

**MILLENNIUM CHALLENGE CORPORATION  
CONGRESSIONAL NOTIFICATION**

July 18, 2005

PROGRAM:	Eligible Countries
APPROPRIATIONS CATEGORY:	FY 2004 Program Funds
OBLIGATION AMOUNT:	\$175,000,000

In accordance with section 610 (b)(1) of the Millennium Challenge Act of 2003 (the “Act,” Pub. L. 108-199, Division D), this is to advise that the Millennium Challenge Corporation (MCC) has entered into a Compact with the Government of the Republic of Nicaragua pursuant to Section 609 of the Act. The United States, acting through MCC, and the Government of the Republic of Nicaragua executed the Compact on July 14, 2005. The provisions of the Compact will enter into force pursuant to Section 1.3 of the Compact, including satisfaction of certain conditions set forth in Section 4.1.

A detailed summary of the Compact follows along with a copy of the text of the Compact.

**Summary of the Millennium Challenge Compact  
with the Republic of Nicaragua**

**I. Introduction**

Once one of the faster-growing countries in Latin America, Nicaragua fell into a state of severe economic collapse in the 1980s and only began a process of slow macroeconomic recovery in the last few years. Looking toward the future, Nicaragua now has an opportunity to achieve growth by taking advantage of regional economic integration and trade openings. The recently-approved MCC program (“Program”) will help the country to build the necessary capacity to take full advantage of these opportunities.

The Government of Nicaragua (GON) presented MCC with a strategy to achieve economic growth and poverty reduction by building the productive capacity of the departments of León and Chinandega, a region with proven growth potential due to its fertile land and connection to international markets. After extensive consultations, the Nicaraguans identified insecure property rights, under-developed infrastructure, and low-value rural business activity as the greatest barriers to growth, and developed a proposal to address them with MCA assistance. The Program will contribute to improving the lives of the 800,000 residents of León and Chinandega by raising household incomes in the region and also will benefit the country by transforming the region into an engine of economic growth. The Program has three objectives:

1. Increase investment by strengthening property rights in León. (Property Regularization Project)

2. Reduce transportation costs between León and Chinandega and domestic, regional and global markets (Transportation Objective Project)
3. Increase profits and wages of farms and enterprises in León and Chinandega (Rural Business Development Project)

The five-year, \$175 million Compact will help Nicaragua accomplish these objectives as outlined below.

## **II. Program Overview and Impact**

### **1. Property Regularization Project (\$26.5 million)**

Insecure property rights, high land transaction costs, and inefficient property registration services undermine enterprise development, investment, and rural income growth in Nicaragua. To address these problems, the GON is focusing on legal, judicial, and institutional reforms at the national level. At the regional level, the Property Regularization Project will expand to León an existing World Bank project in Chinandega, Proyecto de Ordenamiento de la Propiedad ('PRODEP'), thereby leveraging PRODEP's implementation experience and structure. Combined, these efforts will lay the foundation for increasing investment and income.

The Activities of this Project include:

1. Institutional Capacity Building: Provide technical support to government institutions to implement and sustain tenure regularization reforms in León.
2. Cadastral Mapping: Conduct area-wide cadastral mapping in León to obtain current property descriptions to be recorded in a geographic information system.
3. Land Tenure Regularization: Clarify land tenure, resolve disputes, and improve formal documentation of property rights.
4. Database Installation: Link municipal and national registry and cadastral databases.
5. Protected Area Demarcation: Demarcate and legally validate the boundaries of four environmentally-sensitive protected areas, regularize land rights within the perimeter of each, and facilitate the adoption of land use management plans by occupants therein.
6. Analysis and Communications: Fund short-term technical assistance, policy analysis and outreach to promote participation in, use and sustainability of the improved property registration system.

*Benefits:* This Project will work to eliminate the institutional and regulatory barriers preventing productive investment in property in León. Eliminating these barriers will contribute to improving the investment climate, increasing the asset value of land, reducing land-related social conflict, encouraging intelligent management of regional natural resources, and strengthening local government land use planning.

### **2. Transportation Project (\$92.8 million)**

High transportation costs are a significant constraint to economic growth, particularly for agriculture and small- and medium-sized rural businesses. The Pacific Corridor, important for trade between Nicaragua and its neighbors, links producers and consumers in León and Chinandega to markets north in neighboring Honduras and El Salvador and south to Nicaragua's urban center.

Activities under this Project include:

1. N-I Road (segment of Pacific Corridor): Improve a 58-kilometer segment of the Pacific Corridor between Nejapa and Izapa.
2. Secondary Roads: Pave and upgrade key secondary routes to link rural producers to the primary road network.
3. Technical Assistance: Provide technical assistance to the Ministry of Transportation and Infrastructure (MTI) and the Nicaraguan Road Maintenance Fund (Fondo de Mantenimiento Vial or FOMAV).

