NEPAI PROJECT

Núcleo Especial para Analisis e Implementacion

HERITAGE FUNDATION INDEX OF ECONOMIC FREEDOM: ACTUALIZACION Y COMENTARIOS

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Preparado bajo Contrato USAID #524-0339-C-00-4015-00
Marzo , 1996
Managua, Nicaragua

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Marzo de 1996

HERITAGE FOUNDATION INDEX OF ECONOMIC FREEDOM ACTUALIZACION Y COMENTARIOS

I. Resumen de las Anotaciones

Indicador	*Original, 1995*	*Original, 1996*	*Revisionada 1996*
Politica Comercial	5	5	2 +
Tributacion	3	3	2+
Consumo Público	3	2	2
Política Monetaria	5 +	5	2 +
Flujos de Capital e Inversión Extranjera	3	2	1
La Banca	4	3	1 +
Controles de Salarios y Precios	3	3	3
Derechos de la Propiedad	4	4	3 +
Regulacion	4	4	3
Mercado Negro	5	5	3
Global	3 9	3 6	2 5

La Fundacion Heritage de los Estados Unidos ha estimado y publicado un *Index of Economic Freedom*, el cual califica a Nicaragua como un pais de poca libertad economica Ademas de ser un analisis muy subjetivo, la informacion en esta publicacion no toma en cuenta muchos de los cambios y reformas que el pais ha experimentado desde el inicio de la administracion actual El informe no toma en cuenta lo siguiente

Politica Comercial

- La tasa arancelaria media ha bajado a 17%
- La Asamblea Nacional esta estudiando bajar a 1% la tasa arancelaria para materias primas y productos de capital
- Se elimino la mayoria de controles de importacion
- Desde el primero de enero de 1996 no es obligatorio la entrega de divisas al BCN

Tributación

- La tasa maxima a la renta de personas naturales es de 30%, menor que en EEUU
- Solo el 12% de la poblacion mas rica esta sujeto a este impuesto, en EEUU es 44%
- La tasa unica a la renta de personas juridicas es de 25%, menor que en EEUU
- El impuesto a la venta tiene tasa maxima de 15%, pero tambien tasa de 6% y muchos productos estan exentos

Consumo Publico en el Producto Nacional

- Consumo publico ha bajado de 31% del PIB en 1990 a 13% en 1996, menor que EEUU
- El Gobierno ha privatizado mas de 360 empresas publicas, o 93% de todas
- La privatizacion de TELCOR esta en proceso de licitacion.
- Estan preparando el marco regulador para la inversion en el sector energetico

Politica Monetaria

- La inflacion media durante 1993-95 ha sido menor de 10% anual
- La inflacion esperada en 1996 es de 12%

Politicas de Flujos de Capital y la Inversión Extranjera

- Hay muchas concesiones tributarias a la inversion extranjera.
- No hay mayor tramite de la inversion extranjera ni nacional.

La Banca

- Solo hay regulaciones prudenciales de la banca.
- En 1990 no habia bancos privados, en 1994 habia 7, hoy hay 11 bancos privados

Controles de Precios y Salarios

- Se ha deshecho casi todo el sistema de controles de precios.
- El salario minimo esta muy por de bajo del salario de mercado
- Casi todos los precios de derivados de petroleo estan libres desde el año pasado
- Se contempla la liberalizacion de todos los precios de derivados de petroleo en 1996

Regulación

- Se creo la Unidad de Desregulacion en el Ministerio de Economia y Desarrollo
- La Presidenta ha decreto la eliminacion de una cantidad de regulaciones

II. Comentarios

Introduccion

La Fundacion Heritage de los Estados Unidos publico su Index of Economic Freedom, lo cual califica Nicaragua como un país de poca libertad economica La informacion en esta publicacion no toma en cuenta muchos de los cambios y reformas que el pais ha experimentado desde el inicio de la administracion actual El proposito de esta nota es actualizar la informacion encontrada en tal publicacion para que se entienda mejor el nivel de la libertad economica que el pais goza actualmente

Antecedentes

En la decada de los setenta, el pais centroamericano de Nicaragua sufrio una guerra civil entre los somocistas y los sandinistas Ante la complacencia de casi todo el mundo, ganaron los sandinistas y se derrumbo la dictadura somocista Despues de la euforia de la victoria las fuerzas de los comandantes sandinistas instalaron un regimen marxista-leninista y el pais oficialmente se junto con los poderes del internacionlismo, en particular Cuba y la Union de Republicas Socialistas Sovieticas

Con la instalacion de este regimen marxista-leninista, el nuevo gobierno inicio la construccion de una economia *dirijiste* que puso casi todo el poder de asignacion de recursos, consumo, produccion y decisiones de inversion en las manos de los mandos publicos Punto clave en esta transformacion, claro, fue la reduccion de la libertad economica de casi toda la poblacion nicaraguense

Entre los resultados en la economia de este regimen se destacan 1) alto nivel de proteccion de la industria nacional, 2) altos impuestos, 3) alta participacion del gobierno en la economia (produccion, inversion y consumo), 4) eventualmente mal manejo de la moneda y al fin de los ochenta, el pais gano el premio por tener el record mundial para la hiperinflacion, 5) contratacion de deuda internacional sin capacidad de repago, 6) una banca nacionalizada, 7) controles rigidos de salarios y precios, 8) la destruccion de los derechos de la propiedad, 9) alta regulacion de la economia privada, que ya se redujo, y 10) mucha actividad en los mercados negros

