NICARAGUA

ARAP

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<u>Rural Poverty in Nicaragua</u>

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STRATEGIC DIRECTIONS FOR USAID TO ATTACK RURAL POVERTY IN NICARAGUA

It is now 11 years since USAID resumed its development assistance program in Nicaragua. Despite all the problems and challenges left by the Sandinista government of the 1980s, the mood of the early and mid 1990s was optimistic. By 1995, Nicaragua had restored macroeconomic stability, private banks were gathering strength, and initiatives to resolve land conflicts and solidify land tenure were moving forward. Nicaragua was going to export its way to increased growth and prosperity, and small farmers were going to participate in, if not be the principal engine of that growth.

Six years later there are relatively few success stories to report, and export growth appears to have stagnated. Hurricane Mitch, droughts, bank failures, and falling coffee prices all have wreaked their toll. Widespread dissatisfaction with the current state of the economy is fueling a possible Sandinista victory in the upcoming presidential elections. Perhaps most significantly, the optimism of the early and mid 1990s is gone, giving way to pronounced pessimism and an attitude of dependency, especially in rural areas.

Given the dramatic turnaround in mood, it is timely for USAID to pause a moment, assess whether its current program is doing justice to the magnitude of Nicaragua's poverty problem, especially in rural areas, and, if called for, trace out new strategic directions to pursue.

This brief document does that. It is divided in three parts. The first part summarizes rural poverty in Nicaragua and key factors that affect it. The second part outlines the guiding principles USAID proposes to apply in addressing rural poverty in Nicaragua in the future. Lastly, the third part comes down a notch and spells out six specific strategic directions for its future program.

RURAL POVERTY IN NICARAGUA

Poverty, especially in rural areas, is the foremost long-term economic problem facing Nicaragua today. Nicaragua is the poorest country in Latin America. In 1999, its per capita GDP was $430, less than that of Haiti's. Following the transition in the early 1990s from a state-run economy to a market-based, private-sector-led one, Nicaragua curtailed hyperinflation and experienced renewed economic growth. A concatenation of calamities, however, has dealt a significant setback to the prognosis for continued economic growth and reduction in poverty: Hurricane Mitch; the collapse in international prices of coffee, Nicaragua's largest foreign exchange earner and most important source of rural household income; a series of severe droughts; and a banking crisis that resulted in economic losses of close to 20 percent of GDP.

These blows to the economy have affected the most vulnerable segments of Nicaraguan society severely. In 1998, poverty affected half of the overall population, and almost 70 percent of the population in rural areas. Although statistics are not yet available, one can only imagine how much poverty has worsened as drought, declining coffee prices, and the banking crisis hit one after the other.

A virtual laundry list of problems contributes to the plight of Nicaragua's rural poor. The following subsection outlines some of the principal ones. Counterbalancing the problems are a shorter list of advantages and opportunities, which appear in abbreviated form as well.

- **DISADVANTAGES AND PROBLEMS**

    - There has been limited progress in reducing poverty. In 1993, 50 percent of Nicaraguans were poor and 19.4 percent were extremely poor. Five years later, 48 percent of Nicaraguans were poor and 17.3 percent extremely poor. In rural areas, poverty fell from 76 to 68.5 percent, and extreme poverty from 36.3 to 28.9 percent. On the Atlantic Coast, extreme poverty actually rose.

    - The economy is projected to grow at roughly five percent in coming years, not enough to have a major impact on poverty rates.

    - Political problems with Costa Rica and Honduras limit market access. That is unfortunate because Nicaragua needs all the markets it can get.

    - Significant Nicaraguan private capital is going elsewhere in Central America and to the United States, but not to Nicaragua. The culture of dependency in the agricultural sector appears to have worsened over the years, and Nicaraguans are less willing to take risks and invest their own capital.

    - There are about 28,000 jobs in the *maquila* sector, about one tenth the numbers in Guatemala, Honduras, and the Dominican Republic. The Center for Exports and Investment cites the trainability and low absenteeism of Nicaraguans as factors that will attract new businesses. Still, the extension of Caribbean-Basin-Initiative-like benefits to South America and Africa only increases the competition for new business investment.

