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ADMINISTRATION'S TAX PROPOSALS

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

ON

FOREIGN TAX, POSSESSIONS TAX CREDIT, INVESTMENT TAX CREDIT, BUSINESS MEALS AND ENTERTAINMENT, AND OTHER TAX MATTERS

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an additional 13 jobs in the rest of the economy. Not surprising, the industrial sectors that contribute most to construction are the pharmaceutical and chemical industries. Their loss is our loss.

The analysis also found that reduced bank lending, such as would result from the of "936" deposits, would have an enormous negative effect on construction. When considering the impact of a reduction in finance, a further 1,058 jobs could be lost in our industry—for a total job loss of 7,794 jobs. The reduction scenario also depicts four years of stagnation in the construction sector.

Until now, the "936" possessions tax credit has been viewed as an instrument of economic development for Puerto Rico. Over time, however, that notion has significantly altered—the proposed changes respond to a need to increase revenue for the U.S. Treasury. This policy change implies that economic development in Puerto Rico will be at risk without any assurance that, as a result, net additional revenues will be forthcoming from the U.S. Treasury.

The proposed changes to Section 936 entail significant increases in effective taxes for U.S. corporations operating in Puerto Rico under that section of the Code. The AGC Puerto Rico Chapter's study clearly shows that the proposed changes threaten the economic development and stability of the island, causing severe damage to the local economy in the near future. Further, it puts a disproportionate burden of reducing the federal deficit on Puerto Rico's local economy. Section 936 remains the only U.S. incentive to support Puerto Rico's continued industrialization and development.

While we agree that all businesses must bear their fair share of the tax burden, including construction companies in Puerto Rico, we respectfully urge you to drop this provision from the Administration's proposal.

Statement of Dr. Richard L. Bernal, Ambassador of Jamaica to the United States of America

Mr. Chairman and distinguished Members of the Senate Finance Committee, I would like to thank you for the opportunity to provide Jamaica's views on the use of 936 funds. Indeed, this forum is especially welcome because the amendment to the Section 936 program -- which created the opportunity to use section 936 funds for Caribbean financing -- was initiated by this Committee in the Tax Reform Act of 1986.

Seven years later, we can see clearly that this amendment has worked very well. The Section 936 program has made a significant contribution to the economic development of the entire Caribbean basin and to the United States by providing financing to facilitate increased trade and investment. Originally envisioned as a tax provision designed to encourage U.S. firms to invest in Puerto Rico, specifically in manufacturing, the program has now become a major source of financing for projects throughout the Caribbean. Section 936 of the Internal Revenue Code allows funds to be invested in eligible Caribbean countries, i.e. countries which have a Tax Information and Exchange Agreement with the United States and are designated as qualified to participate in the Caribbean Basin Initiative. To date, the following countries have signed Tax Information Exchange Agreements: Barbados (1984), Jamaica (1986), Grenada (1987), Dominica (1988), Dominican Republic (1989) Trinidad and Tobago (1990), St. Lucia (1991), Costa Rica (1991), Honduras (1991), Guyana (1992). At the time these agreements were signed, the understanding was that 936 funds would be available for investments in the Caribbean. These tax agreements commit signatories to cooperate in sharing tax information with the United States, which is an important mechanism to fight money laundering and prevent U.S. tax evasion.

Overall, the impact of this provision has been considerable, as it has resulted in increased U.S.-Caribbean trade and investment and promoted economic growth and employment in both the United States and the Caribbean countries. The impact of this tax provision resulting from investment and trade has been considerable.

A. EXPANDS U.S-CARIBBEAN TRADE

Section 936 financed projects have expanded trade between the Caribbean and the United States by promoting investment, increasing production, exports, and economic growth. Given that Caribbean economies do not have a capacity to produce capital goods, investments require imports, approximately 70% of which are supplied by U.S. firms. As Caribbean countries experience growth and expansion, new opportunities for investment and trade are created for the United States.

Since the Caribbean Basin Economic Recovery Act (CBERA) was enacted in 1984, the U.S. has developed a growing trade surplus with CBI countries: from 1983 to 1990 U.S. imports from the region declined by 15.6% while U.S. exports to the region increased by 64.7% from $5.7 to $9.7 billion. Given that US$1 billion of U.S. exports to Latin America generates 20,000 new direct jobs in the U.S. The increase in CBI purchases of U.S. goods and services from 1983 to 1990 helped to create 80,000 new direct jobs in the U.S. Of every U.S. dollar of foreign exchange earnings by the Central American and Caribbean countries, 60 cents is used to buy American products, as compared to Asia which spends only 10 cents.