El regimen marxista-leninista de Daniel Ortega bajo presiones internacionales, pero al mismo tiempo sobre-estimando su popularidad con el pueblo nicaraguense permitio el voto libre en el año de 1990 Para su sorpresa gano Doña Violeta Chamorro esta seleccion Ante la sorpresa del mundo internacional, el regimen de Ortega permitio la transicion a la nueva administracion de Doña Violeta

Los Factores del Indice de la Libertad Económica

1 **Politica Comercial** Indice de la Fundacion Heritage 5 y estable Este indice indica un alto nivel de proteccionismo Se basa este indice en las altas tasas arancelarias y las restricciones sobre la importacion que predominaron durante la administracion Ortega y al principio de la administracion actual Pero este indice no toma en cuenta la liberacion de la importacion y la desgravacion arancelaria que el pais ha implementado en los ultimos años Ademas, en el anteproyecto de ley de la reforma tributaria el pais esta desgravando aun la importacion de bienes primarios y de capital Ademas, el gobierno ha pactado con los paises centroamericanos de eliminar el impuesto "Arancel Temporal de Proteccion" hasta el año 2000, lo cual representa una continuacion en la liberacion del comercio internacional y la competencia nacional

Dado los avances ya hechos, el nivel de proteccion relativamente bajo actualmente y el progreso pactado, es nuestro juicio que el indice respecto a la politica comercial merecido es de 2+ (Proteccion baja y mejorandose)

2 **Tributación** Indice de la Fundacion Heritage 3 y estable El informe dice que el sistema tributario impone tasas relativamente bajas Este indice se compone de dos indices desagregados 1) impuesto a la renta de personas naturales con un indice de 2 0 (bajo y estable) y 2) impuesto a la renta de personas juridicas con indices de 3 0

Aunque estamos de acuerdo con los juicios particulares, no entendemos porque el indice global es 3.0 en vez de 2 5, lo cual es el medio de los índices particulares

3 **Consumo publico del producto economico** Indice de la Fundacion Heritage 2 y estable (consumo publico medio y estable)

Segun los datos del Fondo Monetario Internacional el consumo ha bajado de 31 1 del PIB en el año 1990 a 14 0 porciento en 1994 Esta caida rapida resulta de una estrategia programada por parte del gobierno de reducir el rol del Estado y fomentar la economia privada sujeto a fuerzas del mercado libre Ademas, el gobierno de Nicaragua ha privatizado una gran cantidad de empresas estatales y ha eliminado una miriada de regulaciones a la empresa privada Al mismo tiempo es reconocido que las cuentas nacionales fuertemente subestiman el producto nacional y que este consumo publico de 14 porciento del PIB es sobre-estimado

Dado las fuertes bajas en el consumo público, en la reduccion de las regulaciones y la venta de muchas empresas estatales, consideramos que Nicaragua merece un indice de 2 0 (consumo publico bajo y decreciente).

4 **Política Monetaria** Indice de la Fundacion Heritage 5+ (muy alta inflacion) Segun el informe, Nicaragua tenia mucha inflacion Durante la epoca de 1985-1993 el pais experimento una inflacion anual de 1,863 porciento, y en 1994 la inflacion era de 12 porciento Lo que no indica el informe es que durante los ultimos años de los ochenta el pais sufria una hiperinflacion, pero desde entonces el pais esta experimentando una relativa baja inflacion En el año 1993 la

inflacion fue 19 porciento En 1994 y 1995 la inflacion era de 12 porciento Se espera una inflacion de no mas de 12 porciento en 1996

El informe no toma en cuenta la disciplina monetaria que se ejerce en Nicaragua ni los grandes exitos que se lograron en terminos de reducir la inflacion Consideramos que el pais merece un índice de 2+ (baja inflación, buen control monetario y estable).

5 **Politicas de flujos de capital e inversion extranjera** Indice de la Fundacion Heritage 2 y estable (barreras bajas a la inversion extranjera) El informe menciona que el registro de inversiones puede ser usado para impedir la inversion estadounidence

Nicaragua ha liberado la regulacion de la inversion extranjera. Ultimamente se elimino el requerimiento de ceder oficialmente las divisas generadas por la exportacion para cambiarlas a travez del Banco Central de Nicaragua Ademas, no solo ha privatizado el gobierno muchas de las empresas estatales, sino, se contempla privatizar en 1996 la empresa de telefonia El gobierno esta preparando un marco regulador para la entrada de la competencia, especialmente a travez de la inversion extranjera en el sector energetico

Talvez más importante aun, el pais ha promulgado una serie de leyes para el fomento de la inversion extranjera. Ademas, la inversion extranjera no requiere de la aprobacion ni permiso por parte del gobierno Es totalmente libre