    - Export transport costs remain high. Nicaragua still has to export to United States markets through Honduras and Costa Rica. Trade through El Rama and El Bluff remains very limited and not suited for perishables.

- Transaction costs for establishing new businesses and importing new technology remain high.

- The economic cost of the bank failures goes beyond the estimated three percent of GDP calculated by the government. Agriculture feels the effect even harder, since even less credit than before now flows to the sector.

- Low world coffee prices will continue to affect the sector for some time. The sector responded to market signals, and coffee export volumes increased from 37,213 metric tons in 1997 to 84,114 metric tons in 2001. Yet export value dropped from $115.7 million to $85 million in the same time period. Coffee growers need to diversify production, increase productivity, and penetrate specialty niche markets.

- The policy environment – especially the overvalued exchange rate -- favors imports as opposed to exports and the production of non-tradeables as opposed to tradeables.

- There is a strong perception that problems with governance and corruption have worsened during the life of the current regime.

- If the Sandinistas win the election, it is unclear what their economic and sectoral policies will be. Conversations with a possible Sandinista Minister of Agriculture suggest that they still fail to think in terms of markets and are concerned primarily about production of foodstuffs.

- **ADVANTAGES AND OPPORTUNITIES**

  - Nicaragua still has excellent soils, good farmers, and a history of agricultural successes, primarily in cotton and coffee. It also has a strong entrepreneurial culture influenced by many INCAE graduates. There are also strong secondary cities with relatively good internal communication.

  - There appears to be potential for continuing to exploit excellent market opportunities in El Salvador, as well as the internal market in Managua for finished products.

  - Red bean production jumped from 68,000 metric tons in 1995-96 to 133,461 metric tons in 1999/2000 in response to the lifting of the ban on red bean exports, providing evidence that small farmers can respond to positive market signals.

  - Managua has become a vibrant city with a dynamic construction industry.

- Land appears to be less of a divisive issue than it was years ago, although land security is still cited as a major constraint to accessing credit.

GUIDING PRINCIPLES TO ATTACK RURAL POVERTY IN NICARAGUA

The brief discussion above outlines the "facts" of rural poverty in Nicaragua and various factors affecting it. But facts do not speak for themselves. To move from thought to action, one needs to filter competing programmatic alternatives through a development paradigm. Without such a paradigm, it is difficult to know which of the panoply of constraints affecting rural poverty it makes sense to attack first. Prior to laying out strategic directions to attack rural poverty in Nicaragua, therefore, this section seeks to explain the reasoning that leads to them.

There are so many worthwhile things one can do to attack rural poverty in Nicaragua that one can justify practically any intervention he or she can think of. The difficulty is that the resources available pale alongside the magnitude of the problem. As a consequence, opportunity-cost thinking is essential.

When faced with the juxtaposition of a plethora of needs and a modicum of resources, one must assess carefully how one chooses to allocate development resources. Any time a scarce resource -- a dollar, a córdoba, or food -- is spent on one thing, it means that it is ***not*** spent on something else -- where potentially, at least, it could fetch a higher social return.

Systemic, across-the-board approaches to solving rural poverty problems tend to be expensive and relatively low probability propositions. In other words, their opportunity cost is high. In most cases, a transactional, problem-solving approach is preferable.

In very general terms, there are two ways to address the problems that stand in the way of making a dent in rural poverty. The first approach, which can be called "transactional," is classic problem solving. Under the transactional approach, one attacks the obstacles one by one as business propositions. For example, if a specific regulation stands in the way of entering foreign markets, one wages the attack against that particular regulation, not against the entire commercial code. Similarly, if insecurity of land tenure acts as a brake on the development of a defined area, one regularizes titles in that area, not nationally.

The second approach is not tied to specific transactions but is generic. For example, if existing legislation stands in the way of parents hiring and firing the teachers of their children, this approach tries to amend the legislation to solve the problem for everyone. Other examples of the systemic approach include programs to improve rural financial intermediation, to establish national agricultural research and extension systems, and to legitimize agile alternative dispute resolution procedures as a way to boost the confidence of potential investors.

