports has stunted production. The US Embassy reports Managua's banana sales are no longer profitable since shipment to new European markets is costly and the fruit often rots en route. Moreover, the regime has been unable to find new customers for its seafood and beef, and withdrawal of the US sugar quota means Nicaragua has to sell on the glutted world market at less than one-third the subsidized price. In addition, the lack of imported spare parts, machinery, and other raw materials and intermediate goods has reduced agricultural production and virtually shut down the fishing fleet, according to various sources. [redacted]

The Sandinistas have been somewhat successful at offsetting the embargo, and its effect probably will be substantially lowered in the future. Immediately following the imposition of the embargo, Soviet Bloc countries responded to Sandinista pleas by providing over \$100 million in increased economic assistance, much of that in hard currency. Since last year the Soviet Bloc has continued to boost financial support, partly in response to Nicaraguan pleas for protection from the embargo. [redacted]

trade and service deficits, Managua is faced with the nearly impossible task of borrowing or rescheduling more than \$1.1 billion during 1986 to finance its imports and stay current on debt obligations. [redacted]

25X1

As a result, Nicaragua is virtually ignoring its debts.



25X1

25X1

Nicaragua's 1986 National Economic Plan also indicates that, to help keep their military and political programs going, the Sandinistas have continued to rely on printing currency to cover deficit spending. As a result, the budget deficit as a share of GDP will probably grow slightly—to about 35 percent of GDP—this year. Even though this way of dealing with the deficit is further driving down the value of the cordoba, the government reportedly has no plan to slow down the printing presses. Meanwhile, the black-market rate for the cordoba plummeted from 500 to the dollar at the beginning of the year, to 2,500 to the dollar by September. While the Sandinistas have sought a partial solution to the problem of currency depreciation by opening a government-controlled exchange house that buys dollars at about half the black-market rate, the regime has devalued only once this year and the cordoba now officially trades at 70 to the dollar, more than 35 times its black-market value. [redacted]

25X1

25X1

25X1

New Distribution Controls

As production and trade continued to deteriorate, the regime demonstrated its commitment to authoritarian, socialist, economic principles by tightening

Secret

Secret**Nicaragua: Foreign Financial Gap, 1978-86***Million US \$*

	1978	1979	1980	1981	1982	1983	1984	1985	1986
Current account balance	-25	180	-392	-563	-505	-559	-631	-801	-908
Trade balance	93	227	-353	-422	-316	-349	-415	-545	-608
Exports, f.o.b.	646	616	450	500	408	429	385	297	232
Coffee	200	158	166	136	124	154	122	123	127
Cotton	141	136	30	122	87	110	134	91	40
Other	305	322	254	242	197	165	129	83	65
Imports, f.o.b.	553	389	803	922	724	778	800	842	840
Net services and transfers	-118	-47	-39	-141	-189	-210	-216	-256	-300
Debt amortization due	68	117	130	97	113	157	166	197	220
Financial gap	-93	63	-522	-660	-618	-716	-797	-998	-1,128
Official capital disbursements	111	115	371	424	458	369	412	525	650
Other capital and errors and omissions	-242	-256	-186	164	-29	-112	-91	-95	-100
Debt rescheduling ^a		138	135	92	7	269	278	179	200
Increase in arrears				37	83	228	208	272	250
Change in reserves	-224	60	-202	57	-99	38	10	-117	-128
Other financial items									
External debt yearend	1,261	1,531	2,147	2,566	2,918	4,185	4,922	5,601	6,300
Debt serving									
Owed	133	202	225	266	293	336	394	496	530
Paid	133	64	90	192	203	106	79	69	60
Net international reserves	-247	-187	-389	-332	-431	-394	-384	-501	-629

^a Includes conversion of Central Bank short-term liabilities from previous arrears into medium-term debt.