El Gobierno reconocio la necesidad de quitar barreras a la inversion extranjera y el tratamiento caprichoso o discresional Por lo tanto, en un decreto de 1994 se termino la discrecionalidad de los ministerios en el tratamiento de la inversion extranjera y establecio normas claras y transparentes Ahora solamente la presidente puede otorgar contratos o tratados con el sector privado que se salen de las normas establecidas por la ley

De todas maneras, Nicaragua tiene un ambiente muy favorable al inversionista extranjero El rol del Estado en la produccion, las leyes de fomento de la inversion y sus incentivos fiscales, el tratamiento legal y la libre remesa de divisas y ganancias indican un pais abierto a la inversión extranjera Consideramos que el pais merece un indice de 1

6 **La banca** Indice de la Fundacion Heritage 3 y estable (restricciones moderadas) Aunque reconoce el progreso que ha logrado el pais en este campo, se dice que aunque el pais ha reducido la regulacion de la banca, de los 10 bancos comerciales, tres siguen siendo estatales El hecho es que hoy existen todavia tres bancos estatales, pero ahora hay once bancos comerciales privados En 1990 cuando entro al poder la administracion actual no habia ningun banco comercial privado En los primeros meses de 1994 ya habian siete bancos privados Hoy hay once Parece que no hay barreras efectivas para entrar al mercado

Ademas, las regulaciones de la banca que continuan son meramente de la superintendencia de bancos y no tiene propositos de dirigir el colocamiento de fondos ni afectar las operaciones bancarias, sino son del tipo prudencial

La banca privada solamente tiene regulacion prudencial y la cantidad de bancos privados ha crecido y ahora la banca privada predomina en el sector El Pais merece un indice de 1+ (pocas restricciones y esta mejorandose).

7 **Controles de salarios y precios** Indice de la Fundacion Heritage 3 y estable (controles moderados sobre salarios y precios) El informe indica que los controles son moderados, pero se nota que el gobierno todavia controla los precios de productos derivados del petroleo, servicios publicos, azucar, cervezas y bebidas gaseosas Por eso merece el pais un 3 (controles moderado y estable)

No se discute

8 **Derechos de la propiedad** Indice de la Fundacion Heritage 4 y estable (poca proteccion de la propiedad privada) El informe indica que la propiedad en Nicaragua esta desprotegida, que se puede confiscar por criminales armados o funcionarios oficiales corruptos y que la Corte no es capaz de tramitar el problema ni el sistema policial

Esta opinion no toma en cuanta que hasta Junio del año pasado que el gobierno ya habia resuelto administrativamente todos, salvo alrededor de 5 mil casos de confiscados de los 117 mil casos registrados (96 porciento) Reconocemos que todavia hay mucho que hacer, por ejemplo 1) titular los predios ya entregados 2) negociar la compensacion en los casos que no pueden ser resueltos por la devolucion de la propiedad a los dueños originales, 3) corregir otros abusos

El gobierno ha tomado medidas para remediar la situacion de la propiedad Con la reciente aprobacion de la Ley de Propiedad y la emision de los bonos de compensacion el gobierno esta tratando de resolver las discrepancias dentro de sus restricciones presupuestarias

Dado los avances que el gobierno ha logrado y los esfuerzos que sigue haciendo, consideramos que el gobierno merece un indice de 3+ (proteccion de la propiedad esta mejorandose)

9 **Regulacion** Indice de la Fundacion Heritage 4 y estable (alto nivel de regulacion El informe indica que estudios de impacto ambiental son requeridos de negocios y que a veces pueden impedir la expansion de empresas ya existentes o la formacion de nuevas El informe indica que se aplican las regulaciones en una forma muy ad-hoc y que la corrupcion queda como problema grave

Desde 1992 la velocidad de la desregulacion de mercados ha crecido El gobierno ha creado una institución especial (Unidad de Desregulacion en el Ministerio de Economia y Desarrollo) y la Asamblea Nacional ha aprobado una legislacion moderna en varios sectores para agilizar la economia y soltar la fuerza del sector privado Ademas, en los ultimos tres años el Gobierno ha decretado la eliminacion de una cantidad de otras regulaciones La privatizacion tambien comtempla la liberación de los mercados y sectores economicos

Consideramos que el nivel de regulación ni es alta y que la discrecionalidad en su aplicacion ha bajado Las "reglas del juego" hoy son más claras que nunca. En nuestra opinion Nicaragua merece un indice de 3+ (regulación baja y mejorándose)

10 **Mercado negro** Indice de la Fundacion Heritage 5 y estable (mucha actividad en mercados negros y estable) El informe indica que el alto nivel de desempleo (40%) resulta en mucha actividad en el mercado negro Ademas, el informe dice que segun la Oficina del Representante de Comercio de los estados Unidos, el pais no proteje los derechos de propiedad intelectual de software y que hay mucha pirateria de gravaciones, videos y emision de señales de television por satelites

El desempleo abierto en Nicaragua es alto pero solamente de alrededor del 16 porciento, no de 40 porciento Alrededor de 53 porciento de la gente economicamente activa en el sector urbano esta trabajando en el sector informal Pero, la mayoria de ellos pagan impuestos de un tipo u otro Ademas, la operacion de mercado informal no necesariamente tiene algo que ver con "mercados negros" La mayoria de estas operaciones no tratan de contrabando El gobierno tiene un regimen especial para el pago de impuestos para "pequeños contribuyentes" Ellos estan obligados a pagar un impuesto que se llama "cuota fija" Con los proyectos de asistencia tecnica financiados por el Banco Interamericano de Desarrollo, el PNUD y USAID se espera aun la incorporacion de este sector en el sistema tributario formal