*Benefits:* This Project will reduce transportation costs, stimulate economic development, and improve access to markets and social services for road users. This will help Nicaragua, Honduras, and El Salvador fully realize the benefits of DR-CAFTA. A sustainable road maintenance mechanism will safeguard the funding of road improvements and lengthen road lifespan.

### **3. Rural Business Development Project (\$33.7 million)**

Despite a comparative advantage in the production, processing and marketing of agricultural products, over 70 percent of the rural population in León-Chinandega is poor. Producers, suppliers, service providers, processors, and marketing agents frequently work in isolation or are absent in the region. Women are less likely to participate in agricultural organizations, receive technical assistance or credit or plant higher profit-yielding crops, despite their significant presence as producers. The region also suffers from pronounced deforestation and water supply constraints to farming and other productive activities, especially the poor communities in the northern highlands.

The activities to be implemented under this Project include:

1. Rural Business Development Services: Expand higher-profit agriculture and agribusiness by providing business development services, disseminating market information, developing improved production techniques, and managing the two Project Activities described below.
2. Technical and Financial Assistance: To help small- and medium-sized farms and agribusiness transition to higher-profit activities, provide technical and financial assistance to these enterprises, including support that will directly offset certain costs of small farms; and
3. Grants to Improve Water Supply for Farming and Forestry Production: Based on a watershed management action plan, provide grants to improve the water supply for irrigation and facilitate higher value, sustainable agriculture and forestry in the upper watershed areas of the region.

*Benefits:* These activities will facilitate increases in the production of high-value goods and the profits and wages of farmers, agribusinesses and other non-farm businesses. These increases in profits and wages will translate into higher disposable incomes of families in the region, reducing the high incidence of poverty. In addition, these activities are expected to generate employment and contribute to a regional economy well-positioned to take advantage of national and international investment and market opportunities. Better water management will encourage more productive use of land and environmental sustainability, particularly for communities in the northern highlands.

#### **4. Measuring Outcome and Impact (\$3.3 million)**

The overall objective of the Program is to increase income and reduce poverty in León and Chinandega, and the Program's success will be measured by the increase in income of beneficiaries due to the Program. The Monitoring and Evaluation Plan will assess progress toward the achievement of the Compact's objectives and goal.

By the end of the Property Regularization Project, an estimated 70 percent of rural and 50 percent of urban properties (or ~43,000 land parcels) in León will have more secure, registered titles. Thousands of disputes over property rights will be expected to have been successfully mediated and the costs in time and money of conducting property-related transactions are projected to have been reduced by 50 percent. Together, this more secure investment climate and more efficient registration system will encourage investment and environmental protection. Farmers who have their land titles regularized by the Project are expected to increase investment in land improvement by 32 percent over five years. All four protected areas in León will be formally demarcated and occupant tenure will be regularized, allowing effective development and enforcement of land use management plans.

Road upgrades will reduce transportation costs between the region and domestic, regional and international markets for an estimated 3,300 current road users per day. Upgrading up to 100 kilometers of secondary roads is anticipated to reduce travel times and transport costs to markets and education and health services for rural communities. Improvements to the N-I road and the secondary roads are important for realizing the economic benefits outlined in the Rural Business Development Project as well as for stimulating new investments in Nicaragua as trade north from Managua to Honduras and El Salvador becomes more efficient and cost-effective.

Thousands of farmers will directly benefit from the Rural Business Development Project by receiving help with transitioning into higher-value agriculture. In addition, an estimated 7,000 jobs will be created. The additional profits and wages of farms generated as a result of the Rural Business Development Project are projected to total \$30 million annually, beginning six years after the Project's initiation. To ensure that the benefits from the Project are long-term, the Project will facilitate linkages among different actors involved in rural business, such as distributors and processors, and build local capacity to link producers to market opportunities. In addition, thousands of hectares of currently arid land will have improved water supply and be under sustainable farm or forest production.

#### **5. Program Management, Financial/Procurement Management, and Audit (\$18.8 million)**

MCA-Nicaragua, a legal entity, will be established to implement the Compact and is the entity ultimately accountable for Program success. This entity will consist of an independent Board of Directors, with central government, local government, and civil society representatives, that will oversee the implementation of the Program. It will also include a technical secretariat staffed with full-time professional staff that will provide daily management of the implementation of the Program. In addition to having observer status on the MCA-Nicaragua Board, MCC will retain approval rights at a number of key decision points during implementation, including key steps in procurements, budgets for Project Activities, major re-disbursements and key personnel decisions.

The Rural Business Project will be managed by competitively hired professional staff who will reside in an office (“Rural Office”) located in the region. For the Property Regularization Project, the Compact will fund additional staff and activities within the existing World Bank implementing unit (PRODEP). For the Transportation Project, management, construction, and supervision will be handled by competitively procured firms that will coordinate closely with the Nicaraguan Ministry of Transportation and Infrastructure.

