Bring Humanitarianism back into Debt Sustainability: Case Study Nicaragua

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Resumen

La investigación del autor estudia las sinergias y las tensiones entre la deuda externa y los derechos humanos. Para ello, el estudio examina el Banco Internacional Fondo Monetario Mundial Conjunta de sostenibilidad de la deuda para los países de bajos ingresos, mientras prestando especial atención al caso de Nicaragua. Los autores encuentran el apoyo a la validez de los argumentos teóricos que enlazan las dos variables. El crecimiento integrador de diagnóstico realizado por Nicaragua proporcionó un estudio en profundidad de los motores de crecimiento (capacidad de pago) y los factores que impiden su crecimiento. Como resultado del análisis, se reveló que los altos violaciónes de derechos humanos (especialmente los derechos civiles y políticos) no sólo han dado lugar a la inestabilidad política, sino también socavado la estabilidad macroeconómica - la estabilidad macroeconómica molesto y creciente endeudamiento. A fin de cuentas, una conclusión provisional es que el marco de sostenibilidad de la deuda para los países de bajos ingresos no tiene en cuenta los riesgos derivados de los riesgos políticos emanado de violaciónes de derechos humanos.

Derechos humanos, la deuda externa, los programas de ajuste, Nicaragua

Abstract

The author's research studies the synergies and tensions between external debt and human rights. To do this, the study examines the Joint World Bank-International Monetary Fund Debt Sustainability Framework for Low Income Countries, whilst paying particular attention to Nicaragua's case. The authors find support for the validity of theoretical arguments that link the two variables. The Inclusive growth diagnostic conducted by Nicaragua provided an in-depth study of the growth drivers (repayment capacity) and factors that are hindering their growth. As a result of the analysis, it revealed that high human rights violations (especially civil and political rights) have not only led to political instability, but also undermined macroeconomic stability - upsetting macroeconomic stability and increasing indebtedness. All things considered, a tentative conclusion is that the Debt Sustainability Framework for Low Income Countries fails to address risks resulting from political risks emanated from human rights violations.

Human Rights, External Debt, Adjustment Programs, Nicaragua

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Introduction

This research aims to relate debt sustainability to human rights and examine the frictions and synergies between them. The research examines this relationship by analyzing the Worlds Bank's (WB's) and the International Monetary Fund's (IMF's) Debt Sustainability Framework (DSF) for Low Income Countries (LICs). Literature pertaining to the probability of a country failing to comply with the contractual obligations of its loans (sovereign default risks) reveals that it must conduct a country risk assessment based on two risk categories: political risks and transfer risks (UN 2009). In other words, to evaluate the risk involved in lending operations, economist must evaluate the actions of governments (government policy and political institutions) that establish incentives for the creation of repayment capacity and the economic environment.

The research hypothesizes that political risks arising from HR violations in Nicaragua (NI) influence the country's debt sustainability. Further, it is hypothesized that the incorporation of HR elements into the DSF for LICs will reduce political risks and enhance human rights. The integration of HR elements into the DSF would not only strengthen the assessment of probable causes of unsustainable indebtedness and deterioration of the county's repayment capacity, but also improve the recommendations to creditor lending and grant allocation decisions. With this in mind, the respect of HR will lower the negative impacts of government policies that reduce debt related risks.

The research in this study will focus on answering these questions: i) How are external debt and HR connected?; ii) Does Nicaragua's history provide evidence of the relationship between debt sustainability and HR?; iii) Does HR influence the capacity of repayment and political stability? iv) What would be the benefits of incorporating HR elements into the DSF?

The main objective of this analysis is to identify political vulnerabilities and HR risks that may undermine the Debt Sustainability of NI.

Renowned contemporary scholars have identified the negative impact of high indebtedness on economic growth (Reinhart, Reinhart, & Rogoff, 2012), debt sustainability (Baldacci, Gupta and Mulas-Granados 2010), and human rights (UN 2011). Others have found that political stability undermines economic activity (Aisen and Veiga 2013). Specifically, as a result of the economic contraction, government revenues fall, which limits the availability of funds to main current expenditure levels (previous crisis) on loan repayments and public services.

The structure of the research is as follows. Chapter 2 reviews the relevant literature with the intention of theoretically associating external debt, political risks, and HR. Chapter 3 concludes with an analysis of the implicit and explicit links between debt sustainability and HR. Chapter 4 examines Nicaragua's repayment capacity by conducting an Inclusive Growth Diagnostics (IGD). Chapter 5 discusses the key findings of the research, presents the theoretical implications and ensuing recommendations. Finally, Chapter 6 concludes the dissertation with a summary of the overarching conclusions.

Methodology

Identifying the factors that affect growth is necessary in order to accurately evaluate Nicaragua's capacity to repay debt. In this research, we used the Inclusive Growth Analytics Framework created by Ianchovichina and Lundstrom (2009) to reach our objective. The Inclusive Growth Analytics Framework explains the reasons why the poor and the majority of the labor force are not contributing and benefitting from economic growth.

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The makers of this analytical tool (Ianchovichina and Lundstrom 2009, 4) state that "inclusive growth refers to both the pace and pattern of growth" to obtain pronounced sustainable growth in the long run and reduce poverty. Inclusive Growth is a growth broadly based across sectors and must incorporate a large share of the labor force.

