Roz
Put in the file on
this meeting.
CR

FYI → Orig: President Clinton
xc: Rubin
Panetta
Montoya
CR

The Mayor of San Juan
Capital City of Puerto Rico

March 10, 1993

Ms. Carol Rasco
Assistant to the President for Domestic Policy
The White House
Washington, D.C. 20500

Dear Ms. Rasco:

It was a pleasure meeting with you to discuss President Clinton's economic recovery initiative and the possible negative impacts on Puerto Rico of limiting or rescinding Section 936 — the cornerstone of the Island's economy. I appreciate the opportunity to convey our concerns and look forward to working with you to ensure Puerto Rico is treated fairly and does not suffer a disproportionate negative impact.

As a mayor, I am very excited by President Clinton's plan, as many facets will be of great benefit to our cities, especially the additional funding for the Ryan White Programs, the $2.5 billion increase for community development projects, the expanded Head Start program and the summer jobs program. Aside from our concern with the Section 936 provision, I feel it is a balanced program, and want to offer my endorsement and support.

I am confident you and other leaders in Washington will not let the plan have such a negative impact on Puerto Rico once a full and thorough evaluation has been realized. During my meetings here in Washington, I met much support and understanding of our position, and hope this will translate into concrete action to ensure this issue is addressed.

Once again, thank you for meeting with us on this most important matter. I look forward to working with you on this issue.

With my best regards, I remain,

Sincerely yours,

Héctor Luis Acevedo
Mayor

Box 4355
San Juan, Puerto Rico

The Jefferson

G R O U P

City of San Juan

José A. Ortiz-Daliot
Senior Vice President

The Jefferson Group, Inc.
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(809) 759-9955
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Roz: Try 4 PM on 3/8

MEMORANDUM OF CALL

Previous editions usable

TO: CR

[✓] YOU WERE CALLED BY— [ ] YOU WERE VISITED BY—

Pierre Paret - San Juan

OF (Organization)

Old Mayor Acevedo's office

[✓] PLEASE PHONE ▶ [ ] FTS [ ] AUTOVON

638-3535 ph

[ ] WILL CALL AGAIN [ ] IS WAITING TO SEE YOU

[ ] RETURNED YOUR CALL [ ] WISHES AN APPOINTMENT

MESSAGE

Re: Domestic Issues as they relate to Puerto Rico

- Wants to meet w/you March 8 or 9

fax: 638-3536

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63-110 NSN 7540-00-634-4018 STANDARD FORM 63 (Rev. 8-81)
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3/8

Mayor

A. (1) Co-Chairman of U.S. Conf. of Mayors on AIDS
+ Greenberg case (Mayans) + insurance related to for AIDS
House has legis. proposed on this.

(2) Music - a useful tool in reaching populations that AIDS spreading to

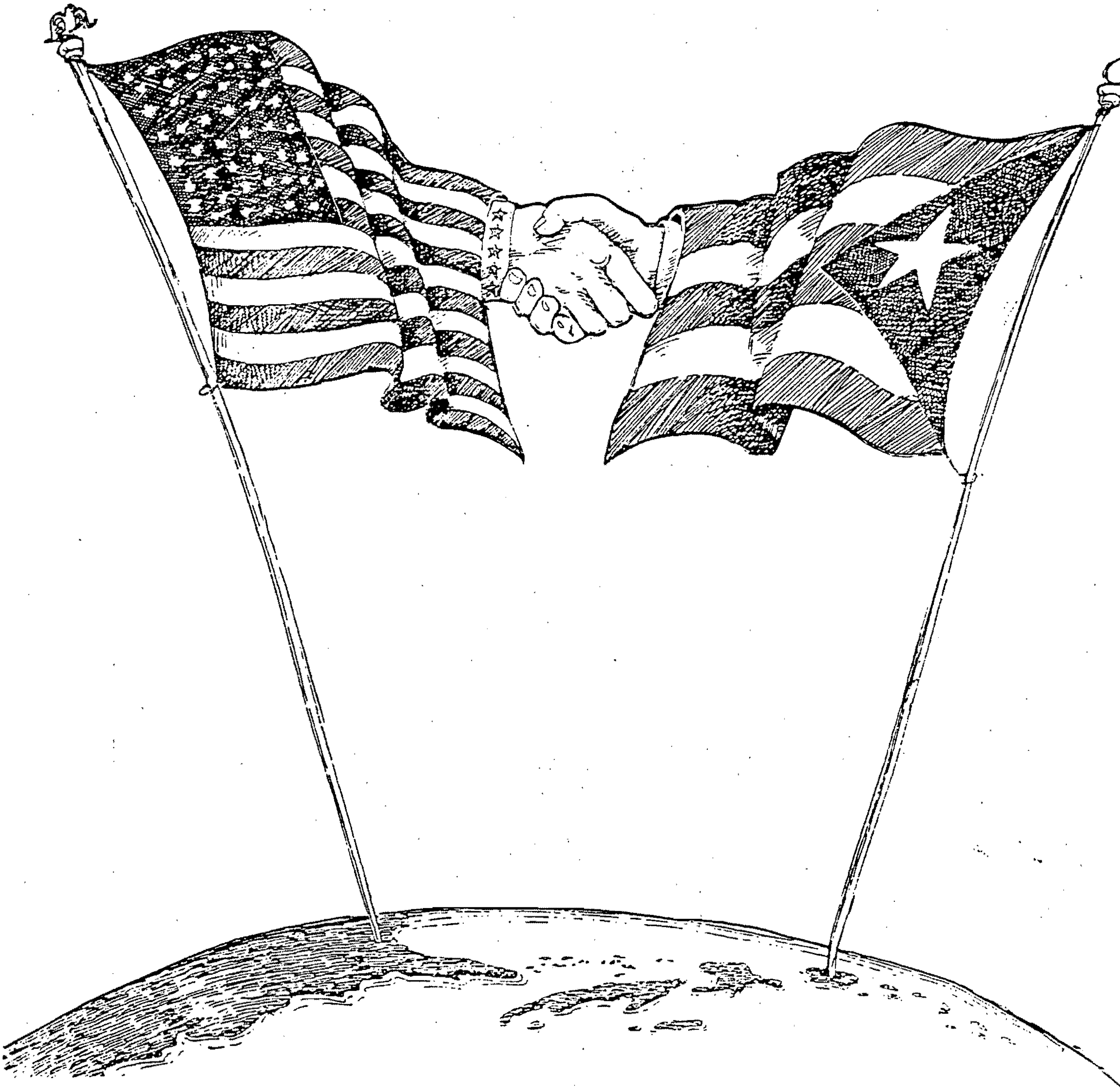
AIDS Czar - shld go to Mayors Conf. in NY June 18-23