[REDACTED]

25X1

marketing regulations, by assuming direct control over more of the wholesale and retail network, and by further prioritizing access to food rations. Last December, the Ministry of Internal Commerce (MICOIN) announced an "iron fist" campaign designed to force consumers and merchants to observe state-authorized distribution channels and prices. The new measures toughened licensing procedures and established a cadre of uniformed inspectors who were given authority to impose fines, confiscate goods, and suspend commercial licenses. Only merchants who had been in business for at least five years and who limited their sales to one specific line of merchandise could renew their licenses. [REDACTED]

Using these new controls, MICOIN aggressively forced thousands of independent merchants out of business during the first half of 1986, according to US Embassy reporting. In mid-June, MICOIN supplemented its authority with a new "July Victory" campaign designed to crack down on informal markets that had developed near traditional marketplaces, on street corners, and at bus stops. The campaign uses 200 plainclothes inspectors to assist the uniformed MICOIN inspectors. [REDACTED]

25X1

25X1

Secret

Secret

Cost of the Military Buildup

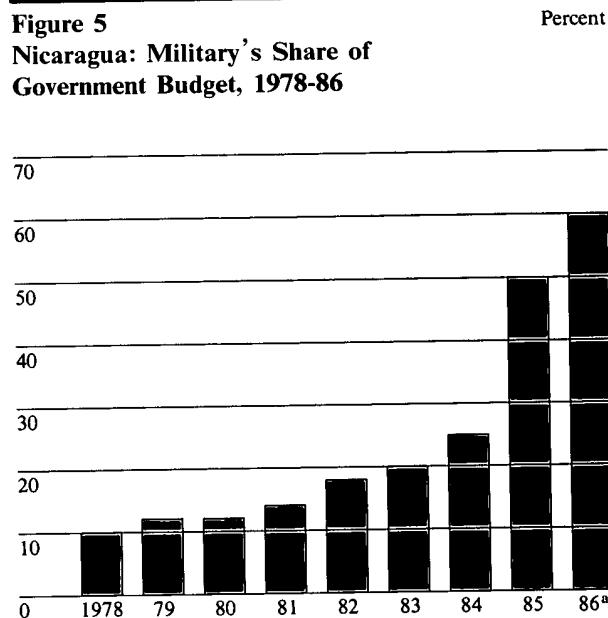
The military is placing increasing strain on Managua's weakening economy. Military spending now absorbs 60 percent of the federal budget and one-third of total GDP.

As military spending soared, vital managerial skills needed to boost economic activity have been allocated to the war, and labor shortages in combat zones have contributed to lower harvests of export crops. Moreover, scarce raw materials and capital goods have been increasingly diverted from development projects, further undermining long-term economic growth. While the regime claims the military expenses have been necessary to fight the insurgency, the active military grew to two-thirds its present size before the insurgency began.

On a net basis, we estimate—on the basis of cost studies prepared by the US Embassy—that the insurgency has cost Managua some \$500 million since 1982. The bulk of the loss is from lower productivity and reduced farm exports, caused by the Sandinistas' diversion of manpower and other resources to the war effort. Direct costs involve insurgent attacks on infrastructure, state farms, and government-controlled cooperatives. The regime's losses, however, have been more than offset by Soviet Bloc and Cuban aid that has totaled \$2.5 billion in Soviet Bloc and Cuban financial support and military assistance since 1982. Military aid alone ballooned from \$6 million in 1980 to \$248 million in 1984.

According to Embassy reporting, MICOIN has used its direct control of an increasing share of the distribution system to reward regime friends. At midyear, the Sandinistas revoked the operating licenses of private perishable-food wholesalers, replacing the wholesalers with a new state company, and took over the country's last privately owned supermarket chain. In August, MICOIN set aside two of the supermarkets for exclusive distribution to the families of designated government employees and party officials. Remaining supermarkets will serve dependents of

Figure 5
Nicaragua: Military's Share of
Government Budget, 1978-86



^aProjected.

nondesigned public employees who will receive half of the rations available to the designated families. Under this scheme, private-sector families are virtually forced to depend on black markets, according to US Embassy reporting.