The three pillars of this framework are as follows: i) The "background analysis": a brief review of the factors that explain the growth and poverty reduction rates; ii) The "economic profile of the economic agents": delivers the scenario of the activities citizens realize to earn their income in order to analyze the growth potential and possible migration to other more productive economic activities; iii) The "identification of constraints to inclusive growth": responsible for analyzing all the factors mentioned above in the decision tree that affect the level of investment and entrepreneurship.

Literature Review

The main objective of the literature review is to link debt and human rights by revealing that external debt has a negative impact on human rights through the following mechanisms: i) debt overhang effect on economic growth and poverty; ii) adjustment programs; iii) social expenditure reduction; and iv) policy conditionality's imposed by the international community and/or debt relief mechanisms as a requirement to receive financial resources.

Debt sustainability is a very complex phenomenon to determine. At present there exist ongoing differences on the measurement of debt sustainability (CESifo 2008, 1). This is because all try to quantify the risk of a country's ability to pay its financial obligations in the future, a future which is unknown. Despite this fact, country risk analyses identify two sources of risk.

First is the ability to pay, addressed in economic literature as "transfer risk" (UN 2009, 1). This deals with national economic performance, debt ratios, and global trends. Second is the will to pay, referred to as the "political risk" (UN 2009, 1), which speaks to the asymmetric information problem.

Debt Overhang

A debt overhang situation is defined as "the presence of an existing inherited debt sufficiently large that creditors do not expect with confidence to be fully repaid" (Krugman, Financing vs Forgiving: A Debt Overhang, 1988, págs. 1-2). This work speaks of an existing negative relationship between growth and high debt because, from a certain threshold, debt begins to generate distortions in the economy. He argues that not all the income that the government receives can be used to pay debt.

This creates uncertainty among investors due to fears of cessations by the government of its financial obligations (default) and its political considerations. Krugman's early theory has been further developed. Some authors have provided systematic ideas on the transmission mechanisms and effects of external debt on growth.

According to existing literature, there are several mechanisms through which debt can affect economic growth.A debt is considered sustainable when "a country can meet its current and future debt service obligations in full, without recourse to debt relief, rescheduling, or accumulation of arrears" (Gunter, Achieving the MDGs and Ensuring Debt Sustainability 2011, 50).

On the other hand, the IMF defines debt as "sustainable if it satisfies the solvency conditions without major correction […] given the costs of financing (IMF 2002).

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The institution defines a country's external debt as sustainable "when the primary balance needed to at least stabilize debt under both the baseline and the realistic shock scenarios is economically and politically feasible, such that the level of debt is consistent with an acceptably low rollover risk and with the preserving potential growth at a [satisfactory] level" (IMF 2013, 4). This also implies that "sustainability is excluded when a debt restructuring is already needed (or expected to be needed), the borrower keeps on indefinitely accumulating debt faster that its capacity to service these debt is growing, or the borrower lives beyond its means by accumulating debt in the knowledge that a reduction will be needed to service these debts" (Megliani 2015, 3-4).

Economic progress creates the conditions for attaching a high importance to citizens' human rights, and consequently the government needs resources to protect all human rights, in addition to requiring adequate staff and laws, and the means to enforce them (Alesina and Guido 1989). Typically, debt levels are expressed as a percentage of some measure or of the capacity to repay debt (Raseel 2005, 345).

High debt levels undermine economic growth and development as a result of the debt overhang problem. A debt overhang is defined as "the presence of an existing inherited debt sufficiently large that creditors do not expect with confidence to be fully repaid" (Krugman, 1988, págs. 1-2).

Despite the consensus on the theoretical aspect of the theory there exist discrepancies of what should be a prudent level of indebtedness and what should be the maximum level of indebtedness

Debt overhang constrains economic growth, is linked to improvements in human rights. It can thus be inferred that economic contraction constrains human rights. Krugman's early theory of debt overhang has been further developed; now some authors have provided systematic ideas about the transmission mechanisms of external debt effects on growth. A modern analysis of debt overhang using endogenous growth models, model of endogenous debt dynamics, arises because of the inability of governments to commit the repayment of de full amount of indebtedness distorting economic outcomes (Aguiar and Amador 2013).

According to the existing literature, there are seven causal mechanisms through which debt can affect economic growth, namely: i) macroeconomic instability; ii) political instability; iii) investment; iv) interest rate; v) capital flight; vi) inflation; and vii) poverty. An overview of these causal mechanisms with debt overhang is presented below.

Alesina & Guido (1989) and Servén (1997), for example, identified the connection between high debt and political instability, given private sector fears of changes in fiscal policy and tax increases, on account of government's strong need for funding that might impair private wealth.

This scenario includes a variety of measures affecting citizens' wealth; a few examples of these measures include tax increases or the introduction of new taxes, currency devaluation, private enterprise expropriations, and capital flow control measures. All of them promote a negative discourse of legal uncertainty among investors.

The emergence of a high debt burden, together with the prospect of higher debt service obligations, undermines the tax system political foundation because it commits limited state resources, and this undermines public spending. The economic situation leads to a decline in public investment and public services rendered to citizens.

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Reduced public safety nets and public services create popular discontent, which can reach critical levels, such as strikes and public demonstrations staged by the various affected groups. This situation exacerbates a state's fiscal stance paralyzing economic activity and undermining government's social support.

Increased popular discontent challenges the ruling party and puts it in the horns of a dilemma: it could either choose to continue repaying creditors and risk losing support in the next political elections or decide to stop repaying creditors and retain political power. In the first case, the ruling party's future in the next elections seems to be bleak. As a result of popular discontent, other political parties will win more votes, increasing incumbent party's probability of losing office and power in Congress.