B. PROMOTES CARIBBEAN DEVELOPMENT

As the Caribbean economies undergo major economic changes and adopt private-sector led, export-oriented growth policies, the availability of funds for investment becomes acute. Countries in the Caribbean have been able to draw on this pool of capital, to promote growth through the expansion of private investment and to finance critical public sector development projects. Section 936 financing has helped to strengthen the economies of each of the eligible Caribbean basin countries. Section 936 funds have financed investments, which have been critical in the creation of jobs, the installation of productive capacity, and the production of goods and services. The specific ways in which 936 funds contribute to Caribbean development and thereby increase U.S.-Caribbean trade are:-

1. INCREASES INVESTMENT

Several Caribbean Governments have implemented comprehensive economic reform programs which involved the removal of all barriers and impediments to the operation of the market. This has resulted in the creation of a private-sector led, market driven economy. The process of accelerating and sustaining economic growth depends critically on the volume of investments in both public and private sectors. Section 936 funds have been important in funding public sector development projects and private sector investments since 1988, see Table 1. These funds have been particularly valuable because they are available in foreign exchange and therefore alleviate the foreign exchange constraint as well as expands the volume of investment. As Table 2 shows, 936 funds were the largest source of capital inflows in TIEA signatory countries, in 1991, accounting for 23.3 percent of total inflows.

These flows have been particularly important, given the reduced U.S. aid (development assistance and economic support funds) allocated to several Caribbean countries since the mid-1980s. In 1984, the Eastern Caribbean received US$104.6 million, but in 1992 this was US$21.7 million, a decline of 79.3 percent. In Jamaica, the amount was US$155.3 million in 1985, but fell to $68.8 million in 1992 a reduction of 55.7 percent. The inflow of 936 funds has offset the decline in US aid flows.

2. BUILDS INFRASTRUCTURE

The resources provided by 936 funds have made a substantial contribution to the rehabilitation and upgrading of infrastructure, which complements and enhances the efficiency and productivity of private investments, as well as improves export competitiveness. For example, the trans-Caribbean telephone cable project financed through Section 936 funds will enhance the region's communication links and provide the countries with state-of-the-art service and equipment.

To compete effectively in today's global economy, modern transportation and telecommunication are essential. Air Jamaica received $51 million in 936 funds to acquire two aircraft which it now uses on high density flights to and from the United States. A phone cable project that improves telecommunications services in Jamaica and expands the volume of international calls that can be dialed directly from the island was also financed through 936 funds. In Barbados, a total of US$35 million was spent to expand and upgrade infrastructure of the Barbados Telephone Company while Grenada Telecommunications Limited benefited from US$8 million, which was used in the expansion and upgrading of their facilities and equipment. Trinidad and Tobago received a total of US$210 million which was spent on infrastructure for natural gas exploration and construction of petroleum facility to separate butane and methane from natural gas, as well as a water flooding project.

3. PRIVATIZATION OF PUBLIC ENTERPRISES

Money from this program has helped to fund privatization programs, which reduced the drain of fiscal resources to public enterprises and transferred assets to the private sector. Hotel privatization programs such as the Wyndham Rose Hall in Jamaica, led to more efficient management, expanded employment and significantly increased revenue generated by that property.

4. INCREASES FOREIGN EXCHANGE EARNINGS

The 936 funds have provided foreign exchange inflow which has helped to stabilize the exchange rate and to generate additional foreign exchange earnings by expanding export capacity in the bauxite/alumina industry, in Jamaica, and improving the plant and efficiency of the tourist sector e.g. the refurbishing of Mallards Beach and Americana Hotels in Ocho Rios, Jamaica, refurbishing of Hotel Embajador and construction of Fiesta Bavaro Hotel, in the Dominican Republic. The wood and sugar processing industries in Honduras also benefitted from the 936 funding.

5. EXPANSION OF FOOD SUPPLY

The agricultural sector has been able to utilize 936 funds to expand its productive capacity e.g. expansion and modernization of broiler meat and hatching egg facilities, in Jamaica; development of banana plantations and related facilities in Costa Rica; establishment of a cardboard box factory in Dominica to supply that country's banana industry and manufacturing sector at a cost of $2.1 million.

6. EMPLOYMENT CREATION

The projects financed with 936 funds both in the public and private sector have directly, and through their multiplier effects, created thousands of new jobs across a range of skill categories. Job creation discourages legal and illegal emigration. Migration movements from the Caribbean and Central America have intensified in the last decade. From 1981 to 1988, emigration from Central America and the Caribbean to the United States amounted to 47 percent of total emigration into he United States.