Consumer Shortages

Taken together, Managua's production and distribution policies have aggravated consumer shortages and are driving black markets deeper underground. Despite well-publicized emergency food shipments from the Soviet Union, consumer shortages this year have been increasingly severe; the US Embassy has noted the extremely short supply of staples from government outlets. Moreover, in recent months a number of staples—including rice, beans, and cooking oil—have been practically unavailable. The Embassy reports that, in these dire straits, more consumers are going directly to farms in search of food. Farmers, however,

Secret



Figure 6. Empty shelves await Nicaraguan consumers

are reluctant to provide any because such sales—and even gifts to relatives or friends—are strictly prohibited and make offenders subject to fines, commodity and land confiscation, or jail terms. While many middle- and upper-income consumers are resorting to the black markets—where commodities cost as much as 10 times their official prices—this option clearly is not open to most families. The US Embassy reports that minimum-wage earners are being forced to postpone purchases of clothing and other basic consumer goods. A pair of slacks on the black market, for example, costs the equivalent of half a month's earnings.

Consumer shortages, government deficits, and de facto cordoba devaluations have caused the government virtually to lose control of consumer prices, and inflation is soaring. In March alone, prices of some 50 consumer necessities were hiked an average 150 percent. Milk, rice, salt, soap, sugar, and toilet paper, for example, were raised an average 130 percent, while corn and bean prices increased 300 percent. Monthly cost-of-living surveys by the US Embassy have shown that inflation grew by more than 10 percent each month from April through September. In these circumstances, regime economists reluctantly admit that inflation is running about 600 percent on an annual basis.

At a personal level, skyrocketing inflation has translated into a further drop in real wages. While Managua boosted minimum wages 90 percent in January and another 50 percent in March, US Embassy analysis and our calculations show that inflation ate up those increases by the first of June, and the regime has announced its intention to hold the line on further wage increases through the end of the year. Even so, real wages will fall at least by 50 percent this year, according to our calculations, for a total decline of three-fourths since the Sandinistas took power.

Looking Down the Road

Because the key determinants of economic policy making—political concerns and the war—almost surely will not change, we believe economic activity will continue to fall through at least 1987 at about the same rate experienced over the past two years. The slide could be even greater as anti-Sandinista insurgent activities intensify and the civil war requires a response from Managua that further drains the Sandinistas' limited resources. Growing public-sector inefficiencies and the poor outlook for agriculture further undermine the medium-term economic outlook. In these circumstances, Managua's ability to keep the economy afloat and consumption at acceptable levels will increasingly depend on the Soviet Bloc's willingness to continue to underwrite the economy.

Poor Prospects for Policy Changes

We see only a remote chance that the Sandinistas would adopt measures needed to increase business confidence and restore trade and financial flows from the West. While key Sandinista policymakers do not always agree on tactical economic positions, that they share a common economic goal—the creation of a Marxist-Leninist state.

* See appendix B for a detailed discussion of economic policy positions of the key Sandinista decisionmakers.

25X1

STAT

25X1

25X1

25X1
25X1

STAT
25X1

Secret

Secret

view, rather than risk breaching consensus, the Sandinista leaders will back away from politically divisive proposals—even if they are more technically sound. Managua has consistently ignored reforms—recommended by pragmatic technocrats and sympathetic Western governments—that could stimulate economic activity. We believe Sandinista leaders are instead preparing for a further centralization of controls by moving against persons they see as state enemies and calling for individual and collective sacrifices.

Embassy reporting.

25X1

In these circumstances, reliance on inexperienced managers and bureaucrats will result in increasing economic waste, in our view.

25X1

government inefficiency is already rampant, particularly in retail and wholesale distribution channels and in state farms and industries.

25X1

25X1

25X1

25X1

[Redacted]

In early 1986, after

Managua revised the land reform law to allow farms of any size to be seized if owned by dissidents or if such action were deemed in the public interest, National Directorate member Jaime Wheelock stated publicly that exclusive land ownership no longer existed in Nicaragua, and that the concept of "private property" had become obsolete.