Opposition parties defying current economic policies will challenge the lack of expenditure on welfare in times of declining standards of living and significant transfer of resources to service external debt.The relationship between debt and poverty was explained by Kemal (2001), Loko, Mlachila, Wallari, & Kalonji (2003), and Maier (2005), who found a high external debt level increases poverty. Maier identified the following mechanisms (Maier 2005, 7-11): first, there is a highly leveraged impact on poverty through the state budget, since a higher debt service leads to shifted priorities and public investment levels, to the detriment of the most vulnerable sectors of population. In other words, the state budget constraint requires changes in public investment that further hurt the poor.

The poverty impact of debt is due to lower economic growth, inflation, unemployment, a drop in government revenues amid declining economic activity, and higher regressive taxes and restrictive fiscal policies.

Fiscal contraction of social spending further harms the most vulnerable, on account of their being the main beneficiary sectors. Education and health coverage affects human capital assets and transfers—grants, unemployment insurance.

The government uses macroeconomic policy adjustments in order to balance the external imbalance resulting from the high indebtedness level. Some of these adjustments include labor reforms meant to lower the cost of labor and laid-off workers' benefits, which affect the labor market. Falling wages, or the rate of wage increases, caused by labor reforms and unemployment have an impact on poverty, leading to lower domestic consumption.

Structural Adjustment

The UN report E/CN.4/Sub.2/1992/16 stated that the common components of adjustments are: i) devaluation of the local currency; ii) decrease in government expenditure on public services; iii) abolition of price controls; iv) imposition of wage controls; v) reduction of trade and foreign exchange controls; vi) restrictions on domestic credit; vii) reduction of the role of the state in the economy; viii) increasing the basis for the export economy; ix) decreasing imports; and x) privatization of public enterprises.

The austerity measures generated economic stagnation (Easterly 2001), lower standards of human rights (Abouharb and Cingranelli 2006a) and reduced workers' rights (Abouharb and Cingraneli 2006b), thus creating concerns among scholars and the international community. The implementation of structural adjustment programs has jeopardized the rights to: i) food; ii) education; iii) shelter; and iv) health (UN 1999).High debt burdens force countries to seek additional resources abroad, in order to meet their financial obligations and avoid default or smoothen consumption.

They can negotiate with international financial institutions to get additional funds or participate in debt relief initiatives. Countries must apply for and comply with economic programs that go beyond mere macroeconomic measures, thus undermining their sovereignty (Briscoe 2006). The depth of IMF and WB policies can be visualized in works dealing with the Latin American and African debt crises in the 1980s (Helleiner 1992) and the Asian financial crisis in the 1990s (Feldstein 2002) which went beyond economic issues. The most compelling evidence were the introduction of new laws, regulations, economic systems, privatization of public entities and non-economic measures as a condition to receive additional resources from the international community.

Appraisal of Debt Sustainability

The DSF is a standardized analytical tool within which evaluations of LICs' debt-related risk are conducted by a DSA. The DSF's main objectives are to advise countries that are taking loans, to counsel lenders and donors of their financial resource allocations, and to appraise data for examination and policy advice from the IMF and WB. The analytical instrument defines a country's debt level as solvent "if the present value of its income stream is at least as large as the present value of its expenditures" (IMF-WB 2013, 6).

The DSF is based on an assessment of the country's debt burden relative to its financial situation via indicators of debt stock and debt service relative to some repayment capacity. It is further linked to the quality of policies and institutions (IMF 2004, 12-21). The basic equation consists of equating a debt indicator with indebtedness divided by repayment capacity. Debt burden indicators consist of solvency indicators like present value of debt per GDP percentage, exports and revenue. Liquidity indicators count debt service in relation to a percentage of its exports and revenue (IMF-BW 2013, 11).

The framework utilizes debt ratios to evaluate fulfillment of the aforementioned sustainability principle. When one comes to the topic of the sustainability condition, it must achieve solvency and liquidity. In fact, the solvency condition is met by generating debt-dynamic projections of debt ratios over a twenty-year period. To comply with the liquidity condition, it evaluates risks related to "debt composition, maturity structure, interest rate structure, and [the] availability of liquid assets" (IMF-BW 2013, 7).

These two conditions are linked to specific debt ratio thresholds, depending on the soundness of the countries' institutions and policies to make appropriate evaluations. The link between debt and CPIA performance is due to Kraay and Nehru (2004). They empirically demonstrated that countries with weaker institutions (lower CPIA scores) face debt-related problems before countries with robust institutions (higher CPIA scores). The CPIA will be analyzed further in the text (Kraay and Nehru 2004).The appraisal of nation-states' institutions and policies is done by the Country Policy Institutional Assessment CPIA, based on the assumption that these elements are essential to determining the effectiveness of a state's use of resources (Santiso 2001, 4) and of its poverty reduction and growth strategies (WB, 2013a, pág. 1).

It aims to assess the quality of borrowers' policies and institutional frameworks and their abilities to foster sustainable growth and poverty reduction, to effectively use developmental assistance (Cagé 2013). A number of scholars have suggested that the DSF and CPIA have several fundamental problems. Subsequently, the research will create a brief literature review of the sparse documents from critics of the DSA and CPIA, placing this contribution in an investigatory context. That literature helps us question the limited validity of the ratings themselves, not how the DSA reaches its assessment.