The presumed advantage of the systemic approach is that it addresses problems across the board. In some cases, such an approach is essential. The big disadvantage is that often the problems in question are so large, complex, or politically charged that they may be virtually impossible to solve in that way, at least in the short and medium run. Systemic solutions can obviously be far-reaching, but they can be "all or nothing" in character. In many instances, it is possible to address the concerns in question transactionally, that is, one by one, as business propositions. When feasible, the transactional approach normally is the preference. Why kill a fly with a bomb when a fly-swatter will do? The bottom line, therefore, is to be realistic from the start: if the probability of success of a systemic intervention is high, go for it; if not, think twice about embarking on a venture that may have little to show for it in the end.

The time has come to shift the balance of the attack on rural poverty from the social to the productive sectors.

In general, one can wage the fight against poverty in two ways. The first way is to institute those policies and take those programmatic actions that reduce poverty, that is, that lower permanently the number of people who are poor. The second way is to institute those policies and take those programmatic actions that alleviate poverty, that is, that ease the burden of poor people but do not have a lasting impact. In the first instance, the incomes of poor people rise, and the likelihood is high that their income stream will continue, through either self- or other-generated gainful employment. In the second instance, the well being of poor people rises in the short run, but its maintenance at that level typically requires recurrent expenditure. The first effect normally is identified with and results from "productive investment." The second effect normally is identified with and results from "social safety net expenditures."

As a practical policy matter, reducing poverty is a long-term proposition. In the short and medium term, therefore, there is a tradeoff between focusing on poverty reduction and focusing on poverty alleviation: one cannot limit oneself to either one or the other. The challenge for public policy is to find the appropriate balance between the two, a work of art more than of science.

In recent years, Nicaragua has emphasized the social safety net side of the equation, waging the fight against poverty largely by directing education, health, and nutrition services to its poor. Although it is hard to fault giving attention to the social service needs of Nicaragua's poor population, the downside can be seen currently in the stagnation of the economy and Nicaraguans' widespread cry for jobs. At the present time, it would appear wise to tip the balance toward productive sector interventions, giving priority attention to the revitalization of the economy, and the inclusion of the rural poor in that revitalization.

For a country like Nicaragua to reduce permanently the number of its people in poverty, its economy must grow for a number of years at a rate of eight to ten percent a year.

Growth in Gross Domestic Product on the order of four to five percent a year obviously is better than no growth at all, but does not amount to much more than a holding pattern. For sizable numbers of rural poor people to cease being poor, sustained, dynamic growth is essential. Fortunately, experience throughout the world suggests that growth of that magnitude is not a pipedream. For it to occur, however, one must be ready to "think outside the box" and depart from business as usual.

Nicaragua's legacy of activism by the state has been exacerbated by government, non-governmental, and donor responses to the crises of recent years. The result is a climate of "asistencialismo," which is antithetical to a long-term poverty reduction strategy.

Years of heavy state intervention have engendered a widely accepted but counterproductive way of thinking about how to bring about broadly based economic growth in Nicaragua. For Nicaragua to return to buoyant economic growth, a collectively shared mindset of self-reliant entrepreneurship must replace institutionalized rent-seeking. Although the crises of recent years – Hurricane Mitch, the drought, and plummeting coffee prices -- have called for direct delivery of goods and services to target beneficiaries, the time has come to reintegrate the poor as active participants in the market economy. The challenge is not to substitute for market forces, but to make markets work for the poor.

The role of government is to encourage private sector activity. It is not to pick winners, to make productive investments, or to produce. Those responsibilities lie with the private sector.