Es cierto que no siempre se respetan los derechos de la propiedad intelectual y que hay pirateria de software, videos y otros productos, pero no hay indicaciones de la extension de esta pirateria, pero tampoco hay indicaciones de que esta actividad sea de mucha importancia

Dado que no hay controles sobre las divisas, los impuestos arancelarios son bajos y no hay regulación de mercados, no se puede decir que hay actividad elevada del mercado negro. La existencia del sector informal no es equivalente al mercado negro. Aceptamos la existencia de la pitarería de productos intelectuales, pero no hay indicaciones que sea una actividad perniciosa Es nuestra opinión que Nicaragua merece un índice de 3.0 en esta area.

NICARAGUA

The Central American country of Nicaragua became an independent state in 1838 Under the rule of the Sandinistas, Nicaragua became a socialist economy in 1979 Despite infusions of foreign aid, Nicaragua's economy came apart Nicaragua held a democratic election in 1990 in which the victor, Violeta Chamorro, promised economic reform Substantial progress has been made on restructuring the economy, and key democratic institutions have been strengthened, but the growth of investment, production, and employment is restricted by property problems, protective tariffs, and the world's highest foreign debt burden

Factor #1· Trade Policy

Score 3+ (Low and decreasing level of protectionism)

According to the World Bank, the average nominal protection of goods in 1992 was 15 3%,[1] as required under the Central American Common Market's common external tariff Because of investment-promoting exonerations, the average rate actually paid was 6 5 percent Nicaragua supports reducing regional tariffs

Factor #2 Taxation

Score - Income taxation 2-Stable (Low tax rates)
Score - Corporate taxation 3-Stable (Moderate tax rates)
Total Taxation Score 2 5-Stable (Moderate tax rates)

Nicaragua has a top marginal income tax rate of 30 percent The tax rate that applies to the average income level is zero percent Nicaragua has a top corporate rate of 30 percent It also has a general sales tax of up to 15 percent, a selective consumption tax, and a municipal sales tax

Factor #3 Government Consumption of Economic Output

Score - 2+ (Low and decreasing level of government consumption)

Nicaragua's government consumed 14 0 percent[2] of GDP in 1994 This share has decreased rapidly from 31 1 percent in 1990, when the Chamorro Administration took office

Factor #4 Monetary Policy

Score - 2+ (Low and decreasing level of inflation)

Nicaragua had an average rate of inflation from 1980 to 1991 of 583 7 percent Since that year, which marked the start of the economic liberalization and stabilization program, inflation has been below 20 percent (12 percent inflation in 1994), even as price regulations have decreased

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[1] *Nicaragua Country Economic Memorandum*, World Bank Report No 12066-NI, Washington, D C , February 2, 1994

[2] *Nicaragua - Statistical Annex*, International Monetary Fund Report No SM/95/151, Washington, D C , June 26, 1995

Factor #5 Capital Flows and Foreign Investment Policy

Score - 1-Stable (With improving investment climate)

Nicaragua promotes foreign investment, without restrictions, through tax holidays and other incentives Government approval is not required Nicaragua has almost completed the privatization of the State-owned enterprises inherited from the previous government

Factor #6 Banking

Score - 1-Stable (Very low restrictions on banks)

The private banking system in Nicaragua includes 11 banks and one investment finance company Private banks now account for over half of commercial bank deposits and over a third of loans Four new private banks have begun operations since the start of 1994 Interest rates are freely set by the market No deposit insurance system exists Normal prudential rules are enforced

Factor #7 Wage and Price Controls

Score - 2+ (Low and improving wage and price controls)

Almost all price controls have been lifted, most recently in the petroleum sector However, the Government still negotiates prices with a few protected industries The legal minimum wage is below the market rate for labor Nicaragua needs to modernize its labor code

Factor #8 Property Rights

Score - 3+ (Moderate but increasing protection of private property)

Unresolved property rights questions remain a key impediment to the growth of investment and production in Nicaragua Despite good progress on reviewing and settling claims, judicial enforcement and the title registry system remain inadequate, and flagrant occupancy abuses have to be corrected

Factor #9· Regulation

Score - 3+ (Moderate and deceasing regulation)

Government efforts to strike unnecessary regulations from the books have to be strengthened and regulatory jurisdictions within the Government resolved Environmental impact statements can restrict new investments The private sector is unclear as to "the rules of the game "

Factor #10 Black Market

Score - 2- Stable (Very low black market activity)

With 20 percent unemployment and underemployment common, the virtually unrestricted informal sector affords income-generation opportunities to many people Smuggling and under-reporting of tax liabilities are the major illegal activities, which the weak public administration can only try to control Improved tax administration is key to stopping the unfair competition these illegal activities inflict on legitimate businesses

