

## Taxes for a better future



The country will not be able to adopt a sustainable development model unless it can overcome its current lack of resources. The country has serious environmental problems including over-exploitation of the soil, the near-exhaustion of fishing resources, increasing deforestation due to indiscriminate tree cutting and unsustainable practices in agriculture, and overdependence on coffee as a cash crop, which depletes soil fertility and pollutes water resources. Yet the State's coffers are empty. The way forward is to completely reform the taxation system to make it fairer, and to invest the extra funds in education and in promoting methods of production that cause less damage to the environment.

### Coordinadora Civil

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If Nicaragua is to implement policies to promote sustainable development it needs far more resources than are currently available, so the tax system will have to be changed to increase revenue. Development assistance is also decreasing in absolute terms and as a percentage of GDP, and the only way to cover the shortfall is to raise more income from taxes.

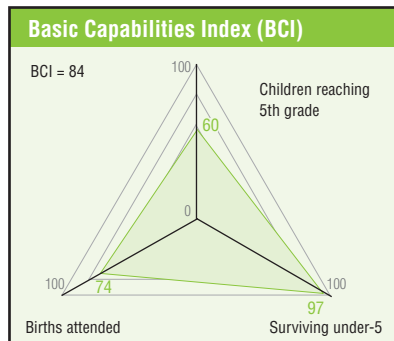
For the State to maintain adequate investment in human capital, basic infrastructure, social protection, and to pursue its equity goals, a greater portion of the burden of financing this expenditure will have to be borne by the higher income strata of society rather than the middle and lower strata (see box on Coordinadora Civil proposal).

Furthermore, this need for added finance responds to a basic principle of a sustainable economy, which is inter-generational fairness, a concept defined in 1974 by James Tobin: "The trustees of endowed institutions are guardians of the future against the claims of the present. Their task in managing the endowment is to preserve equity among generations."<sup>1</sup>

### Environmental challenges

Nicaragua does not have a sustainable development model, which is all too evident when we consider how poorly successive governments have performed in terms of administering the country's natural resources. For example, water reserves are being depleted due to pollution and deforestation, and this has not only increased the cost of the investment needed to provide the population with drinking water but has also reduced the amount of water available for agriculture and for the generation of hydroelectric energy.<sup>2</sup>

Moreover, the country is losing 75,000 hectares of forest a year because of illegal tree cutting and slash-and-burn agricultural practices which often cause huge forest fires. Another factor is that currently 76% of the fuel used for cooking is wood.<sup>3</sup>



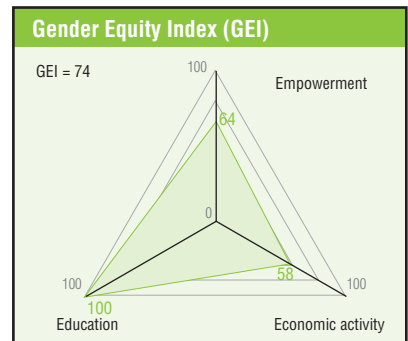
This deterioration of the forests also contributes to soil erosion, which in turn poses a danger to agriculture.

In June 2011 the Government expressed concern about this bleak scenario and announced that it had managed to reduce the rate of deforestation by 50%.<sup>4</sup> However, of the country's 12 million hectares of forest more than 8 million are still degraded.

Another aspect of Nicaragua's unsustainable economic growth model is the over-exploitation of fishing resources. For example, lobsters are being extracted at twice the species' natural replacement rate, and this problem is exacerbated by the Government's failure to take adequate measures to combat illegal fishing.<sup>5</sup>

There is also the shrimp farming industry, which has not only inflicted serious damage on the mangrove swamps and wetlands of the Pacific coast but polluted other bodies of water through the dumping of waste and toxic chemicals.

Waste is a problem in urban areas too. The way solid waste is managed in cities is inadequate causing increasing problems as rubbish tips are spreading in densely populated areas. This, added to an overall lack of urban planning, has made the poorest sectors of the population more vulnerable to disease and to the effects of natural and environmental disasters. It goes without saying that their increased vulnerability puts the country in a



delicate situation in the face of the various impacts of climate change.<sup>6</sup>

However, Nicaragua's biggest environmental problem is over-dependence on coffee cultivation. Some 26% of agricultural enterprises produce coffee, accounting for 15% of all cultivated land and 25% of the land devoted to export crops.<sup>7</sup> Data from the Centre for Nicaraguan Exports (Cetrex) indicates that "in the first five months of the harvest (from October 2010 to February 2011) coffee earned USD 154 million, which was around USD 85 million more than was generated in the same months in the 2009-10 harvest."<sup>8</sup> However, the intensive cultivation of coffee is extremely aggressive in terms of environmental degradation as it leads to deforestation, the loss of biodiversity, pollution with agro-chemicals, soil erosion, and worst of all the exhaustion of water resources, since both growing and processing coffee requires a great deal of water.<sup>9</sup> Nicaragua's natural environment was pillaged and devastated for more than a century by

<sup>6</sup> Ibid.

<sup>7</sup> L. Castrillo, "El Café Nicaragüense," *Nicabilingüe*, <nicabilingue.com/index.php?option=com\_content&view=article&id=46:el-cafe&catid=43:medio-ambiente&Itemid=49>.

<sup>8</sup> Cited in América Economía, *Cosecha de café en Nicaragua crece 8,6% y reporta US\$154 millones*, (22 March 2011), <www.americaeconomia.com/negocios-industrias/cosecha-de-cafe-en-nicaragua-crece-86-y-reporta-us154-millones>.