The government does not have the wherewithal, by itself, to create permanent jobs for the majority of Nicaragua's poor people. That task falls to private parties. Nevertheless, government policies have much to do with the degree to which private economic activity flourishes and the degree to which those relatively poorly endowed participate in that activity. In essence, the government has two fundamental roles to play: first, to set clear and transparent rules for market activity and to enforce compliance with those rules; and, second, to invest in public goods -- physical infrastructure, primarily -- essential for the conduct of private economic activity. Of all the actions that a government can take, those are the most basic -- and those that typically will have the biggest impact in lowering transaction costs in the economy and making it more competitive.

Roads probably are the most common example given of public goods that reduce market transaction costs. There also are other, less obvious examples of public goods that governments and donors can invest in for the same end. The underwriting of non-financial business development services by private parties is a case in point.

For Nicaragua to make a permanent dent in rural poverty, the productivity of its rural poor people must increase. For the productivity of its rural poor people to increase, they must have more capital, both physical and human, to work with.

Nicaraguans are hard-working people. Why then is the productivity of Nicaragua's labor force so low? In comparison with labor forces in other countries, the Nicaraguan labor force has relatively little physical capital at its disposal and exhibits relatively low levels of educational attainment. As a consequence, investment promotion and education call for high priority attention.

Although the payoffs from basic education are not immediate, Nicaragua’s illiteracy problem is so severe that it can not be ignored.

Rates of illiteracy in Nicaragua, especially in rural areas, are alarming. They also constitute a major constraint to broadly based growth, both now and for years to come. Thus, even though the impacts of expanding and improving basic education are seen years after the life of a typical USAID strategic objective, it is imperative to give priority attention to this pressing problem, either through policy dialogue or through action programs.

Experience worldwide suggests strongly that education is the surest way for a government to set a nation on the path to a more equal distribution of income. Although one does not see the result in the immediate term, human capital is something an individual has with him or her always.

Realistically, poor people have limited capacity to expand physical capital on their own. As a result, one must look to the non-poor, both in and outside Nicaragua, for the lion's share of the investment required for future growth in jobs and incomes.

For many purposes, it is desirable and admirable to work directly with the poor in resolving their problems. Realistically, though, there are limits to how far, by itself, such a strategy can go. Nicaragua's needs for employment-generating investment far exceed the capacity of poor people to do it themselves. As a consequence, the climate for investment in Nicaragua is a matter of primordial importance. To generate jobs, Nicaragua needs to attract risk-taking ***employers***.

A number of the success stories resulting from USAID's support of rural enterprises over the last decade illustrate this point. The expansion of medium and large enterprises obviously increases employment therein. In many instances, though, it also provides catalytic incentives for alliances with relatively small produces -- through subcontracting and outsourcing arrangements, for example – thereby having far-reaching impacts beyond the initial enterprises affected.

Both macro-economically and locally, the major constraint to development in Nicaragua is lack of effective demand. As a result, connections with outside markets are essential. In other words, Nicaragua must export, both externally and internally.

Nationally, Nicaragua's productive apparatus is constrained by the low level of effective demand -- that is, purchasing power -- within the country. As a practical matter, therefore, Nicaragua has no choice other than to look to external markets for buyers of its goods and services -- and to make its investment climate one that is oriented outward rather than inward. Opening up to trade is not a luxury, but a necessity.

The same argument has validity at the local level. Despite their heavy dependence on markets, poor people, especially those in isolated areas, typically enjoy only limited access to them. To break out of the low-level equilibrium trap in which they find themselves, it is essential that they enjoy access to a broader range of market opportunities.

In Nicaragua, the best public investment for expanding market access is roads.

In principle, there are a variety of policy and program actions that can tie markets together and tie currently poor people into those markets. In Nicaragua, however, there is little doubt that the poor state of roads -- both trunk and access roads -- is the major impediment to integrating domestic markets and linking them in turn with international markets. As a result, the rehabilitation and maintenance of the country's road network must be public investment priority number one.

Not only is lack of effective demand the key constraint to development in Nicaragua. Demand is the point of entry for attacking its poverty.

All constraints to reducing poverty – and all points of entry for attacking it -- are not created equal.