Summary

NICARAGUA INDEX OF ECONOMIC FREEDOM ASSESSMENT

Comments on the Introduction

The first four sentences of the Introduction to the Nicaragua-specific ratings are undisputed facts However, we cannot agree with the rest of the Introduction First, while it is true that economic growth has not been as strong as anyone would wish, the country's economic house has been set in a much better order than the condition in which this Government inherited it Inflation has been brought down from over 10,000 percent per year to less than 20 percent every year since 1991, last year, it was 12 percent, and this year inflation should be in the single digits This bespeaks a dedication to conservative economic policies, recognition of the need to exercise monetary and fiscal constraint, and a willingness to sacrifice immediate consumption in order to firmly establish the bases for strong, private sector-led growth in the future Second, over the last year, civilian control of the military was firmly established New heads of the police and armed forces have been appointed by the President, replacing the old-line Sandinista leaders who had headed up these organizations Third, the Sandinistas have not been able to stave off the massive privatization of the many enterprises nationalized during their regime In addition, while the Sandinistas have been fighting a rear-guard action to hold off solution of the largest single problem facing the country--the equitable resolution of property rights disputes, continued vigorous implementation of Government programs to settle property title questions and the weight of public pressure doom their struggle to eventual oblivion. With the help of the international financial community and its bilateral friends, Nicaragua is making substantial progress even with this thorny issue We believe the Introduction should recognize the depth and scope of the progress made over the last five years to overcome the weight of the prior regime's policies and structures

There follows a detailed commentary on the individual factors used by the Heritage Foundation in deriving its overall index of economic freedom for Nicaragua.

Factor #1 Trade Policy

Suggested new score 3+ (Low and decreasing level of protectionism)
Original score 5-Stable (Very high level of protectionism)

The average tariff on manufactures in Nicaragua is estimated at 17 percent, which is programmed to decrease to 15 percent over next four years Tariff rates on other goods are generally lower, but trade in these goods is small This tariff structure is in accord with Central American agreements on economic integration Nicaragua has supported El Salvador's initiatives to reduce tariff barriers and has recently decreased some duty rates, in addition to implementing (earlier this year) the scheduled reductions agreed with the other Central American countries

In Nicaragua, significant duty exemptions are granted, such that the average tariff paid in 1993 was only 6.5 percent of recorded import value. This measure is a better indicator of

reality than theoretical tariff rates Also, almost all non-tariff barriers have been dismantled licensing requirements are mostly formalities, and customs procedures are becoming less difficult (for example, the Government of Nicaragua has already expanded the role of customs brokers and intends to privatize customs operations, starting with air cargo operations in Managua) In addition, starting April 1 of this year, the Government has relinquished its monopoly on the importation of crude petroleum and petroleum products as part of its program to withdraw entirely from petroleum marketing and pricing and to turn this area over to the private sector

In view of the small average tariff actually paid and significant progress in all other areas, the score for this factor should be 2+ (Improving) rather than the 5 (Stable) score originally assigned. Nonetheless, because the Government is hoping to decrease exonerations (which would raise average duties actually paid), a score of 3+ would also be appropriate

The statistical data used here are drawn from a special USAID-supported study[3] of tariff protection in Nicaragua that forms part of the Government of Nicaragua's efforts to improve the fluidity of foreign trade and overall productive efficiency

Factor # 2: Taxation

Suggested new score for individual taxation 2-Stable (Low tax rates)
Suggested new score for corporate taxation 3-Stable (Moderate tax rates)
Suggested new score for total taxation 2 5-Stable (Low to moderate tax rates)
Original score for individual taxation 2-Stable (Low tax rates)
Original score for corporate taxation 3-Stable (Moderate tax rates)
Original score for total taxation 3-Stable (Moderate tax rates)

We cannot disagree with the original ratings, as they accurately portray the current tax structure (although the sales tax has 3 rates--of 0%, 6% and 15%--and is not applied to many staple goods) We would like to point out, however, that the Government is anxious to reduce tax burdens It is conscious that a relatively small number of individuals and enterprises are paying relatively high rates, while the vast majority of people and enterprises pay essentially no income taxes Because of its weak administrative structures, the Government has been forced to rely on this system, which includes high customs duties that sometimes protect inefficient industries The Government would like to enforce its current tax legislation better (to reduce evasion), while at the same time reducing public sector operations to the minimum consistent with good government and closing off the many exonerations that can impart elements of horizontal inequity As stated in its indicative multi-year plan for the future, the Government believes that the tax base must be broadened and tax rates reduced significantly We hope to see an improved score in the future as planned tax reforms are implemented

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[3] Berlinski, J , "La Estructura de Proteccion Arancelaria de la Industria Manufacturera de Nicaragua." January, 1995, Proyecto NEPAI-USAID

This having been said, it is not clear why an arithmetic average of the two scores was not used originally. Using the arithmetic average would change the overall score from 3 to 2 5

Factor # 3 Government Consumption of Economic Output

Suggested new score 2+ (Low level of government consumption and low level of GDP produced by the state-owned sector)
Original score 3-Stable (Moderate level of government consumption)