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This is not to say that the DSF assessment does not help improve observations of debt-related risks and enhancements in IMF and WB activities in LICs (Buffie, et al. 2012, 4).

On the other hand, the DSF does not take into account the in determining the debt thresholds the occurrence of debt overhang, debt overhangs can be identified even at lower debt sustainability levels stablished in the DSF (Caner, Grennes and Koehler-Geib 2010). These authors calculated that Nicaragua lost 4.7% of average economic growth from debt overhang during the period 1980 to 2008, while Patillo, Poirson and Ricci (2004) identified debt overhang constraints growth when debt to GDP is above range from 30% for low income countries.

My own view is that if debt overhang threshold are unique the threshold of the DSA can be misleading to determine a benchmark of an unsustainable level for all countries without taking account this growth constraint and country's specifies. Bannister and Barrot (2011) observe that Nicaragua and Honduras face debt intolerance when their debt-to-GDP ratios are at 28.38% and 21.1%, respectively (Bannister and Barrot 2011, 20).

The existing DSF has been widely criticized for various reasons:

- Its predictions aren't very accurate (Berg, et al. 2014)
- It doesn't contain a contingency mechanism to address external shocks (Ferrarini 2008).
- It questions the significance and reliability of its governance indicators in predicting debt distress (Ferrarini 2009).
- It makes arbitrary political risk assessments (Wyplosz 2007).
- It does not consider the impact that social and economic indicators show regarding countries' capacities to carry debt (Gunter, Rahman and Shi 2009)
- It is not compatible with development goals (Spratt 2007).
- It limits its debt sustainability concept (Gunter 2007).
- It policies are conservative by assuming that government do not react to shocks in the stress test scenarios (Buffie, et al. 2012, 5).
- Does not reliably assess variable characteristics of LICs (Cassimon, Moreno-Dodson and Wodon 2008).
- the DSF ignores the point when countries start facing debt overhang (own)
- And, lastly, it does not consider violations of civil and political rights as factors that undermine quality governance and institutions (own).

The existing CPIA has been widely criticized for various reasons:

- Relies on a subjective assessment of policy and institutional quality (GTZ 2008, 19).
- The lack of external assistance during this process.
- CPIA ratings have experienced changes, and this may or may not modify its link to development outcomes (GTZ 2008, 23).
- CPIA ratings are not affected by HR violations, like civil and political rights such as non-competitive elections (own)

The conventional wisdom validating the role of institutions and national policies on economic growth has been recognized theoretically (North 1991) and empirically (Acemoglu, Johnson and Robinson 2004).

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Robust results prove that institutions do matter to economic growth and development outcomes. Meanwhile, inquiries of national policies on economic growth also have reached similar conclusions empirically (Easterly 1992) and theoretically (Easterly 2005).

The mandate of the DSF to "provide guidance for creditors lending and grant allocation decisions and improve IMFs and WBs Policy advices" (IMF 2013, 6) suggests that it needs to keep up with changes in development cooperation. Coupled with regard of the new paradigm shift of development aid of the integration of human rights into development to provide better guidance.

The international community has changed its approach based on the idea and assumptions that HR can generate the necessary social changes to construct better governance and reliable institutions. Additionally, WB acknowledges that respects HR are important to increase development outcomes and is an "irreducible goal of development" (WB 1998, 2).As an illustration of this trend of incorporating HR into development aid, Nicaragua had to create of a Poverty Strategy Paper and its application in which HR elements were incorporated as a mean to improve governance and institutions.

The fourth pillar of this strategy, governance and institutional development, to combat poverty, explicitly stated that "improving the nations governance and institutions will require consolidation of rule of law and mayor institutional strengthening, greater transparency and efficiency in public expenditures, institutionalization of a culture of integrity and promotion of democracy through an expanding decentralization, participation of civil society and respect of human rights (Government of Nicaragua 2001, 35-36).

The Poverty Strategy Paper placed strong emphasis on respect on human rights to governance to receive HIPC debt relief and concessional financing.

Another key exemplification of this trend is The Paris Declaration of Aid Efficiency in which its expansion The Accra Agenda of Action (2008) the OECD member countries and 80 developing countries agreed to harmonize "their respective development policies and programs are designed and implemented in ways consistent with their agreed international commitments on HR (OECD 2008, 3). The latest aid effectiveness forum, The Busan Partnership for effective development in 2011, also recognized that "promoting human rights […] are an integral part of development efforts" and constitutes one of their principles (OECD 2011, 1, 3). Human rights promotion reinforces positive externalities since "aid only promotes economic growth under specific circumstances, or can be reduced or stimulated by several elements, which human rights record being one of them" (Keeley 2012, 90).

It has become a common agreement and several countries experiences seem to corroborate that in order to countries achieve successful development, they must "combine sound macroeconomic with market oriented reforms, good governance with reliable institutions and proper interaction between incentives and supply of public goods, so as to balance economic dynamism with social inclusiveness" (UNIDO 2005, 21-22).

For instance, several studies evidence that "fast [economic] growth is partly the outcome of favorable social arrangements", like health, education coherent with human rights (Temple and Johnson 1998).

Economists have traditionally not only ignored the effects of human rights in the macroeconomic performance (Uvin, 2004), governance and institutions. HR constitutes a specific manner of governance[2]and behavior of institutions based on HR principles that assign rules and standards stablished in the HR treaties (Mihr and Gibney 2014, 382). WB (2010) exposed that HR contributes to development by: establishment of norms, values principles; and its instrumental nature of empowerment role, protective role, and constructive role.