Perhaps even more detrimental are the economic distortions caused by growing corruption. According to US Embassy state graft is more prevalent now than at any time in recent memory. Regardless of the exact level of corruption, US Embassy reporting suggests official graft is clearly frustrating many private-sector business transactions and is further undercutting public-sector efficiency. As the state squeezes more private farmers, merchants, and industrialists out of business, and new government regulations dictate an ever-increasing portion of business transactions and economic decisions, we believe the incidence of official corruption will grow apace. Moreover, further deterioration in living standards will very likely encourage even more government workers to use their positions for personal benefit.

25X1

25X1

As the economy worsens, Managua almost surely will emphasize political responses.

virtually all economic decisions will continue to take a back seat to the goal of creating a socialist state. Moreover, we believe that heightened reliance on Communist assistance and advice will reinforce Managua's move into the Soviet camp and inexorably toward full state-economic control.

25X1

25X1

In our assessment, the Sandinistas at best will only restrain the growth of official graft. Because access to the public till has been a principal technique for winning and rewarding Sandinista militants and collaborators, we believe the regime is likely to take measures only against flagrant abusers or uncooperative bureaucrats.

25X1

25X1

Growing Managerial Problems

As state domination continues to grow, the critical shortage of managers will constrain the economy further. Despite seven years of on-the-job training, the regime lacks enough committed technocrats or skilled collaborators to manage the state farms and industries, government-controlled cooperatives, and public-sector enterprises they have now, according to US

Agricultural Deterioration

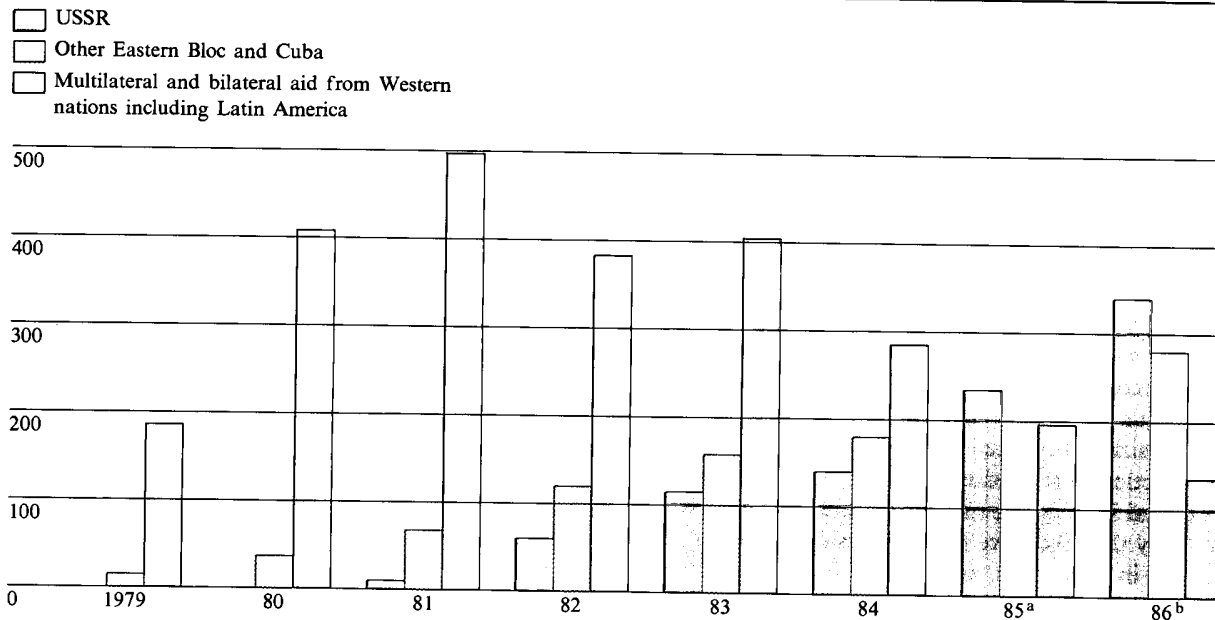
Nicaragua's medium-term outlook for recovery of the key agricultural sector is very poor. The recent surge

Secret

Secret

Figure 7
Economic Disbursements to Nicaragua, 1979-86

Million US \$



^aEstimated.