According to the latest IMF data for 1994[4], government consumption expenditures were 14 0 percent of GDP, down from 16 5 percent in 1993 and 19 5 percent in 1992 (and 31 1 percent in 1990, when the current government took over) This rapid decline is the result of deliberate Government policy to reduce the size of the public sector, a policy that is reflected in its program of privatizations as well as in its strict controls over Central Government expenditures Further, the number of state-owned enterprises is continuing to shrink (see the discussion of foreign investment under Factor 5) The percentage of GDP produced by enterprises still in the state-owned sector is estimated today at no more than 2 percent, to which should be added the 5-7 percent of GDP produced by public utilities in 1994 **Overall, these percentages are more consistent with a score of 2 than with the score of 3 originally given.**

Factor # 4 Monetary Policy

Suggested new score 2+ (Low and decreasing level of inflation)
Original score 5+ Very high level of inflation

Nicaragua had an annual inflation rate from 1980 to 1991 of 583 7 percent However, this high figure is due mostly to the hyperinflation period of the second half of 1980s (under the Sandinista regime) and into 1991, when the present administration launched a serious stabilization program From April 1991 through the end of 1994, the annual inflation rate averaged only 11 6 percent, showing a downward trend overall The original score is due mainly to the inflation brought about by the wrong-headed economic policies of the previous regime This marked decline in inflation is clearly the result of the change of economic orientation of the country, leaving behind a centrally-planned economy in favor of a liberal, competitive market-oriented economy This change is roughly comparable with those that occurred in the former Soviet Union The Nicaraguan people have suffered a lot as a result of the Sandinista regime, the Heritage Foundation should not further castigate the country for those errors by continuing to assign such a negative score for this factor **A score of 2+ would be apt recognition of the vast improvements in monetary (and related) policies pursued and achieved by the current administration.**

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[4] International Monetary Fund, 1995, Nicaragua - Statistical Annex, Table 2

Factor # 5 Capital Flows and Foreign Investment Policy

Suggested new score 1-Stable (with improving investment climate)
Original average score 3-Stable (Moderate barriers to foreign investment)

The large majority of state-owned productive enterprises inherited from the previous regime have been privatized, liquidated, returned to their former owners, or otherwise disposed of At the end of July 1995, of almost 360 enterprises once held by the state holding company (CORNAP) only 23 had not been privatized, a rate of accomplishment of 93 6 percent Of the remaining 23 enterprises, 20 are in the final stages of privatization or liquidation, CORNAP will privatize the remaining 3 this year

Beyond these, only a handful of public service companies (mainly the telephone, electricity and water utilities) remain in state hands The telephone utility will be privatized this year, culminating a USAID-assisted multi-year process which included pre-qualification of interested international bidders A bill for the privatization of telecommunications has been in the National Assembly for almost a year Final approval is expected in August or September, 1995, now that the Assembly has approved (in July of this year) a modern regulatory framework for the sector In addition, contracts have been let for the private generation of electricity, and a private investor has been negotiating to buy a major geothermal electricity generation facility, as part of a process of privatizing the electricity sector Further, both the electricity and the water utilities are receiving a modern regulatory framework to facilitate their decentralization and possible privatization

Perhaps more important than any Government plans for privatization of a given sector, foreign direct ownership of enterprises is not only permitted but is encouraged Since 1992, the country has had a foreign investment promotion law, which offers significant tax holidays and other incentives to foreign investors willing to come to Nicaragua. With the privatization of previously state-owned productive assets and the operation of foreign investment and related incentive legislation, foreign investors present in country have greatly increased over the last three years, especially in mining and services but also in manufacturing In addition, foreign investment does not even require government approval, some investors have come without benefit of the special treatment offered under foreign investment and related laws

Nonetheless, the Government of Nicaragua recognizes that past practices allowed significant ministerial discretion in the approval of several types of economic transactions, including foreign investments This situation prompted the Government to issue a decree in 1994 that terminated ministerial discretionality, only the President is now allowed to approve agreements with the private sector (foreign and domestic) which vary from the norms established in the law

Overall, the legal and administrative climate in Nicaragua strongly favors foreign investment, and (as discussed in Factor #3, Government Consumption) the role of the State in production is rapidly approaching zero. Thus, a score of 1 would be more appropriate than the original score of 3.

Factor #6 Banking

Suggested new score 1-Stable (Very low restrictions on banks)
Original average score 4-Stable (High restrictions on banks)

In the 1980s, Nicaragua's financial system consisted only of state-owned banks, but with the change in government in 1990, the first private banks in over a decade were authorized By mid-1995, 11 private commercial banks and one foreign-owned investment bank (financiera) are now in operation, up from zero in 1990 and 7 in early 1994 Thus, there do not seem to be significant barriers to the entry of new banks in Nicaragua Savings and loan associations are slowly recovering from more than a decade of neglect and official hostility Private commercial banks have rapidly increased their share of bank deposits and loan operations More than half of all deposits in Nicaraguan financial institutions are now held in private commercial banks, which also provide over one-third of all commercial bank loans Private banks even compete for deposits of public funds

A Superintendency of Banks (created under this Government) establishes and enforces prudential norms regulating the operations of all commercial banks and authorizes the establishment of new financial institutions (banks and others) The Superintendency is an independent, autonomous public body Interest rates are freely determined by market forces, without the intervention of the Central Bank of Nicaragua or any other public institution There are no state controls over lending practices, such as required minimum lending by sector or by size of borrower (prudential norms do limit exposure, however) Private banks in Nicaragua operate with as much freedom (and perhaps more) as in developed countries, including the United States, to the point that there is not even a government deposit insurance, either compulsory or voluntary Finally, there are no domestic geographic barriers to banking operations in Nicaragua (such as inter-state restrictions)

At present, no foreign banks have established offices in Nicaragua, not because of government obstacles or impediments, but because the small size of the market does not justify having a physical presence in country As with many other countries, foreign banks find they can conduct their business in Nicaragua more efficiently from off-shore locations However, all of the private commercial banks have extensive correspondent relationships with foreign banks, especially U S banks, which includes facilitation of foreign bank loans for domestic customers In addition, several private banks are working jointly with foreign capital, especially from the United States, Europe and Central and South America.