Additionally, Rhoda Howard points out not only role of HR in the promotion of peaceful understanding between political forces diminishing the option of usage of violence and/military options but also its role in “promoting the application of reasonable policies to ensure equitable distribution of wealth and guarantee social and cultural rights” (Howard 1983, 469-474).

Another key point is the empirical evident of the association between low levels of political and civil rights and corruption, in which one form can be the capture of the state by the elite

Daniel Kaufman identified in an empirical study a link between governance, corruption and HR, in which low levels of respect of HR were associated with high levels of corruption (Kaufmann 2004, 14-15).

The respect on RH can combat legal and illegal corruption, in other words corruption with legal framework or without legal framework human rights promote accountability and “societies with lower accountability impose higher costs on the population if it were to react to corrupt public policies” (Kaufmann and Vicente 2011, 200).

Case Study: Inclusive Growth Diagnostic Nicaragua

This chapter aims to identify what is constraining economic growth in Nicaragua (NI) (namely, its capacity to pay debt). Contains an inclusive growth diagnostic of the country under scrutiny. This will shed light on what elements are limiting their debt payment capacities. Upon identifying the structural constraints to inclusive growth, I can suggest policies to monitor that which stands to hinder these repayment capacities.

Background Analysis

Economic growth is fundamental for the success of a country; consequently, we should try to understand past sustained growth. NI has a low-middle-sized economy. In 2013, it had a population of 6 million citizens and its GDP was 8.3 billion US dollars. It has a per capita income of $1,366 at constant 2005 dollars (WB 2015a). Output per capita has shown marginal improvement, with 0.35% average growth from 1961 to 2013. These results become worrisome when we consider the average evolution of key variables in the same time period, like GDP growth rates of 2.7% per year, population growth rates of 1.67% per year, 23% of its revenues being grants, the 14.5 billion dollars in debt relief (CBN 2014), and a 5.6% of remittances (as percentage of GDP) (WB 2015a).

NI's long-term growth has been poor, still below levels it had reached in 1977. NI had similarly large economy, with an $8.3 billion GDP, but a higher a GDP per capita ($2100 at constant dollars) (WB 2015a). This is shown in Figure 1. The country under-performs economically when compared to other developing countries in Latin America and the Caribbean. NI's GDP represented less in 2013 than it did fifty-three years ago. Also, the income gap within the region (as measured by GDP per capita) rose. In 1960, NI's GDP represented 0.5% of the GDP in the region. It represented 0.2% of it in 2013.

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GDP per capita was 46% below the average for the region in 1960. In 2013, it was 76% below the average (Figure 2). This indicates that NI's standard of living is not catching up to those of neighboring countries. Instead, income differentials are widening. Why is NI performing below the average? Have political instability and HR issues affected Ni's growth performance?

The data on International Pls are only at national level and the national criteria were selected due to lack of alternative statistical of poverty. The analysis recognizes the limitations of this measurement because it omits measurements of inequality among the poor and violations of the axioms of monotonicity and transfer (Sen 1976, 219).

Surveys use two methods to present poverty lines (PLs): the cost of basic needs approach and the method which uses the National PL and International PL. NI's PLs stipulate a consumption bundle, one deemed adequate with food intake of 2268 calories. It also stipulates nonfood components like housing, transportation, etc. A poor person, according to the National PL, earns below 1.558 dollars at nominal terms per day. An extremely poor person earn less than 0.917 dollars (INIDE 2009, 6-7). By the International PL, a poor person earns 2 dollars in PPP terms and an extremely poor person 1.25 dollars.

Household survey comparisons show that headcount poverty rates using the International PL standards were highest in rural areas and lowest in urban areas throughout the period analyzed. The estimates in Figure 11 indicate that the incidence of poverty and extreme poverty had declined considerably in NI as a whole, from 50.3% to 42.5% and from 19.4% to 14.2% respectively, from 1993 to 2009. It also shows that generalized poverty affected approximately 26.8% of the population in urban areas and 63.3% of residents in rural areas in 2009 (INIDE 2009, 13).

The big picture is that NI reduced poverty by 7.8% (0.45% annually) and extreme poverty by 5.2% (about 0.3% annually).

Analyzing poverty under the International PL, 21% of the population was poor in 2009, and 8.54% lived in extreme poverty then (WB 2015a). See Figure 12. The gap between the PL and the average income of the poor and extreme poor decreased considerably in NI as a whole, from 16% to 3% and 26% to 7% respectively, from 1993 to 2009. That means a narrowing of the poverty gap. This holds despite increased severity of poverty and extreme poverty compared to levels in 2005. See Figure 13. The Gini Index also showed signs of improvement. It dropped from 57.36 to 45.73 from 1993 to 2009, suggesting that the gap between the rich and the poor is also narrowing, although it increased 13% from 2005 to 2009.

Identifying the constraints to inclusive growth

This research analyses the elements that are constraining economic growth, with special emphasis on variables that affect private returns from economic activities and cost of finance, since they stimulate investments and entrepreneurial activities. Work by Ianchovichina and Lundstrom (2009) states that "private returns in turn are determined by social returns, which depend on complementary factors or inputs that individuals cannot or have very low incentives to provide", wing to space limitations the investigation will only address the impact of government actions and institutions.

Are Nicaragua's Government Actions a Constraint?