<sup>9</sup> N. Pérez Díaz, R. M. Castillo Ramos, L. R. Carballo Abreu, J. Á. Veliz Gutiérrez, *Impacto ambiental en el cultivo y procesamiento del café y su repercusión social*, (Cuba: University of Pinar del Río), <www.monografias.com/trabajos-pdf/impacto-ambiental-cultivo-procesamiento-cafe/impacto-ambiental-cultivo-procesamiento-cafe.pdf>.

<sup>1</sup> J. Tobin, "What Is Permanent Endowment Income?" *American Economic Review*, (May 1974), p. 427.

<sup>2</sup> *Clima y ambiente de Nicaragua, Un cambio de actitud en el día de la Tierra*, (22 April 2009), <climayambiente.blogspot.com/2009/04/un-cambio-de-actitud-en-el-dia-mundial.html>.

<sup>3</sup> Ibid.

<sup>4</sup> Diario Web Centroamérica, *Nicaragua logró reducir la deforestación en 50 por ciento*, (7 June 2011), <www.diariowebcentroamerica.com/region/nicaragua-logro-reducir-la-deforestacion-en-50-por-ciento>.

<sup>5</sup> Ibid.

## THE COORDINADORA CIVIL TAXATION PROPOSAL<sup>1</sup>

The Coordinadora Civil taxation proposal is based on three basic principles:

- *The principle of universal taxation.* To be able to finance increased expenditure on investment in human capital, basic infrastructure and social protection, the State will have to expand the country's taxation base as much as possible. This means that, in principle, all persons resident in Nicaragua who have sufficient means must contribute to financing the services the State provides. Moreover, non-residents who obtain rents in the country must also be obliged to contribute. This would mean far-reaching changes to the current generous system of tax exemptions whereby whole sectors of the economy, usually the most dynamic and profitable ones, pay no taxes.
- *The principle of vertical equity.* People who are able to contribute more must make a greater relative contribution than people with lower incomes. This would mean doing away with the preferential treatment that rents and income from capital are granted, and obviously income of this kind is highly concentrated in the higher-income strata of the population.
- *The principle of horizontal equity.* People at similar economic levels must be treated in a uniform way by the tax system. It is unfair for two people who have the same capacity to contribute to pay different amounts (one paying more than the other) or that one should be taxed and the other not.

To put these principles into practice the basic pillars of the tax system, taxation on rents and value added tax will all have to be completely overhauled.

As regards the first principle, the proposal is that the income tax system should be changed. In the current system, separate and preferential treatment is given to passive income from capital or rents, and this is highly discrimina-

tory to the detriment of people who earn their income in wages and salaries as these are the only sectors that are subject to a scale of progressive marginal rates. This system will have to be replaced by a global scheme in which all income is treated the same. There will also have to be a change from a national criterion of tax jurisdiction to a world jurisdiction principle.

The adoption of a global income tax system means that in principle each contributor would be taxed on all his income regardless of the source of each item. The adoption of a world income tax jurisdiction criterion means that taxpayers resident in the country would have all their sources of income liable to taxation regardless of whether this income is generated in the country or abroad. This would mean each person's full income would be taxed, which would be a genuine application of the principle that each individual should pay in accordance with his capacity to pay. This scheme would not only greatly increase the tax yield, but facilitate the redistribution of resources through taxation and thus make it possible to achieve greater equity in the country, in a horizontal sense as well as vertically.

The income of non-residents would be treated in line with the international trend to use the principle of benefit to justify taxing the income of non-residents at source, and the principle of ability to contribute for taxes paid in the country. This involves splitting the power to levy taxes between the two principles, which is exactly what is in play in the context of international conventions to avoid double taxation.

In the plan to modernize the income tax system the proposal is to incorporate regulations that are in line with the financial and trade liberalization of the last ten years, which involve regulations governing the prices of transfers between different parties, thin capitalization and transactions with tax havens.

<sup>1</sup> See: <[www.ccer.org.ni/](http://www.ccer.org.ni/)>.

fruit companies and it cannot sustain the growth and expansion of the coffee industry indefinitely unless the State implements regulations on cultivation techniques so as to give the soil a chance to recover. There can be no sustainable growth if the land itself is barren and exhausted.

### Deterioration in education

Sustainable development has to do with the legacy of goods the people of today pass on to future generations. For this model to be successful the population has to be educated so they can exploit the human and natural resources they inherit in the best possible way, but in Nicaragua the outlook in this respect is discouraging. A survey by the consultancy firm M&R that was published in May shows that most people

think the country's education system is seriously deteriorating and the quality of teaching is perceived as being very poor and out of date. One factor in this dismal scenario is that teacher's salaries are far below average pay in the country.<sup>10</sup>

Of the people interviewed, 78.9% rated school infrastructure as being in bad or very bad condition and 70.8% perceived the quality of the education received as bad or very bad. Some 91.8% of the interviewees thought teachers' pay in State primary schools was bad or very bad, and 89.4% saw teacher salaries in State secondary schools the same way.

There was a general consensus that if the State significantly increased investment in primary and secondary education (to at least 7% of GDP) this would improve the situation and result in greater

education access and improved teaching quality. Some 92.8% of the people surveyed thought the Government ought to make a considerable increase in the budget allocation for education.

Similarly 93.5% said the country needs to establish a wide-ranging long-term national agreement so that, regardless of the party politics of the government in power at any given time, any policy geared to improving education would be respected and maintained in operation. However, it will only be possible for the State to reform education and pursue sustainable development if taxation is thoroughly overhauled so that extra funds over and above what the tax system yields today can be generated. The first objectives on the road to sustainable development can be summed up as taxation, preservation and education. ■

<sup>10</sup> See: <[www.ccer.org.ni/noticias?idnoticia=769](http://www.ccer.org.ni/noticias?idnoticia=769)>.