A competitively selected joint venture of international private-sector accounting/consulting firms will serve as the Fiscal/Procurement Agent (Agent) for the Program. The Agent will provide professional services for (1) funds control, disbursement documentation and management, cash management and accounting; and (2) the planning, management and supervision of the procurement processes contemplated under the MCC Program.

The Board of Directors will engage auditors to conduct both financial audits and compliance audits of all financial and procurement activities. For the first year of the Program, audits will be conducted every six months. For subsequent years, the MCC will consider whether audits should be conducted more or less frequently than every six months. An auditor will be competitively selected from a list of approved auditors to be provided by the MCC Inspector General.

### **III. Assessment**

#### **1. Economic Analysis**

The Property Regularization Project has an economic rate of return (ERR) of 29 percent. Clearer definition of property rights through improved land titles is expected to benefit the economy by increasing the private returns to investments on land, improving the ability to use land to leverage credit, reducing high costs of land-related transactions, and reducing the need for defensive expenditures to protect property rights. The preferred basis for estimating economic returns is to combine estimates of increases in land values (reflecting new economic benefits of having land) and savings in transactions costs.

The ERR for the Transportation Project is estimated to be 13 percent. This return is the weighted average of the returns for two activities: N-I Road (23 percent) and Secondary Roads (8 percent minimum). The economic benefits from the Transportation Project derive both from the direct benefits of reduced transportation costs and from the stimulus to new investment from lower transportation costs. The stimulation of new businesses and investments due to lower transport costs are more difficult to measure, but are likely to increase the economic benefits. Sectors whose ratio of transport costs to production price is relatively high, such as agriculture and agro-processing, are likely to receive new investments as a result of improved infrastructure. Additionally, improved transportation can have additional benefits through increased school enrollment and improved health outcomes. These indirect benefits have not been factored into the economic returns, so the ERR mentioned above is likely a conservative estimate of the gains from the Project.

The ERR for the Rural Business Development Project is estimated to be 15 percent, calculated as a weighted average of its activities. The return to the Rural Business Development Office was estimated to be 18 percent, based on projected costs, current crop profitability and employment generation. An estimated 7,000 new jobs will be generated as a result of this farm transition. The

specific activities for the improvement of water supply for farming and forest production will be determined over the course of the Program. These activities, however, will be required to achieve at least a 10 percent economic rate of return.

## **2. Consultative Process**

The technical team charged with developing the MCA proposal held numerous meetings and work sessions in Managua and the country's regional departments with leaders in the political and private sectors, non-governmental organizations (NGOs), and various associations. Many of the consultations included Nicaragua's Local Development Council (LDCs) – representative bodies at the regional department level whose members are elected from the public and private sector and civil society. The technical team also spoke with local farm and women's cooperatives, local business associations, and NGOs about the Program's technical details.

Nicaragua's consultative process for the MCA proposal resulted in three key outcomes: 1) a shift from a national to a regional focus, 2) the prioritization of proposal components, and 3) ongoing participation and ownership at the local level.

- 1) As discussions at the national and regional level progressed about Nicaragua's constraints to economic growth and poverty reduction, stakeholders came to focus on the departments of León and Chinandega, a region believed to have the greatest potential for economic growth as well as some of the most extreme poverty.
- 2) The León and Chinandega Development Councils—which collectively represent over 100 civil society, private sector, and local government organizations—provided crucial assistance to the GON technical team in developing and prioritizing the proposal components. The team also solicited feedback from other private sector and civil society organizations at the regional and national level.
- 3) The GON technical team continues to involve the Local Development Councils and other local groups and expects them to play an important role in program oversight, including having representation on the Board of the MCA-Nicaragua governing entity, an organization that will be established specifically to implement and oversee the Program.

## **3. Government Commitment and Effectiveness**

The Program has received a significant level of government attention from the President of Nicaragua, Ministers and their staff. The GON has also committed to make reforms as part of the Compact. These reforms include passing and enacting several laws which relate to MCC qualification criteria and to the implementation of components of the Compact (e.g. road maintenance funding, new law governing tenure regularization, etc.).

## **4. Sustainability**

Sustainability of the Property Regularization Project will be derived from the extent to which people use the improved registration system and from the fiscal capacity of the registry, cadastre and titling services. The incentives for people to use and pay for services as well as the costs of

services will be appropriate in the local context. Several recent policy reforms (e.g., new cadastre and registry laws) and proposed reforms (e.g., tenure regularization law) will bring about new institutional relationships and operational practices that will more effectively facilitate the process for keeping property records up-to-date. The GON's ability to maintain modern, computerized land records and maps and a well-trained staff will depend on both an adequate public budget and the GON's ability to set and collect fees for services. More accessible, reliable and efficient services will likely increase the willingness of users to use the system and to pay for services. The new registry law will provide an autonomous budget for the registry so that it can more rationally project its costs and revenues and set fees and budgets accordingly. This Project includes specific support for training, technical assistance and analysis of policy, fee structures and other measures to help ensure sustainability.