NI's government also must work to protect land rights. Land rights reduce economic uncertainty and incentivize the best use of resources (FUNIDES 2013, 40). NI has a long and persisting history of problems with land rights and tenure insecurity (WB 2008b, 24).

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Land rights insecurity has generated surges in social conflicts in NI, some leading to armed conflicts. The Somoza family amassed over 2,000,000 acres of land over the course of its 1936-to-1979 dictatorship (Staten 2010, 95), conducting legal and illegal confiscations (Staten 2010, 54), and assassinating farmers (Morley 1994, 54) and opposition leaders for their land (Gritzner 2010, 65). These actions helped breed the revolution that toppled the Somoza dictatorship. During the Sandinista Revolution between 1979 and 1990, land reform expropriated land from the Somoza family and the bourgeoisie, leading to a counter-revolutionary movement in NI's northern central region from 1983 to 1989.

This period is characterized by unrecorded transactions, where rights to land possession were conducted arbitrarily and without documentation (FUNIDES 2013, 40). Also, several state properties were transferred to the Sandinista elite (Morris 2010, 177). Land reforms during this period affected more than 5,500,000 acres of arable land from 1979 to 1990. Only 7,400,000 acres of Ni's land is arable (Rose 2010, 14-15).

NI's return to democracy in 1990 posed several challenges for land tenure: the review of titles distributed from 1979 to 1990, the privatization of several state properties, the institution of land rights, and the implementation of new agrarian reforms. President Chamarro's new land reform came from an demobilization deal with counter-revolutionary military personnel (Contras) and the Sandinista People's Army. It made “almost one million acres of land to peasants and former soldiers” available. This action complicated land tenure security in NI, since part of the redistributed land was the same land redistributed during the revolutionary years.

The lack of land ownership titles and of policies to reverse some confiscations from the Sandinistas led to violence in rural areas throughout the 1990s.

Land insecurity led to massive invasions of land on NI's agricultural frontier. Armed conflicts between ex-Sandinistas and former Contras were common in rural regions (Close, et al. 2008, 105). For instance, the city of Estelí faced an armed rebellion, as groups demanded access to land, in 1993 and 1995. Increased political stability came after a deal (promoted by Ex-president Jimmy Carter) between the Sandinistas and non-Sandinistas to emit internal debt.

Nicaraguan Compensation Bonds paid the owners who were expropriated during the years of the Sandinista Revolution (Staten 2010, 138-139). This is an example of how human rights violations can cause state debt obligations. At the end of 2009, there were $739,000,000 yet to be paid (CBN 2010, 122). In March 2010, the state paid more than $1,200,000,000, with some cases still pending (Rose 2010, 15). International perceptions of property rights in NI are negative.

The Global Competitiveness Report 2014-2015 ranked NI among the worst, 128th of 144 countries evaluated. The WB's CPIA property rights and rule-based governance rating has maintained a score of 3 out of 6. The International Property Rights Alliance ranked the country among the worst in protecting physical property rights, 73rd of 97 countries evaluated, scoring a 4.5 out of 10 in its 2014 International Property Index (IPRI 2015). Currently, land titles are often contested, and individuals with government or Sandinista National Liberation Front (Frente Sandinista de Liberación Nacional, or FSLN) connections seem to be at an advantage during property disputes (Freedom House 2014). The latest cause of massive land insecurity in NI was the approval of Law 840 “Special Law for the Development of Nicaraguan Infrastructure and Transportation Pertinent to the Canal, Free Commerce Zone, and Associated Infrastructure.”

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It gave a Hongkongese company, Nicaragua Canal Development, the license to construct an inter-oceanic canal, a free trade zone, and adjacent projects in NI. The latest study on this matter by the Nicaraguan Academy of Science (NAS) reveals that the company's investment can make use of the Central Bank of NI's reserves as collateral in the event of additional costs due to government actions. The NAS (2014) argues that the Law of Canal violates the following constitutional articles: 1, 2, 3, 4, 5, 6, 7, 11, 44, 80, 82, 83, 87, 88, 102, 182, and 183 (NAS 2014, 96).

NI's HR standing has regressed. Freedom House's assessment of NI's Civil Rights reveal that the press has faced political and judicial harassment (Freedom House 2014).The Nicaraguan Center for Human Rights (CENIH) reports that, between 2007 and 2013, there have been seventy-nine murders by NI's security forces, police, and army, in rural areas and without proper investigation. Families report that these assassinations were politically motivated. Some showed signs of torture (CENIH 2014, 9). Several political rallies and protests have been attacked by mobs. Those mobs arrived in governmental vehicles (CENIH 2014, 9).

Are Nicaragua's Institutions Producing Further Constraints?

NI's political system is characterized by the dominance of all-state institutions by the two major parties. The control of institutions by party interests has undermined the rule of law and governance. Polarized institutions in NI have lost impartiality in imposing justice and mediating conflicts between members of society that conflict with the interests of either party. The World Bank Governance Indicators depict NI's governance performance from 1996 to 2013. NI's execution is considered among the worst in the world. It ranks around the 10th to 25th percentile in control of corruption and government effectiveness.

It also ranks around the 25th to 50th percentile in voiced accountability, rule of law, regulatory quality, political stability, and the absence of violence/terrorism (WB 2015g).