The vast majority of the strategy documents that USAID and other parties have produced over the years contain an obligatory "constraints section," that is, a discussion of the various obstacles to overcome to achieve broadly based economic growth, reduce poverty, etc. The discussion typically goes to great pains to be encyclopedic in its coverage, but rarely is explicit in saying that A is more important than B, that B is more important than C, etc. Almost universally, lack of market access appears in such lists, but as one item among many.

The taxonomic nature of most anti-poverty strategies points up their main drawback: the absence of a development paradigm. The programmatic intent presumably is to plow through the various constraints one by one, but without asking the question, "Which constraint, if removed, will trigger the removal of others?"

Most development practitioners are willing to accept the argument above that lack of demand constitutes developing economies' principal constraint and argue, accordingly, that trade is essential for broadly based economic growth. Interestingly, though, few apply the same logic to the sectoral and microeconomic sphere. Although "market oriented" and "demand-driven" approaches are now in vogue, few put the demand horse squarely in front of the supply cart. It is one thing to argue for connections with markets; it is quite another to look to -- and accept – demand as the engine of the process. In effect, it typically is only when demand is present that honest-to-goodness incentives exist to tackle supply problems. For example, development experience is replete with agricultural technology transfer programs that have foundered in the absence of demand. But development experience also points up the opposite side of the coin: small farmers can and will adopt modern practices, but when they know beforehand that someone will buy their product at a price acceptable to them. In short, when demand is present, it furnishes incentives for economic actors to address supply constraints; when it is absent, however, attacking supply constraints is tantamount to pushing on a string.

The considerable literature that has burgeoned in recent years on the importance of non-farm income to poor farm households is a further illustration of the need to rethink inherited development paradigms. Although the literature in question acknowledges the potentially significant role that linkages with intermediate cities can play in reducing poverty, the underlying paradigm has it backwards: instead of starting at the market and looking back to the farm, it starts at the farm and looks out to the market. In the final analysis, the thinking is the conventional production-based farm management model with demand simply grafted on to it. Again, despite claims to be demand-driven, the model is really supply-push: do what you normally do on farm and then figure out how to connect to the market afterwards -- as opposed to taking the market as the starting point and adjusting productive activity to it. In short, the thinking is *"vender lo que se produce,"* when what is called for is *"producir lo que se vende."* A market-driven approach is not one that figures out how to market one's given product. It is one that heeds what the market is demanding – quantity-, quality-, and timing-wise -- in the first place. In other words, the challenge is for suppliers not just to *articular* with demanders, but to react to demanders.

If one sees the development process as driven by demand, pitting city against countryside makes little programmatic sense. In fact, urban and rural areas interlock naturally with each other in tight commercial relationships.

In many quarters it is common to look at urban and rural areas in dichotomous terms, that is, whether it makes sense to invest in cities as opposed to the countryside. Doing so fails to do adequate justice to the ties that bind urban and rural areas together.

Development is driven by demand. Demand for rural products is found primarily in cities. Cities drive rural development.

Agricultural production takes place in rural areas, but the income and employment generated as a result extend far beyond the farm. From both demand and supply perspectives, therefore, it is time to break down artificial conceptual barriers between the two supposedly distinct economic domains.

It is useful to relate this discussion to the distinctions drawn above between supply- and demand-side approaches to development. In general, there are two ways of thinking of agricultural and rural development, as a supply-push process and as a demand-pull process.

If one thinks of agricultural and rural development in supply-push terms, one focuses on productivity concerns and how much additional product one can "push" from the countryside. If one conceives of development more as a demand-pull process, then one shifts one's focus to look at overall effective demand in the economy and the potential role that cities and market towns can play in "pulling" agricultural production out of rural areas. Both development theory and programmatic experience in a variety of countries – including Nicaragua --suggest that the latter perspective is the more appropriate of the two. When the development process is looked at in that way, city and countryside are not rivals, but allies. The two demand goods and services from each other: in the city, industries with backward and forward linkages with agriculture grow and mature, and absorb immigrants from rural areas; in the countryside, increases in effective demand in the city furnish real incentives to invest in primary agriculture and make it more productive, modern, and profitable.

