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Nicaragua Business: Cautious Optimism

President Daniel Ortega is getting the benefit of the doubt from local and foreign investors.

Michael Cobb is going full speed ahead with his mega-project in Nicaragua - the Gran Pacifica Beach & Golf Resort. The project includes condominiums and villas next to a golf course and beach on Nicaragua's Pacific coast, one hour north of capital Managua. So far, the company has invested \$14 million and now plans to start two new condo buildings worth \$4 million.

Cobb, the U.S.-born CEO and co-founder of the project, is not deterred by Daniel Ortega, a leftist former president who returned to Nicaragua's presidency in January. "The reality is that President Ortega is saying the right things and doing the right things," he says. "Private property rights are being protected...The local economy is humming right along."

Other investors include U.S.-based International Textile Group, which is building a \$100 million, Cone Denim assembly factory in Nicaragua, and Carlos Slim, Latin America's third-richest man, who is boosting business and social investments in the Central American country. "In Nicaragua there are a lot of opportunities for investment," Slim said after meeting Ortega in Managua last month.

The investments stand in contrast to Ortega's first presidency (1979-90), when private property was expropriated, inflation skyrocketed and the economy went into freefall as the government implemented radical economic policies and aligned the country closely with Cuba and the Soviet Union.

A DIFFERENT ORTEGA

However, Ortega says he has changed and has pledged to respect private property rights and foreign investment, while maintaining relations with the United States and multilateral institutions like the International Monetary Fund and the World Bank.

"I think it's too early to make an opinion regarding this issue," says Jorge Arias, general manager of the Nicaragua operations of U.S.-based car rental agency Avis. "But I'm not waiting [restrictive] economic policies from the Ortega Administration."

Jerry Haar agrees. "It is ludicrous to think that Daniel Ortega would alienate current and potential investors -- local as well as foreign," says Haar, a professor of management and international business and associate director of the Knight Ridder Center for Excellence in Management in the College of Business Administration at Florida International University. "Possible tax reform, anti-inflation policies, and judicious management of internal and foreign debt are positive signs."

In fact, so far Nicaragua continues with the same national budget that was prepared by the prior administration, with some increases in education and health, points out Rene Gonzalez, managing partner at KPMG in Nicaragua and the president of the American Chamber of Commerce in Nicaragua.

"The current government has not [yet] set up the course that the Nicaraguan economy will take," he says.

IMF MEETINGS

Meanwhile, initial meetings with the IMF have been held aimed at reaching an agreement over a new standby program. "This program will indicate the strategy the country will implement to manage its economy," Gonzalez argues. "That strategy must be aligned to obtain a balance between the macroeconomic stability and the efforts put into poverty reduction through investment in the social programs that the country urgently needs."

The Nicaraguan government is scheduled to meet with the IMF next month to present its plan. It will likely include some changes to the tax system, keeping tax exemptions for sectors that generate many jobs and reducing or abolishing those for the sectors that don't, according to statements by Bayardo Arce, an economic advisor to the government, to Spanish news agency EFE last week.

Ortega inherited an economy that has been growing an average of 3.2 percent the past five years. Last year, it grew by 3.7 percent. The economy has been helped by exports of coffee, coffee, beef, shrimp and lobster, tobacco, sugar, gold and peanuts, a growing tourism and real estate sector as well as remittances from Nicaraguan workers abroad and foreign government aid and credits.

Real estate companies like Coldwell Banker and Re/Max are promoting Nicaragua as an attractive real estate destination, helped by its low prices and expected future growth. (See [Real Estate: Nicaragua Optimism Despite Ortega](#)). Last year, remittances reached \$950 million, a 11.8 percent increase from 2005, according to the Inter-American Development Bank.

Inflation, meanwhile, reached 8.6 percent last year - a slight decline from 2005. It grew an average of 7.6 percent in the five-year period 2002-06.

Despite the steady economic growth, most experts agree that Nicaragua needs much higher growth to reduce its widespread poverty. Nicaragua is the second-poorest country in Latin America, measured both in GDP size and GDP per capita. Nearly half - 48 percent - of the population live below the poverty line, according to 2005 data from the CIA.