NI's 1990-established electoral system is currently under scrutiny because of anomalies in the state elections of 2008 (CINCO 2011, 3) and 2012 (Revista Envío 2012) and in the presidential elections of 2011 (The Carter Center 2011, 6-7). In then, the Sandinistas won most of NI's 140 states, its presidency, and more than two thirds of its congress. The electoral system bent to the will of President Ortega, making two congressmen who violated the party vote discipline were dismissed (Vargas 2014, 227). Additional to this, several opposition mayors, deputies, and councilors of municipalities were dismissed by the Electoral Supreme Council due to allegations of irregularities (Martí i Puig 2013, 275).

Now the FSLN controls almost all of the 153 municipalities. Human rights groups have denounced their use of public resources, but no investigation have been conducted (CENIH 2014, 67).Velasquez (2011) states that NI's institutions fail to comply with the rule of law. Justice is instead interpreted and applied through negotiations of political party interests. Laws are constantly re-interpreted, such as the 2013 Supreme Court resolution to declare Article 147 and 178 of the Constitution of no presidential re-election invalid. This allowed President Ortega to run for a second consecutive term. Another was the annulled twenty-year sentence of ex-president Aleman in 2009 (NIC-SCJ 2009). This has provoked political polarization and radicalization.

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Public demonstrations are generally allowed, but there are several cases of groups, reportedly made of Sandinista supporters, that attack crowds with impunity. A group young people that rallied in front of the Social Security Headquarters was beaten and robbed by such a crowd (Miranda Aburto 2013). An elderly group that rallied in front of the General Assembly was also beaten with no perpetrator sent to justice or official report of the event. Opposition members have accused the police.

The abuse of power by the State during the Ortega administration has cause political instability but has not yet affected the business environment because of the tacit alliance between the government and with the Nicaraguan business elite (Spalding 2012, 21-39). The official documents of the big business association, COSEP, expose they have been collaborating with the government in drafting several laws. As an illustration is the latest tax reform which Baez and Aguilar estimated that the big capital obtained more than a billion dollars (equivalent to the 9.3% of the GDP in year 2014) in tax breaks and a lower tax rate than in previous fiscal regime (INIET-ANJF 2015).

In like manner the influx of foreign resources and discretional of funds of Venezuela has raised the relevance of the FSLN and its member as important economic actors. The most compelling evidence regarding to this matter is the report by Chamorro and Salinas that linked governing party members (specially the presidential family) with new acquired businesses: security enterprises, transportation companies, construction companies, hotels (Chamorro and Salinas 2011).

With attention to keep a positive public opinion to the performance of the government, several publication expose the acquisition of media cooperation's (OSF 2014): controls several radio stations, 4 of the 8 local TV channels and 2 of the 3 local newspapers "Diario Hoy" (Telenica.com 2015) and "El Nuevo Diario" (Diario Las Américas 2015).

Daniel Ortega's presidency from 2007 to today sees several donors withdraw their cooperation with NI due to deficits in governance and corruption. In May 2008, some donors in the Budget Support Group (BSG) of NI revealed concerns over the deterioration in governance and announced the suspension of aid until matters improved. In November of that year, irregularities and fraud allegations favored the ruling party in the municipal elections.

The BSG members then withdrew permanently, claiming infringement on free elections in NI (Oxfam 2010, 190-191).

Findings and Policy recommendations (Proposal)

This chapter describesthe findings from inclusive growth diagnostics (IGDs) as they relate to the country risk analysis for Nicaragua (NI), with focuses on transfer risks and political risks. It then recommends policies to resolve the identified problems.

Debt literature reveals that sustainability assessments consist of two separate analyses: one of transfer risk and one of political risk. Transfer risk analysis analyzes the evolution of different economic and financial variables as they pertain to the financial burden of a country's indebtedness and repayment capacity. Political risk analysis assessespolicymakers' willingness to repay debt. It also assesses what political actions may negatively impact macroeconomic stability and normal behavior among economic agents.

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The items chosen in this research show that transfer risk and political risk significantly limitcountries' repayment capacities, changing core variables of debt dynamics and increasing default probabilities. Political activitieshave repercussions on transfer risk. The cost of economic transactions can modify economic agents' behavior, affecting economic activity and aid effectiveness. The Paris Declaration of Aid Effectiveness, the ACCRA Agenda for Action, and other high-level Aid Effectiveness meetings show that the presence of HR can potentially increase aid effectiveness, and therefore lower probabilities of over-accumulating debt. Conversely, HR violations might increase political risk and lower repayment capacities by hindering economic growth and aid effectiveness.

By comparison, a decrease in HR violations could decrease political risks and increase repayment capacities by increasing economic activity and aid effectiveness. The level of respect for HR seems to dictate the assessment somewhat, as respect for HR would measurably decrease public expenditure in socioeconomic programs. Indebtedness levels also seem to dictate the availability of resources that provide public services promoting HR.

The relationship between political risk and indebtedness is exemplified in NI. Frequent HR violations (mainly civil and political) in NI have been found to be a direct source of political and macroeconomic instability. This has impactedNI's capacity to honor its financial obligations, as its governments' unsustainable policies were used to preserve power. Indebtedness was simply a symptom of HR violations, bad governance, and institutional problems.

Our historical analysis has shown how NI experienced political instability that turned a sustainable economic course unsustainable. High debt levels made NI unable to finance its social programs and repay its debt.