If one sees the development process as driven by demand, then the first thing to do to improve the lot of poor small farmers is to identify buyers of what they can produce. The starting point programmatically must be traders, processors, or larger farmers looking to outsource.

It is one thing to identify and describe who the rural poor are. It is another to define appropriate programmatic responses to assist them in bettering their lot.

In the absence of demand for what they can produce, there is little incentive for small farmers to invest heavily in their farms, become more efficient, and earn more money. The trick to enhancing the incomes of Nicaragua’s poor farmers, therefore, is to identify buyers of what they can produce. In other words, improving the lot of Nicaragua’s rural poor means looking elsewhere – once again, to sources of demand for their goods and services. Doing so is not “trickle-down” economics, but a simple recognition of the demand-driven nature of the development process as well as the potential of outsourcing and subcontracting mechanisms.

Poor small farmers move out of poverty only when they diversify out of basic grains.

Although, again, it is not for government -- or donors -- to pick winners, available evidence suggests strongly that poor Nicaraguan farmers escape from poverty only when they cease relying predominantly on basic grains and diversify their sources of income into high-value agricultural activities or, alternatively, into non-agricultural activities. As important as basic grains are to small farmers – and as important as they continue to be even as incomes rise – by themselves they are not the ticket to substantially higher incomes.

Tax, tariff, and interest rate interventions are blunt instruments for supporting different economic sectors or regions. Let fiscal policy apply equally to all. If public policy wants to promote specific sectors or regions, make appropriate public good investments to lower transaction costs affecting their competitiveness.

If governments choose to favor specific sectors or regions, it makes sense for them to do so as efficiently as possible. In Nicaragua, high tariffs furnish heavy effective protection to producers of corn, rice, and other basic grains, making those crops artificially more profitable than other rural economic activities. If ultimately the path out of rural poverty involves shifting out of basic grains, such protection is misguided. Obviously the government can not align the tariffs for those products with those for others in the economy overnight, but steady movement in that direction is essential. Reducing rural poverty hinges on making rural economic activities more competitive, and competition hinges on the mechanism of relative prices working effectively. Competition is a good, not a bad thing: it breeds higher productivity, which in turn, though maybe not immediately, raises incomes and creates jobs.

In a similar vein, Nicaragua's running of heavy deficits contributes to high interest rates for everybody, thereby discouraging investment. A firm hand at the fiscal policy rudder is essential.

STRATEGIC DIRECTIONS FOR USAID

- **USAID'S CURRENT PROGRAM**

The Mission's agricultural and rural development program has evolved into a strong small farmer program with significant outreach and capable NGO partners. Its salient characteristics include:

- **Strong and Effective PVO Partners.** The government's poverty reduction plan cites the Save the Children program in León and Chinandega and the Catholic Relief Services program in Jinotega, Nueva Segovia, Estelí, Chinandega, and Matagalpa as highly effective. Both programs use the poverty map for targeting. The Mission also has involved Nicaraguan NGOs, including UNAG, the small farmer association allied with the Sandinistas.

- **Drought Response: PL480 Title II.** The $10.5 million PL480 Title II program works through four United States PVOs. It appears to be an appropriate medium- to long-term response to the drought. The program monetizes 75 percent of donated food. The remainder goes to Food for Work and direct distribution. The program recognizes that feeding people is not a permanent solution and includes interventions to diversify household incomes and make income activities more resistant to drought and other disasters.

- **Post Mitch Agricultural Recovery.** Of the $94 million Mitch response, the Mission channeled $59.5 million into agricultural recovery programs. A $35.8 million program involved seven United States PVOs, taking advantage of their existing on-the-ground presence. Interventions included solar drying, silos, irrigation, cash crop marketing, rural road repair, soil conservation, agroforestry, certified seed, and revolving agricultural loans.

- **Rural Credit Unions.** As a result of Mission initiatives, from 1996 to 2001 membership in rural credit unions has grown from 1,588 to 16,953 people, and savings from C$76,064 to C$20,082,200.