NO CHAVEZ

Ortega won the November presidential elections on a platform emphasizing poverty reduction. But despite his radical past and his close relation with Venezuela's investor-hostile president Hugo Chavez, most foreign analysts don't expect Ortega to follow similar policies.

"Chavez has oil, Ortega doesn't; therefore the former can do what he pleases, the latter cannot," Haar says. "I believe Ortega will pursue the macroeconomic policies of recent administrations combined with heavy attention to social issues (education, housing, health, social services). State intervention will be restricted to the most part to those functions and services of a social nature of within the economic sphere, such as tax policy, where intervention will provide benefits to the mass of the population. Poverty reduction is one of Ortega's highest priorities."

Carlos Caicedo, head of the Latin American office at UK-based risk consultancy Exclusive Analysis, concurs. "We see Ortega heed a balance between keeping CAFTA alive ... having a working relation with the U.S. and also keeping the IMF engaged in the country," he says. "We don't expect ...confiscations, nationalization – all the radical policies in Venezuela or Bolivia."

Unlike Chavez, Ortega does not control the legislature and depends on support from moderating parties and groups, both Haar and Caicedo argue. "Ortega's party does not control the legislature and his alliance partners come from a variety of ideological orientations -- mainly conservative and pro-business. "Pragmatism" will be the word of the day," Haar says.

THE PACTO

Ortega's main alliance partner is the PLC party led by former president Arnaldo Aleman (1997-2002). "Ortega ...has become a very pragmatic politician," Caicedo says. "He mainly cares about staying in power. He doesn't mind who will be his political ally as long as he can control of congress. And he has found in ... Aleman the right person to do this."

In fact, Ortega's alliance is not new. As far back as 1999, he reached an agreement with the Aleman to divide power between them. The agreement, known as the *pacto*, undermined the administration of President Enrique Bolaños (2002-07) and led to Ortega's party, the FSLN, effectively controlling most of Nicaragua's judiciary.

"Nicaraguans now assume as a matter of course that resolving a major court case requires making sizeable payments to cronies of Ortega or Aleman; indeed, legal prosecutions are often nothing more than financial extortions in the first place," Richard Feinberg, a former Latin America advisor to President Clinton, wrote in *Latin Business Chronicle* last fall.

The *pacto* has also led to Aleman receiving special favors from Nicaraguan courts. Although he received a 20-year jail sentence in 2003 on corruption charges, the sentence was later changed to conditional freedom, restricting Aleman to Managua. Nine days ago, he announced that the parole was again softened so he could travel freely throughout the country. He publicly thanked Ortega for helping him.

Aleman is still wanted in Panama on charges of using 60 bank accounts to launder \$57 million in embezzled funds, facing a civil trial in Miami due to allegations that he bought U.S. bank certificates with embezzled money and barred from traveling to Spain and 14 other European nations.

Both Ortega and Aleman - who were one time enemies - say their alliance forms part of a policy of reconciliation.

As for relations with the United States, both Ortega and U.S. officials have expressed a desire to work together despite the growing relations with Venezuela.

"Ortega can call the shots on this one," Haar says. "Here he is in a stronger position than either the U.S. or Venezuela. The U.S. cannot afford to have him jump into bed with Chavez; and Chavez needs at least some lip service, if not action, to his "21st century socialism." Neither the U.S. nor Chavez will push Ortega to choose, fearing that the push could drive him into one camp of the other. All parties know this. Ortega will need to be a clever political juggler like [Pakistani strongman] Pervez Musharraf or Bill Clinton."

So far Ortega's balancing act appears to have paid off. According to a CID-Gallup poll published in *La Prensa* newspaper last month, Ortega enjoys the support of 61 percent of Nicaraguans. That's higher than any other leader in CAFTA. That's also nearly double the 37.9 percent he received in the presidential elections.