The adjustment programs which aimed to diminish that debt involved a reduction in the satisfaction of economic, social, and cultural rights. NI's current status is fraught with issues: electoral fraud allegations, partisan governmental behavior, and the approval of an unconstitutional Law 840.The study showed that restrictive fiscal and monetary policies on adjustment programs, those meant to resolve debt-related risk and macroeconomic imbalances, could advance economic performance, but produced negative externalities on the realization of HR. Structural adjustment policies reduced public (government) spending, lessening provisionsfor socioeconomic programs that protected those citizens most vulnerable to rights violations. Rising unemployment and poverty rates, as well as lower respect for fundamental workers' rights, led to demonstrations, riots, and rebellionsamid NI's structural adjustments.

Note that strengthening institutions through adjustment programs sought strengthen governance and institutions through legislation, but this ignored counterproductive partisanship withinNI's state agencies. The IMF´s and WB´s methodology to evaluate debt sustainability, the DSF, is no guarantee to measure appropriately Nicaragua’s debt sustainability given the result of HR violations have had on Nicaragua’s repayment capacity and conditioned its political stability. In the case of Nicaragua empirical evidence discloses that the real repayment capacity is the result of complex interactions between politics and economics that determines economic activity.

The review of the DSF discovered that the framework ignores HR issues in its methodology which inhibits the framework to: accomplish its mandate to provide guidance to multilateral and bilateral lenders that have incorporated HR elements in their development aid interventions ii) to consider HR violations, specially civil and political rights as a factor that undermines the quality of governance and institutions; iii) ignores HR impacts of the policies which reduce debt related risks.

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The indicators that Debt Sustainability Framework (DSF) and the Country Policy and Institutional Assessment (CPIA) use to evaluate governmentaland institutional functionality are incomplete.It does not account for local power dynamics, politics, violence, and exclusions that shape states' economic policies. According to the research, integratingHR elements and principles into the DSF is feasible. Following successes from the UN and OECD, the integration of HR elements in development cooperatives is not only is feasible, but also improves development outcomes. Section Two explained how respect for HR promotes economic growth andbuilds quality governance and institutions. Similar findings regarding aid effectiveness exist in the Paris Declaration on Aid Effectiveness and the Accra Agenda for Action.

Recommendations

The qualitative analysis links HR violations with issues of economic growth and political risks. It exposes a need to broaden the scope and depth of HR in NI's growth dynamics and political development to evaluate its ability to repay its debts realistically. Therefore, an econometric regression stands to assess the presence of a linear or non-linear correlation between these phenomena (as variables):

- HR and political instability,
- political instability and debt, and
- HR and debt.

Independent institutions should conduct such assessments to eliminate conflicts of interest among duty bearers, duty holders, and donors. Additionally, a multidisciplinary team should evaluate how development aid impacts NI's economy, governance, institutions, and HRstanding.

Also, it should assess the externalities that such programs' reforms may produce.Ideally, one needs only to build upon the current DSF to more accuratelyassess a country's ability to generate resources and to evaluate its institutions.

Subsequently, the external environment would serve to assess how loans assist or hinder economic growth, as well as assess public spending of those finances. Strengthening the preventive capacities already contained within the DSF would require a more detailed review of macroeconomic assumptions, governance, and institutions.The study advises the inclusion of respect for HR in institutional analyses by addressing power dynamics around which governmental and institutional quality pivot. Conductingan in-depth study of NI's governmental and institutional functionality, as well as its respect for HR,will improve how the DSF monitors political instability in its debt sustainability analysis.

Thus, the research proposes the adoption of the UN's HRBA to NI's economic development, and that the debt sustainability framework use a CPIA which includes HR assessments.

Conclusions

A methodological problem was identified in the DSF, the omission of political risks and HR violations, which were identified in the inclusive growth diagnostic as important sources of constraining Nicaragua's economic growth (repayment capacity) ability to obtain development aid. Additionally, the CPIA fails to consider the link between political risk emanated from HR violations as a source of lowering the quality of governance and institutions.

The DSF fails to fulfill its mandate to provide guidance to lenders by the inability to guide development agencies that have incorporated HR elements in their aid interventions.

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The study reveals that structural adjustments in the past made significant improvements in macroeconomic stability and not only improved civil and political rights but undermined economic, social and cultural rights. The reduction of macroeconomic instability indicators such as hyperinflation, unstable exchange rate, high public deficit and high public debt are clear signs of success. The adjustment programs can integrate HR to evolve from an exclusive macroeconomic emphasis to a more integral perspective taking into account socioeconomic indicators and governance.

Although external debt levels have fallen due to individual debt reliefs, multilateral debt relief initiates, official development aid and grants by themselves does not guarantee the maintenance of sustainable debt levels once these resources stop or diminish significantly.

Nicaragua's history reveals that high human rights violations, especially civil and political rights, lead to political instability that undermined macroeconomic stability that disturbed macroeconomic stability that stimulated indebtedness as a response to solve the temporarily shortages of resources. Comparatively once Nicaragua reached high debt levels, the expenditure to honor its debt consumed most of its revenues and was unable to meet the growing needs of the population and the protection of economic, social and cultural rights.

The research confirmed the theoretical inconsistency keep political risk assessments independent from debt sustainability framework. The historical evidence of Nicaragua suggests political risks are important in keeping macroeconomic stability and prudent debt management. This variable portrays a pattern in the Nicaraguan history that endogenous elements of political risks led to macroeconomic instability, violence and ultimately accumulation of external debt to unsustainable levels.

The qualitative results expose for Nicaragua that the repayment probability cannot be only explained by debt to economic indicators and reveals the need to incorporate political risk assessment to explain debt related risk.

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