The only restrictions on private banking--foreign and domestic--that exist in Nicaragua are of a prudential nature. Barriers to the entry of new banks must be negligible, since four new private banks have been launched since the start of 1994. Domestic private banks regularly facilitate foreign bank loans for their customers. Nor does the Government infringe the ability of private banks to make their own operational decisions, including interest rates. Thus, it would seem that a score of 1 (very low restrictions on banking) should be given.

Factor #7 Wage and Price Controls

Suggested new score 2+ (Low and improving wage and price controls)
Original score 3-Stable (Moderate level of wage and price controls)

Apart from public utilities (water, energy, communications), medicines and transportation services, prices for goods and services are determined by market forces in Nicaragua (Figueroa, 1995, Tello, 1994)[5], the only additional exceptions being locally-refined sugar, milk, beer and soft drinks Prices in these areas are negotiated with producers, although prices at the consumer level sometimes vary from those officially established In the transportation sector, the Government is interested in seeing enough profitability to insure that the owners of previously public sector-owned transport vehicles can repay the loans financing their purchase of these assets In the area of petroleum prices, the Government has set the stage for complete price liberalization as part of its program to promote free private sector operations in the importation and marketing of petroleum products at the wholesale and retail levels Earlier this year, the Government freed all petroleum product prices, except for diesel, kerosene and liquid natural gas, thus, prices for regular and super gasoline, aviation gas and other fuels and lubricants are set by the market.

In general, the system of strict and pernicious price controls inherited from the previous regime has been dismantled Basic grain production is a major case in point. It provides the livelihood for small farmers, whose income possibilities were particularly undermined by the old system Now, no controls whatever are in place for basic grains (Figueroa, 1995, as previously cited) In addition, a commodities exchange, dealing with both spot and futures contracts, has been launched by the private sector to reduce information imperfections affecting basic grain production and marketing The privatization of some basic grains storage and treatment facilities is one Government contribution to improving the transmission of market signals in the basic grains sector

While a minimum wage does exist by law, it has for several years been much below the market rate for labor It is thus not relevant for private sector economic decision-making Further, the labor code is being modernized with an eye to making wage determination and the conditions of employment more flexible An attempt last year by the Assembly to legislate impediments to freely negotiated wages and conditions of employment met with a Presidential veto A revision to the code is being negotiated with the Assembly In any case, real wages in Nicaragua have been decreasing since at least 1992 (Tello, 1995)[6] in response to market pressures, underscoring the economic irrelevance of the minimum wage

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[5] Figueroa, E , 1995, "La Desregulacion de los Granos Basicos en Nicaragua 1990-1994", Proyecto NEPAI-USAID, Tello, M D, 1994, "Informe Tecnico para el Programa de Desarrollo de Nicaragua," Proyecto NEPAI-USAID

[6] Tello, M D , 1995, "La Nueva Encuesta Industrial Metodologia y Resultados, 1992-1994," Proyecto NEPAI-USAID.

In light of the above steps, we believe the previous score of 3-Stable should be raised to at least 2+ (Low and improving wage and price controls)

Factor #8: Property Rights

Suggested new score 3+ (Moderate but increasing protection of private property)
Original score 4-Stable (Low level of protection of private property)

The sanctity of property rights is central to the market-driven model of development pursued by Nicaragua, including claims to real property Unresolved real property questions constitute a major impediment to increasing the investment needed to increase production, employment and incomes Upon assuming office in 1990, this Government inherited a chaotic system of property claims and counter-claims, disastrously weakened public administrative systems, and a divided body politic A major program of privatization of state-owned enterprises and economic liberalization was one of the first initiatives of the new Government. The first step to resolving real property claims was to establish mechanisms for recording the interests of claimants, pass on the admissibility of their claims, and institute proceedings against those who illegally occupy properties Either because of a lack of knowledge of the administrative mechanisms so established, or through a fear of reprisal, claimants were slow to come forward at the beginning, some claimants are just now emerging

Because of the direct economic and social impacts of pending property questions, the Government is fully engaged in equitably resolving all recorded property disputes This includes definitively resolving title questions for over 70,000 agrarian reform beneficiary families (affecting 25 percent of arable land), over 11,000 house ownership claims, title to over 90,000 urban lots, and the claims of over 5,000 individuals and corporations involving almost 16,000 assets The size and complexity of this problem are daunting