BENEFITS

So what is luring foreign investors like Cobb and Cone Denim to Nicaragua? Real estate developers can buy large amounts of property at attractive prices, Cobb points out. Many real estate investors see Nicaragua as the "next Costa Rica" - with property prices expected to gain value over the next few years as more and more U.S. baby boomers choose to retire in the country.

Labor is also a plus. "Labor costs are low and the labor pool is plentiful," Cobb says.

Last, but not least, the climate is attractive for developers and tourism industry officials. Gran Pacifica, for example, can offer year-round warm weather. And being on the Pacific coast, it benefits from dry weather - except for the rainy season from May through October.

Local and foreign investors have the same rights in Nicaragua, Arias points out. Foreign investors also benefit from special fiscal exemptions and incentives, especially in tourism.

"Nicaragua offers great business advantages, such as a young and fast-learning workforce, modern telecommunications infrastructure, very high levels of personal safety and emerging productive sectors that represent great potential for investment," Gonzalez says.

And Nicaragua has economic sectors with competitive advantages, such as the textile industry, food-processing, tourism, forestry, agriculture and livestock, beef, dairy products, energy production/distribution, fisheries and aquaculture, he points out.

"Nicaragua offers many competitive and comparative advantages because of its geographical location, natural resources, long beaches in the Pacific and Atlantic, significant investment incentives, competitive costs and clear stable and regulations," Gonzalez says.

Nicaragua's economy is also more open than those of countries like Guatemala and Honduras, according to the Heritage Foundation. Nicaragua's economy is 62.7 percent free and thus "Moderately Free" Heritage says in its 2007 survey on economic freedom.

And thanks to high trade levels and remittances, Nicaragua is the third-most globalized country in Latin America, according to the Latin American Globalization Index 2006. Only Panama and Costa Rica are more globalized. The index looks at such factors as exports of goods and services as a percent of GDP, imports of goods and services as a percent of GDP, foreign direct investment as a percent of GDP, tourism receipts as a percent of GDP, remittances as a percent of GDP and Internet penetration.

CAFTA SUCCESS

And then there's CAFTA. The free trade agreement between the United States, Central America and the Dominican Republic (officially known as CAFTA-DR) was signed in 2004 and implemented in Nicaragua a year ago.

No other CAFTA country has benefited as much as Nicaragua, according to a *Latin Business Chronicle* analysis of trade data. Last year, total Nicaraguan trade with the United States reached \$2.3 billion, an increase of 26.3 percent from 2005. That was highest percentage increase within CAFTA and the third-highest increase in all of Latin America. By comparison, the average CAFTA growth in trade with the United States was 9.2 percent.

Most importantly, Nicaraguan exports to the United States - which generate badly-needed revenues - grew by 29.2 percent to \$1.5 billion, according to the U.S. Census Bureau. While Nicaragua still trails behind the other CAFTA countries in terms of the size of exports to the United States, CAFTA shows the potential for further growth, experts say.

And CAFTA is also bringing more investment into Nicaragua, partly lured by the investment guarantees it offers. "The DR-CAFTA will trigger investment incentives for those investors interested in certain goods and services," Gonzalez says.

However, CAFTA is by no means bulletproof. "An agreement is only as good as the willingness of its signatories to abide by both the spirit and letter of the accord," Haar says. "CAFTA provides a guarantee, but CAFTA was not elected president of Nicaragua."

CHALLENGES

Despite the cautious optimism, Nicaragua has suffered from the election victory of Ortega. The country's political risk has grown the past year, according to Caicedo. And sales at Gran Pacifica are down 20 percent from last year, largely due to the perception of the consequences of an Ortega victory, Cobb acknowledges.

Ortega's close alignment with Chavez and countries like Iran - an international pariah state - has also raised concern among local and foreign investors. Two weeks ago, Chavez and Ortega signed several agreements that enable Nicaragua to receive Venezuelan oil at favorable prices. At the same time, Venezuela plans to build a refinery in the country and provide development assistance. In February, Ortega hosted Iranian President Mahmud Ahmadineyad and proclaimed that the 1979 revolutions in Nicaragua and Iran were similar in that they brought freedom and democracy to their people.