^bProjected.

[Redacted]

310659 11-86

25X1

in land reform almost surely will accentuate farm-management problems, continue to reduce plantings, and further undercut field-maintenance operations. Poor weather conditions thus far in 1986 will substantially reduce important cotton, coffee, banana, and staple harvests, [Redacted]

agriculture will have to continue relying on less efficient Soviet Bloc equipment, which will further constrain farm production. [Redacted]

25X1

25X1

The Soviet Safety Net

[Redacted]

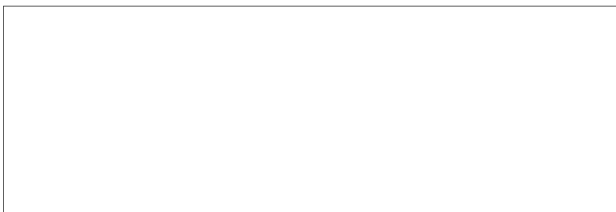
25X1
25X1

The US trade embargo also will continue to depress Nicaraguan agriculture over the medium term. While some of the initial export disruptions caused by the embargo have been overcome, [Redacted]

[Redacted] another two years or more will be needed to replace lost US commodity markets. On the import side, Nicaraguan

25X1

Secret



Public discontent over economic shortages is underscored by unprecedented consumer disturbances

25X1

• Two government market inspectors were killed in separate incidents early this year as they tried to enforce Sandinista policies against the black market, according to the US Embassy.

25X1

Although we believe that the Soviets will continue to increase economic support to keep the Sandinistas afloat, we calculate that probable increases in foreign financial support will not be enough to reverse Managua's economic slide in the near term. To date, the generous Soviet increases have not been sufficient to offset revenue losses from lower Nicaraguan exports and higher food import requirements. We expect that little, if any, extra Soviet Bloc financial support will be available to boost capital goods and raw material imports needed to restore factory output or increase agricultural production.

• In June, four police detachments were needed to restore order when a crowd attacked a MICOIN inspector trying to arrest a woman for illegally selling beans.

• Shortly thereafter, an Embassy source reported that hungry consumers hijacked a government corn truck near Managua and made off with its cargo.

• During July and August, the Embassy reported that peasant groups took corn and Soviet rice during raids on state farms near Leon and at the port of San Juan del Sur.

25X1

A review of Sandinista and IMF projections for Nicaragua's 1986 balance of payments, for example, shows that substantially higher Soviet Bloc aid will probably be just enough to maintain imports at the depressed 1985 level.

we project Soviet Bloc financial support to increase by some \$150 million during 1986 to a total of some \$600 million. In our estimation, however, none of this will be available to increase productive imports because of compensating reductions in Nicaragua's export earnings, the continued decline in Western financial support, and higher prices for most nonoil imports.

• In September, a patrol car was smashed by angry vendors as police attempted to close a clandestine food market just north of Managua.

25X1

25X1

• consumers are increasingly disgusted with shortages of foodstuffs and other goods Nicaragua formerly exported, and blame the government rather than external forces for the growing economic problems

25X1

25X1

25X1

Implications for Sandinista Vulnerabilities

In our assessment, the dismal economic situation will become an increasing point of vulnerability for the Sandinista regime.

As living standards continue to erode, we believe chances are growing that government policy moves could spark sharp consumer reactions, including serious food riots or even work disruptions over the next 18 months.

Both government allies and opposition groups have recently joined the chorus of public criticism. Last April, the collaborationist Conservative Democratic Party used the progovernment press to declare that Sandinista inefficiencies were wrecking the economy and that Nicaraguans could not survive on current rations. Further, the statement from the usually sympathetic Conservative Democrats warned that corrective actions were needed because "the counterrevolution begins in the kitchen."

25X1

25X1

25X1

Secret

In our assessment, increasing official corruption will further undercut the population's flagging confidence in the Sandinistas' ability to manage the economy and could seriously undermine the regime's moral authority. Growing official graft also risks increases in the perception of average Nicaraguans that the Sandinistas are unable or unwilling to control the bureaucracy and deliver foods and social services as promised.