The jobs created by investments, funded by 936 funds, are not at the expense of jobs in the United States. In fact, production and employment in the Caribbean and the United States are complementary. For example, the production of apparel in the CBI region is complementary to production in the United States. Of the apparel produced in Jamaica, 80 percent of the finished goods consist of U.S. raw material, machinery, and other inputs, most of which is made for U.S. firms. Without this complementarity of production between the U.S. and CBI countries, U.S. firms and Caribbean producers would not be able to maintain their market share or their competitiveness in the global market place.

7. DEMOCRACY AND SOCIAL STABILITY

Economic development is a necessary, but not sufficient condition to ensure democracy. Since development is the foundation on which enduring democracy can be built and maintained, U.S. foreign policy must aim at supporting economic development in the Caribbean as the basis for political stability and democracy in the region. These small countries are very vulnerable to narcotics and drug trafficking. Therefore, vigorous anti-drug trafficking programs will have to be pursued nationally and regionally. While focusing on destruction of crops and processing facilities, interdiction, public education, and against money laundering, more attention and resources must be devoted to providing jobs and economic activity as an alternative to involvement in drug trafficking. In Jamaica, through the 936 program, the construction of 750 low-cost prefabricated housing units, which were manufactured in Puerto Rico and assembled and installed in Jamaica, added significantly to the housing stock, from which the lower income earner benefitted.

RECOMMENDATIONS

Section 936 has operated according to the original intent of the U.S. Congress and has brought about the desired results and its place in Caribbean development has grown more prominent and important each year. It is an essential program without which many important projects throughout the Caribbean would not have been realized.

The countries which have signed TIEA's recommend the retention, without modification, of the Section 936 tax incentive because the availability of Section 936 funds provide an invaluable source of financing for investments in the Caribbean economies and trade between the United States and the Caribbean. The development of the Caribbean economies and the other economies in the region contribute to the economic growth of everyone in the region, including the United States.

Changes in the tax incentive structure to the Section 936 of the Internal Revenue Code would adversely impact on investment and growth in the Caribbean and on U.S. exports and employment.

TABLE I

USE OF 936 FUNDS BY CBI COUNTRIES
Calendar Years 1988 ~ 1992
Millions of Dollars

	Disbursed	Pending	Total
Jamaica	275.1	60.0	336.1
Trinidad and Tobago	210.0	124.0	334.0
Dominican Republic	77.6	5.0	82.6
Costa Rica	52.7	5.2	57.9
Barbados	36.2	–	36.2
Grenada	8.0	–	8.0
Honduras	2.9	0.9	3.9
Dominica	2.2	0.5	2.7
Guyana		0.6	0.6
Total	665.8	196.3	862.1

TABLE 2

TOTAL LOANS DISBURSED BY FINANCIAL SOURCES IN TIEA SIGNATORY COUNTRIES DURING 1991

Millions of Dollars

Inter-American Investment Corporation	3.0
German Investment & Development Company	3.3
International Finance Corporation	20.1
Overseas Private Investment Corporation	22.8
Caribbean Development Bank	27.4
Business Advisory Services	37.2
International Development Association	50.7
European Investment Bank	71.9
Commonwealth Development Corporation	75.9
Overseas Economic Corporation Fund	94.9
International Bank of Development and Reconstruction	161.2
Inter-American Development Bank	201.9
Sub-total	770.3
SECTION 936	233.4
Total	1003.7

STATEMENT OF THE CARIBBEAN/LATIN AMERICAN ACTION

I. INTRODUCTION

Mr. Chairman and distinguished Members of the Senate Finance Committee, I would like to thank you for the opportunity to appear before you today and to present the views of Caribbean/Latin American Action on the Administration's proposal for Section 936. Caribbean/Latin American Action is a non-profit 501(c)(3) organization committed to promoting private-sector generated economic development in the countries of the Caribbean Basin.

Clearly, the countries of the Caribbean Basin are deeply concerned over the future of Section 936. A reduction in Section 936 tax benefits substituted for wage credits would jeopardize the pool of 936 funds available for development-oriented private sector projects in the Caribbean Basin.

Recent studies conclude that Section 936 funds have become one of the leading sources of project funding for new investments and business growth in eligible Caribbean Basin countries. In some countries, 936 funds are the primary source of loan financing. 936 funds are vital to the development goals of the Caribbean Basin, particularly as other sources of development assistance have declined.

In my testimony, I will argue that the Administration's proposal relating to Section 936 works at cross-purposes with U.S. policy in the Caribbean Basin. That policy aims to protect U.S. economic and security interests by fostering a stable democratic region through economic development. Furthermore, it works against the development goals and objectives of the Caribbean Basin and the many efforts underway to establish healthy free-market oriented economies.