Nonetheless, as of June 30 of this year, the Government has administratively resolved all but 5,030 of the 117,178 recorded claims (96% complete) Much remains to be done, however, to get definitive titles issued, negotiate compensation in those cases where properties cannot be returned, and correct the abuses of the law committed by some present occupants of real properties We are working to strengthen technical, legal and administrative constraints to more rapid progress, including especially expanding title issuing/recorded facilities and the capacity of the prosecutorial and judicial systems to handle the legal aspects of resolution Nicaragua is now a member of the International Center for the Resolution of Investment Disputes, which we believe will assist the equitable resolution of property questions that are not resolved by direct negotiation The claims of U S and other nations' citizens are receiving priority attention in this process

We estimate that $650 million dollars of compensation will eventually have to be paid as part of the process of resolving property disputes, and have decided that the proceeds of privatizing the telecommunications enterprise and several other major properties will be dedicated to financing compensation bonds In addition, these bonds have the backing of the full faith and credit of the republic, provision for interest payments will continue to be included in future budgets

Private usurpation and uncompensated official expropriations of private properties are illegal in Nicaragua, and the recently promulgated Constitutional reforms strengthen the security of title and prohibit confiscation It is the Government's intention that the corrections it is pursuing of past abuses be irreversible

In view of the solid progress already obtained in resolving the overall property question and the Constitution reforms recently enacted, the Government believes that a score of 3+ is a more reasonable ranking, while it reaffirms its dedication to providing equitable solutions to all past abuses.

Factor #9· Regulation

Suggested new score 3+ (Deregulation of economic activities is improving)
Original score 4-Stable (High level of regulation)

Since 1992, the speed of the deregulation of markets and transactions has been increasing (World Bank, 1994, Figueroa, 1995, Tello, 1995a) [7] The Government has created a special institution for that purpose (the Deregulation Unit at the Ministry of Economy) and has passed modern legislation in a number of fields designed to release the power of private initiative to increase economic efficiency Over the last couple of years, scores of regulatory decrees and other regulations have been eliminated Privatization itself is a major step to freeing economic decisions from State control The reduction of ministerial discretionality (cited above) will, with time, also increase the clarity with which the private sector perceives the "rules of the game "

Because the level of regulation does not constitute a generalized real constraint to private sector economic activity, the score in this area should be changed. However, the Government is conscious of the fact that perception lags reality. Until that perception catches up with reality, a score of 3 should be given; a "+" should be added to note that things are improving on this front.

Factor # 10: Black Market

Suggested new score 2-Stable (Very low black market activity)
Original score 5-Stable (Very high level of black market activity)

Up to now, no study has provided data on the extent of black market operations in Nicaragua. However, from labor surveys and studies, some indirect information can be gleaned about the informal economy, into which black market activities presumably feed One recent survey of the

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[7] Ibid footnotes 3 and 4 See also Tello, M D , 1995a, "Caracteristicas del Sector Industrial en Nicaragua 1990-1994," Proyecto NEPAI-USAID

labor market (MITRAB, 1994)[8] points out that 53 percent of the total urban labor force is engaged in informal sector productive activities, with the informal sector being defined essentially as those enterprises employing less than 5 workers, whether legally registered or not However, the output estimated to be produced by the informal sector in some lines of economic activity is less than 10 percent of the total output of the sector (Tello, 1995)[9]

But informal economic activity is not "black market" in and of itself, "black market" by definition consists of outlawed activities The major illegal activities present in Nicaragua are smuggling and the under-reporting of profits, which exist because customs duties and income and sales taxes are significant As discussed in the sections dealing with trade and taxes, customs duties and taxes are often exonerated as part of the Government's efforts to favor small producers or certain sectors, such as cooperatives and farmers This, of course, causes legitimate complaints that some economic agents receive preferential treatment and can compete on unequal terms with larger companies Given the small size of the market in Nicaragua, the openness of its frontiers, and the undeveloped state of its tax collection structure, incentives exist to engage in these illegal activities

The question remains one of how important these activities are relative to GDP, as that is how this factor is scored One basic problem is that Nicaraguan GDP is widely regarded as being significantly under-estimated[10], such that the ratio of tax collections, for example, to GDP is over-stated In this case, it is unlikely that customs duties and incomes/sales taxes that are illegally not paid exceed 5 percent of recorded GDP (and less of real GDP) Although no formal study of evasion has been undertaken, the Inter-American Development Bank and the World Bank are providing assistance to improve customs and tax administration, including the estimation and reduction of evasion. The Government is keenly aware that expanding the tax base will allow the reductions in tax rates that are necessary to give incentives to greater voluntary compliance with tax legislation.

Other illegal activities, such as copyright infringement on audio cassettes, are on a small scale, and are due more to the need of the informal sector to have the low prices required to sell goods (incomes typically have fallen greatly with economic stabilization and structural adjustment) than being the result of government interference in goods markets

In light of the nature and relatively low level of illegal activities in Nicaragua, the score for this factor should be much reduced. While a case could be made for a score of 1, a score of 2-Stable would also be understandable in light of the Government's inability to protect all legitimate private sector concerns.

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[8] MITRAB, 1994, "La Situacion del Mercado Urbano en Nicaragua 1993"

[9] Op cit footnote 4

[10] World Bank, 1994, op cit., p 4