There are also other, more practical, challenges facing local and foreign investors in Nicaragua. When Cobb started building Gran Pacifica he also had to develop the infrastructure around it, from water and sewer to telecommunications and electricity. And with Nicaragua being seen as a high-risk country, financing remains a challenge, Cobb says.

Corruption is also a problem. Nicaragua scores 2.6 on the latest corruption survey from Transparency International, where 10 is best. That makes it the second-most corrupt country in Central America behind Honduras.

Nicaragua's economy also suffers from low competitiveness compared to other countries. Nicaragua has the least competitive economy in Central America and the third-least competitive economy in Latin America, according to the 2006 Global Competitiveness Index from the World Economic Forum.

All in all, Nicaragua is the second-worst place to do business in Central America and the fourth-worst in Latin America, according to the latest Latin Business Index published by *Latin Business Chronicle*. Nicaragua is better than Honduras, but worse than its other Central American neighbors, according to the index, which looks at factors such as the macro environment, globalization & competitiveness, business environment, technology level and political environment in 19 countries.

ELECTRICITY PROBLEMS

Nicaragua's poor infrastructure - especially ports and airports - are also a challenge, as is the lack of stable electricity, Arias says.

Nicaragua suffers from frequent blackouts. Ortega has blamed Spanish power company Union Fenosa,

which controls Nicaragua's two distribution companies. Union Fenosa, however, blames the problems on users who are not paying their bills.

Nicaraguan legislators earlier this month raised the penalties on electricity theft. Meanwhile, electricity regulator INE has launched arbitration proceedings against Union Fenosa, which may end with the contract being receded.

The uncertainty surrounding the contract, combined with the tone of Ortega's criticism against Union Fenosa - and the Spanish Embassy when it tried to defend the Spanish company - has raised some concern among business people.

"The renewed uncertainty over Union Fenosa's contract coincides with an appeal by President Ortega for businesses in Central America and the Caribbean to invest in the electricity sector in Nicaragua," U.S.-based consultancy Global Insight said earlier this month. "These contradictory messages being sent out by the President will not send out a positive signal to investors."

However, Caicedo expects there will be more fall-outs like this between foreign businesses and Ortega. But it will be limited and on a case-by-case basis and not form part of a larger anti-business policy, he forecasts.

REFORMS

So, what should the government do to make life easier for local and foreign investors?

"The reforms that the government must do to make private and local foreign investment more attractive are those related to judicial security [resulting in] a full and complete rule of law," Gonzalez says.

Nicaragua also needs an integral fiscal reform, which should fairly distribute the fiscal charges, but also provide incentives for investment in tourism, energy, agribusiness and technology, he adds.

"A state reform must be elaborated to straighten democracy and make the state more efficient, [a] better regulator and [major] facilitator to make the country more competitive," Gonzalez says.

To create confidence in the local and foreign investors, it is essential to have political and economic stability, argues Arias.

OUTLOOK

Nicaragua's economy is expected to grow by 4.2 percent this year, the IMF forecasts. That's better than last year's growth. However, some sectors of the economy are slowing down. Coffee exports will be significantly reduced because of a decrease on harvests, Gonzalez points out. The coffee decline will result in agricultural output only growing by 2.0 percent this year (down from 3.0 percent), Haar says.

So far there has been a slowdown in house sales and imports as well. The sales of homes fell by 30 percent during the first two months this year, the Nicaraguan construction chamber told *La Prensa* on Friday. However, construction of supermarkets and malls is growing.

On the positive side, Nicaragua should see an increase in remittances, which possibly can reach as much as \$1 billion this year, Gonzalez says. Tourism revenues are also expected to grow to as much as \$300 million, he predicts.

And exports of sugar, peanuts, other agricultural products and agribusiness exports will cushion the coffee decline, Haar believes.

Meanwhile, Cobb remains bullish. With 80 million U.S. baby boomers about to retire and three million Americans seriously considering Central America, projects like Gran Pacifica are expected to benefit, he believes.

"We're moving ahead," Cobb says.