[redacted]

In response to further economic deterioration and growing popular discontent, we believe that concern for regime survival will encourage Sandinista leaders to increasingly emphasize political solutions. For example, in a mid-July press interview, Interior Minister Tomas Borge said he favored continuing coercive economic measures—presumably property confiscations—to neutralize opposition leaders still in Nicaragua. Almost certainly, concern about peasant support for the anti-Sandinista insurgents will prompt the regime to step up land confiscations for redistribution. Even so, we doubt that the Sandinistas would allow corresponding increases in actual peasant control over government cooperatives. While other regime policies probably will continue to be designed to deflect blame and intimidate the opposition, we believe that most Nicaraguans will continue to hold the Sandinistas responsible for economic mismanagement.

[redacted]

In our assessment, the growing economic plight, particularly if combined with increasing battlefield losses, will continue to erode internal confidence in the Sandinistas, and could eventually translate into increased popular support for the insurgents. Increased military pressure against the regime in the wake of scheduled boosts in international support for the rebels would further divert already scarce Sandinista managerial and budget resources. We believe that, as the economy spirals downward, the Sandinistas run the risk that regime stability could in no small measure be determined by public perceptions of Sandinista policy responses. Moreover, on the basis of tactics to date, we believe there is a greater likelihood the Sandinistas will be viewed by many Nicaraguans as both unresponsive and repressive. While mounting political, social, and economic controls will almost

surely force a considerable number of Nicaraguans to abandon the country, we believe that the rising popular discontent will also encourage a significant number of Nicaraguans to join the rebels. The number of those who cast their lot with the insurgents probably will grow to the extent that increased international support results in insurgent battlefield successes.

[redacted]

As the economy deteriorates and Managua further tightens controls, Sandinista vulnerabilities will increase to the extent that:

- Regime crackdowns on new consumer-worker demonstrations are viewed by the public as excessively repressive.
- Regime centralization policies and distribution inefficiencies are perceived as unresponsive to the basic values and needs of the people.
- New revelations of official graft raises the perception that the Sandinistas are unable or unwilling to control the bureaucracy and deliver food and services as promised.
- Rebel leaders offer a sophisticated propaganda campaign to further establish the culpability of the regime for economic hardships.
- Insurgent leaders are able to assure the populace that a rebel victory would not jeopardize the positive aspects of land reform and extended health, education, and other social services.

[redacted]

25X1

25X1

25X1

25X1

Secret

Appendix A

Sandinista Economic Decision Making

The reporting on economic decision making in Nicaragua is [redacted] often conflicting, making it difficult to dissect and analyze the policymaking apparatus. We believe, however, that decisions are reached through the interaction of a tiered structure of several executive bodies. In descending order of importance, these organs are: the Sandinista National Liberation Front's (FSLN) National Directorate and Executive Commission, and the executive branch's National Planning Council and Planning and Budget Secretariat. [redacted]