STRATEGIC DIRECTIONS FOR THE FUTURE

The main dilemma presented by the Mission's current program is the "patches-of-green" syndrome. The program is bettering the lives of significant numbers of Nicaraguans, but the benefits do not go much farther than that. The challenge for the future is to build on what has worked in the past in such a way as to broaden the program's overall impact. In the future, the Mission proposes to be more selective in its interventions, choosing those points of entry into Nicaragua's rural poverty problem that are likely to trigger incentives for other economic actors to expand and broaden economic activity on their own accord. Specifically, it foresees adopting a number of strategic directions that flow from the principles discussed above. The interlocking directions are summarized below.

It is important to stress that the proposed directions contain no magic bullets. Nor do they imply wholesale surgery to the current program. The program will not go back to the drawing broad, but will build on what USAID has learned works – and does not work – over the last 11 years.

GIVE PREFERENCE TO TRANSACTIONAL APPROACHES

Nicaragua desperately needs to overhaul its investment climate, making it one that encourages investment rather than discouraging it. For the foreseeable future, it is unlikely that major changes in overall investment policy will have much of an effect. For that reason, the Mission proposes to take more of a transactional approach, nurturing business successes one by one. To avoid falling once again into the patches-of-green syndrome, it proposes to accumulate visible, medium- to large-scale success stories that not only generate jobs on their own but show other investors that, "yes, one ***can*** invest in Nicaragua and make money." In short, the demonstration effect is key: only when skeptics see others making money investing will they internalize that lesson themselves.

Pragmatically, an additional advantage of the transactional approach is that it allows one to see results relatively quickly. Rather than waiting for the whole economy to turn around, building up success stories, when they are big and visible enough, can generate both jobs and changes of attitudes in the short to medium term.

Operationally, the Mission proposes to seek out and support potential investors, not by underwriting their operations, but by helping to reduce the transaction costs that stand in the way of their launching and expanding viable enterprises. The transaction costs in question include the high costs of making market contacts, learning about cost-effective productivity-enhancing technologies, and obtaining financing for their operations.

The widespread decapitalization of the agricultural sector makes it tempting to address the finance constraint – and the whole credit culture associated with it -- systemically. The Mission will not do so. Despite first impressions, there is capital in or willing to come to Nicaragua. It will only come, however, when there are profitable business plans to support. That, not the financial side of the equation, must be first priority.

Instead of reacting to decapitalization as a "credit issue," USAID proposes to broaden its horizons and explore mechanisms to bring additional equity into Nicaragua's rural sector. Although the Mission has had limited experience in equity programs, it is not a neophyte, either. The APENN cold storage unit at the Managua airport is one of its success stories of the last decade.

The equity financing in question need not be solely Nicaraguan. For example, Nicaraguans complain that the root crops they export to Costa Rica are frozen there and imported back into Nicaraguan supermarkets. What will it take to get Costa Ricans to establish and manage a freezing plant in Nicaragua?

The Agency's Global Developmental Alliance and Partnership for Prosperity initiatives offer opportunities to develop alliances and partnerships with new private sector partners. Possibilities include:

- Specialty Coffee Association of America (SCAA) for quality certification schemes and development of new niche markets.
- Latin American Agribusiness Development (LAAD) for investments in value-added agribusinesses such as freezing facilities.

- Monsanto for genetically modified crops such as cotton and corn. Nicaragua could take the lead in adopting new biotechnology before its Central American neighbors.

One final note. Adopting a transactional approach does not rule out taking a systemic posture when appropriate. Before addressing issues in that way, however, the Mission will be sure they meet two tests: first, that they grow out of and respond to specific business problems; and, second, that the probability of success is relatively high.

- **FOCUS ON PROFITABLE, HIGH-VALUE PRODUCTS**

It is not USAID's job to select the business opportunities in which private entrepreneurs invest. As a practical matter, however, the likelihood is high that the enterprises it supports will produce, not basic grains, but high-value agricultural and non-agricultural products. The fundamental criterion here is profitability, and all indications are that basic grains satisfy it to a much lower degree than other alternatives.