The technical assistance activities in the Transportation Project will promote institutional sustainability as well as the policy reforms in the Compact. The Program will include conditions that have specific targets, by date, for funding escrows required for maintenance. In addition, the GON has agreed that if it has not satisfied its funding obligation by year two of the Project, certain elements of this Project will not be funded any further. The GON also expects municipalities to cover a significant portion of maintenance costs for the secondary roads.

The Rural Business Development Project's primary objective is to increase the economic viability of farmers and agribusinesses in the region. Initially, a Rural Office will be established as a division or subsidiary of MCA-Nicaragua based on the view that the impacts must be sustainable. Selection criteria for activities funded under the Project will include their potential for self-sustainability. Expanded horticultural production will create economies of scale that reduce the unit costs of inputs and post-harvesting services. The Project is expected to improve rural access to finance through its financial literacy campaign and by promoting 'bankable' business activities. The watershed management action plan will provide a basis for improving environmental sustainability of land uses throughout the region, and beneficiaries will be assisted in establishing business models that will pay the costs associated with maintaining investments over time.

## **5. Environmental and Social Impacts**

### *Property Regularization Project*

Overall, this Project is expected to be positive from an environmental and social point of view. PRODEP promotes the conservation of forests and other natural habitats directly through the strengthening of existing protected areas. A Project-specific environmental plan will be developed, similar to the plan in place for PRODEP's work in Chinandega, to monitor potential negative impacts. The Project also will (i) identify measures to facilitate increased access by poorer households to land via land markets, (ii) help advance gender equity in land tenure regularization to empower women property owners, and (iii) work to gain consensus on indigenous community land rights within the context of tenure regularization.

### *Transportation Project*

While the majority of the works under this Project will occur along existing rights-of-way, this Project qualifies as a significant rehabilitation. For some of the roads, this rehabilitation will fundamentally change the nature of the traffic, and therefore the impacts after construction.

Comprehensive road-specific Environmental Impact Assessments (EIAs) have not yet been conducted; however, each of the roads to be improved under this Project will require completion of environmental analysis acceptable to MCC. The Project budget includes funds to conduct the requisite environmental analyses.

### *Rural Business Development Project*

Activities under this Project could potentially have adverse environmental impacts that are site-specific and largely mitigable. The Compact specifies the environmental review criteria for activities sponsored by the Project and describes the environmental sustainability principles for the agricultural and agribusiness technical assistance. The activity to improve watershed management, in particular, will have significant positive environmental impacts. Nicaragua has one of the highest rates of deforestation in the region, resulting in decreased soil productivity, significant erosion, and flooding. In addition, the Estero Real estuary in the region is one of the most important ecosystems in Central America and one of its most vulnerable. It is vital for shrimp production and as a sanctuary for migratory birds and endangered species, and serves as a natural flood control system. Improvement in soil conservation and reforestation in the Project area will positively benefit this sensitive ecosystem.

## **6. Donor Coordination**

The proposed Projects complement and supplement efforts by other donors. Nicaragua's Program calls for increasing rural incomes and financing infrastructure. USAID, USDA, the World Bank, the Inter-American Development Bank (IDB), IFAD, NDF, UNDP, and other development agencies are all active in supporting various rural development activities. Work to upgrade the Nicaraguan Pacific Corridor is being funded by the World Bank, the Central American Bank for Economic Integration, and the Nordic Fund. In addition, the IDB and World Bank have funded projects to strengthen the capacity of MTI and the Road Maintenance Fund. Further coordination with the larger donor community will include participation by MCC in the Infrastructure and Rural Development Donor Coordinating committees chaired by the GON. The Rural Office also will assist farmers and agribusinesses in the region to gain information on and access to programs sponsored by other donors.

## **IV. Summary and Conclusion**

Nicaragua's MCC Program focuses on creating a regional engine for economic growth in the northwestern part of the country by transforming the rural business sector into a high-value, sustainable corridor that is primed for greater trade with regional and international markets. The Program complements economic growth strategies such as The Dominican Republic-Central America-United States Free Trade Agreement (DR-CAFTA) and enjoys broad support from civil society. The Property Regularization, Transportation, and Rural Business Development Projects will build the capacity of León and Chinandega to accelerate the economic transformation from subsistence farming to a demand-driven, market-oriented, rural business zone. The combined effect of these three core Projects will have a positive impact on economic growth and poverty reduction in Nicaragua.