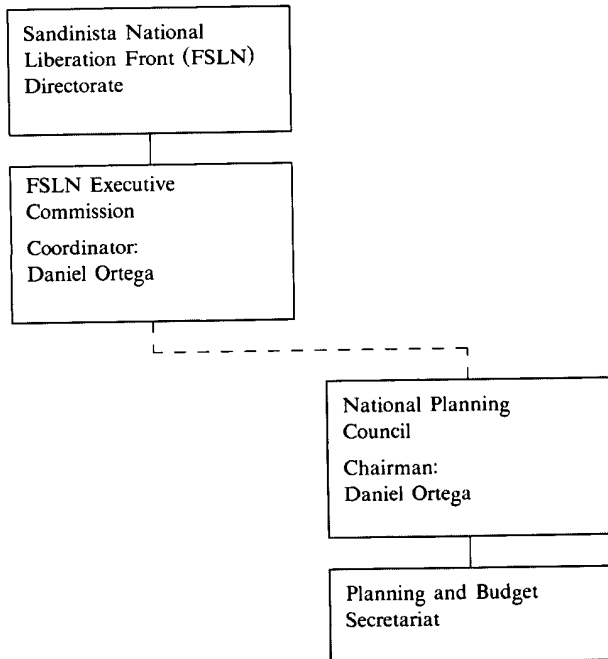
The Role of the National Directorate

The ruling nine-man National Directorate is at the apex of the decisionmaking process. As the self-proclaimed vanguard of the Sandinista revolution, the Directorate chooses and initiates policies. It has established numerous administrative and consultative bodies to secure control over Nicaragua's economy. These organizations operate under the direct authority of the National Directorate but lack decisionmaking power. [redacted]

Even though the Directorate customarily makes decisions by consensus, it is not necessarily a cohesive group. Ortega, Wheelock, and Ruiz each represent one of the three original factions within the FSLN: the Terceristas, the Proletariat Tendency, and the Prolonged Popular War, respectively. We believe that the three original factions still maintain differing political, social, and economic outlooks that complicate the decisionmaking process and agitate personal rivalries. Although the Directorate members have a common goal for Nicaragua—that of a Marxist-Leninist state—they apparently disagree on issues such as the pace and amount of private property confiscations, how to deal with the private sector, and fiscal and budgetary policies. Hardliner Henry Ruiz, for example—supported by members Tomas Borge and Bayardo Arce, both fellow members of the National Directorate and of Ruiz's faction—favors a more rapid and thorough government takeover of

**Figure 8
Nicaragua: Party Government
Policy Links**

Party Policy Apparatus **Government Policy Apparatus**



25X1

25X1

25X1

310660 11-86

25X1

private property and harsher policies to limit the influence and power of private business leaders. On the other hand, Ortega has sought a slower rate of confiscation to project a moderate image to the world and to soften international criticism. [redacted]

25X1

Secret**The Executive Commission**

The next level of the hierarchy is the Executive Commission, a group of five National Directorate members responsible for implementing all—not solely economic and financial—Directorate policies. In addition, the commission is designed to bolster the FSLN's ties to government organizations and Nicaraguan society by strengthening the quality of the party's vanguard and leadership. US Embassy reports indicate that the commission members (Daniel and Humberto Ortega, Bayardo Arce, Tomas Borge, and Jaime Wheelock) wield more power than the four remaining Directorate members (Henry Ruiz, Victor Tirado, Luis Carrion, and Carlos Nunez). [redacted]

The National Planning Council

The National Directorate and the Executive Commission receive support from a variety of subordinate administrative and ministerial organizations that provide advice and carry out day-to-day tasks. Prominent among these bodies is the National Planning Council, which, since its creation in January 1985, has become the primary government organ dealing with the economy. The Council is made up of representatives from the five key economic sectors—agriculture, industry, infrastructure, foreign assistance, and finance—who are responsible for coordinating and supervising policies and projects in their respective areas. The establishment of cohesive and complementary policies is a principal objective of the Council. According to President Daniel Ortega, the Council is responsible for assuring that the country's economic program supports those areas vital to military defense and the survival of the Sandinista revolution. [redacted]

The Planning and Budget Secretariat

Another advisory body, the Planning and Budget Secretariat, is largely dedicated to economic planning and to counseling both President Ortega and the National Planning Council. The task of overseeing both the planning and budget aspects of the economy gives the Secretariat an influential hand in policy-making formulation. Because it is indirectly controlled by Ortega and is composed of his own personal advisers, we believe the Secretariat may be more cohesive and not as subject to internal conflict as are the other decisionmaking mechanisms. [redacted]

25X1

25X1

25X1

Secret

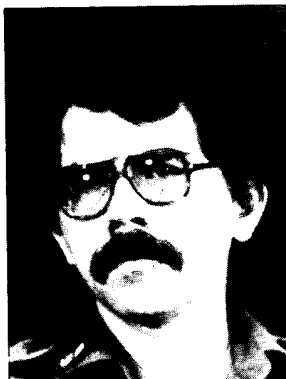
Appendix B

Key Economic Policymakers

In our opinion, a relatively small group of officials directs Nicaraguan economic policy: Daniel Ortega, Jaime Wheelock, Henry Ruiz, and Sergio Ramirez. We believe they are the most influential in the economic realm because they hold top Sandinista National Liberation Front positions as well as economic or administrative portfolios. Moreover, these four, along with other technocrats, are prominent in several of the above-mentioned core policymaking organizations and ministries.