- **LOOK TO EXPORT MARKETS**

The challenges to expanding exports remain daunting. The unwillingness of Nicaraguans themselves to invest and take risks can be overcome only by establishing a track record of successful export business ventures. Among other options, the Mission is contemplating a new PROEXAG-like activity involving APENN to help make that happen.

In the search for export markets, regional markets – especially El Salvador – offer promising opportunities. To a more limited degree, substitution of food imports from neighboring countries also is an avenue to explore.

- **ADOPT A DEMAND-PULL APPROACH**

The supply-side constraints to revitalizing Nicaragua's rural sector are legion, and the current Mission program addresses many of them. That is fine, provided there is a filter for selection and setting of priorities. In the future, the Mission proposes to make this linkage much more explicit.

Operationally, the strategy of reducing transaction costs discussed above must give first priority to the identification of markets, not generically but in buyer-specific terms. Once one knows who is going to buy his or her product, not only do quantity, quality, and timing issues become more apparent, but so do the specific supply-side constraints one must tackle to address them.

Among the Mission's current partners, contractors appear to have a comparative advantage institutionally in addressing demand-side problems, while PVOs are remarkably adept at organizing supply. To capitalize on the comparative advantages of each, the Mission has promoted linkages between them, and proposes to make those linkages even tighter and more explicit in the future.

- **FOCUS ON PROMOTION OF BUSINESSES, NOT ON THE SIZE OF CLIENTS**

USAID's current program focuses almost entirely on small farmers. Although this focus is laudable in a number of ways, one can not revitalize Nicaragua's agriculture – and generate increases in incomes and jobs on a broad scale – on the backs of small farmers alone. The entry and expansion of medium- and large-scale farms are essential. Accordingly, in the future USAID will give less attention to the sizes of the enterprises it is supporting than to their inherent profitability. This is not to say that it proposes to renege on its commitment to small farmer development. Rather, it proposes to do so in a way that even more can benefit. Again, the success of one small farmer is a good thing for the farmer, but it does not necessarily spin off into broad, self-sustaining benefits.

An analogous example from the Mission's current program helps to make the point. When CARE launched its rural access road program, it confronted a tradeoff: employ as many poor people as possible directly in the construction of the roads or make the roads of the highest quality possible. CARE made the latter choice, and is now seeing the payoff. Although fewer poor people had jobs in the short run, the presence of reliable transport to and from markets has vitalized whole areas, expanding incomes and jobs – non-agricultural as well as agricultural – for the communities in question.

None of this is to say that the Mission proposes to throw the baby out with the bathwater and work directly only with medium and small farms in the future. There are instances in which small farms can be quite profitable -- the greenhouses sponsored under the Title II program are a case in point. To repeat, the basic criterion here is profitability, not scale. Get businesses going, no matter the size.

One final point. The "counterparts" of the Mission's future program will not be sectors, but individual businesses. Sectors will develop only as individual businesses develop.

- **EXPLOIT SUBCONTRACTING AND OUTSOURCING ARRANGEMENTS TO PULL IN SMALL FARMERS**

The shift in focus outlined above sounds good in theory, but is there evidence to suggest that small farmers indeed can benefit from the dynamism of larger actors in the sector? Although the spin-off is far from automatic, there is ample evidence to support the hypothesis. The first example is the PROEXAG experience that enjoyed success throughout Central America and whose approach Missions throughout the region have replicated in various shapes and forms. The second set of examples come from the Mission's current program – onions, garlic, shrimp, cheese, and vegetables, to name the obvious. In sum, it is indeed feasible to involve small farmers, especially when scale creates incentives for various forms of subcontracting and outsourcing arrangements.

Finally, evidence from other countries – from Guatemala, most recently – highlights the substantial spin-off effects into local communities of shifts from basic grains into high-value products. Small farmers typically have a high propensity to spend additional income on locally produced goods and services. Small farmers who shift successfully to higher-value products generally become more productive in basic grains as well. The shift into higher-value crops leads both to increased capitalization and better understanding of agricultural technology across the board.