[Redacted]

25X1



Daniel Ortega

President. Member, National Directorate. Coordinator, Executive Commission. Chairman, National Planning Council. Age 40. [Redacted]

STAT

Ortega, who leads the four most important decisionmaking bodies, is possibly the reigning economic policy maker. [Redacted]

25X1

[Redacted] In addition, we believe that Ortega's influence is bolstered by the position and power base of his brother, Humberto, a National Directorate member and Minister of Defense. Both are members of the moderate Tercerista faction of the FSLN. [Redacted]

25X1



Jaime Wheelock

Member: National Directorate, Executive Commission, and National Planning Council. Minister of Agriculture and Agrarian Reform. Age 39. [Redacted]

STAT

Wheelock holds several high-level offices that give him an important role in decisionmaking; moreover, he heads the most crucial sector of the Nicaraguan economy—agriculture. Despite its dismal performance under his leadership, he remains influential and popular. [Redacted]

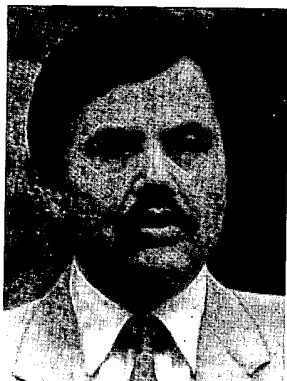
25X1

[Redacted] his stewardship of land reform policies has made him popular in rural areas. An intellectual Marxist-Leninist, he is a member of the Proletariat faction.

[Redacted]

25X1

Secret



Henry Ruiz

Member: National Directorate and National Planning Council. Minister of Foreign Cooperation. Age 42. [redacted]

STAT

Ruiz is responsible for obtaining financial and material assistance from foreign nations and organizations. Ruiz advocates rapid confiscation of private property, and he has stated that he does not envisage a mixed economy in Nicaragua's future. [redacted]

25X1

25X1

25X1

[redacted] He has close ties to the Soviet Bloc as a result of study in the USSR and frequent trips to secure aid for Nicaragua.

25X1



Sergio Ramirez

Vice President. Member, National Planning Council. Age 44. [redacted]

STAT

Ramirez [redacted] oversees activities relating to the country's infrastructure: construction, transportation, and communications. [redacted]

25X1

25X1

[redacted] US officials in Managua say he is at least as influential as Ruiz and Wheelock. Ramirez is not identified with a particular faction and apparently tries to maintain a neutral position in the government. A moderate, he often represents Nicaragua abroad and is well regarded both inside and outside the country. [redacted]

25X1

Important Technocrats

Several notable technocrats provide guidance and advice to the decisionmakers and hold posts in the lower ranks of the economic organizations. [redacted]

25X1

Dionisio Marengo. Director of the Planning and Budget Secretariat, technical secretary of the National Planning Council, and key adviser to President Ortega. Excellent administrative abilities, politically adept . . . has led various ministries and trade delegations . . . loyal to Ortega and Tercerista faction . . . age 40. [redacted]

25X1

Emilio Baltodano. Minister of Industry. National Planning Council member responsible for coordinating industrial production, fishing, and mining . . . a capable, experienced official . . . age 35. [redacted]

25X1

Joaquin Cuadra. President of Central Bank. National Planning Council member in charge of financial sector . . . very capable and experienced . . . moderate views . . . former corporate lawyer and finance minister . . . age 68. [redacted]

25X1

Alejandro Martinez. Minister of Foreign Trade. Reportedly has close ties to Ortega . . . economics background, educated in the United States . . . travels abroad extensively . . . [redacted] . . . age 39. [redacted]

25X1

25X1

Secret

Secret

Secret