B. ★ High unemployment in Puerto Rico 17%
Some pieces of pkg. will create unemployment in Puerto Rico, Technical part of wage? tax credit (65%)
WE SHOULD LOOK AT THIS! (he says)

Dem. Party Platform Promises being reversed

Leaving me out the paper
Treasury.
IRS - Econ. incentives

Section 936 — The Cornerstone of the U.S-Puerto Rico Economic Partnership



The Jefferson

G R O U P

Section 936 — The Cornerstone of the U.S-Puerto Rico Economic Partnership

Possible impacts from removal of Section 936 incentives include:

- It has been established that 300,000 jobs are directly and indirectly created by Section 936. Tinkering with Section 936 could result in the loss of these jobs.

- Approximately one-third of the funds deposited in U.S. banks operating in Puerto Rico are originated by companies operating under Section 936. The amount of funds on deposit has been estimated to range from $6 to $10 billion.

- Island banks are insured by the FDIC; any banks troubled by the possible loss of deposits will cause the Federal Government to take them over, thus adding to the strain on federal bank insurance funds.

- The present unemployment level is around 15%; the elimination of Section 936 would most likely cause this level to rise dramatically, thus causing an unexpected increase in federal unemployment benefit costs.

- Migration of islanders to the continental U.S. in search of jobs and better subsistence benefits would increase, since all Federal assistance applies to U.S. citizens in Puerto Rico. For example, approximately 62% of the Island's families would be eligible for food stamp benefits, but since Puerto Rico's Nutritional Assistance Program (NAP) is capped at a fixed level, the larger the number of families, the lower the benefits, triggering the migration of families. AFDC and Medicaid are other examples where migration would enhance the benefit level for families.

- The loss of competitiveness by U.S. industry in Puerto Rico may cause them to relocate to foreign sites offering incentives greater than Puerto Rico, such as Ireland, Mexico or the Far East. Relocations of this nature produce a net loss of jobs in the U.S. economy.

- Loss of the 936 tax credit may not result in enhanced revenues, since 936 companies could then resort to the use of foreign tax credit, thus limiting revenues to the U.S. Treasury.

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- The $10 to $13 billion that Puerto Ricans purchase in U.S. goods, making them the 5th or 6th largest buyer of U.S. goods in the world, would also be in peril. Unemployment usually leads to a diminishing capacity for the acquisition of goods, U.S.-made or otherwise.

- The decrease in manufacturing of goods in Puerto Rico would lead to a substantial decrease in the shipping of goods to the continental U.S. by U.S. vessels. Today, approximately 25% of the total value of shipments handled by the U.S. merchant marine is trade with Puerto Rico, primarily through ports in Louisiana, New Jersey, New York, Maryland, Florida and others. This could be a major blow to the U.S. maritime industry.

- The $2.3 billion purchased by just 50 corporations in supplies and services from mainland suppliers in 46 states and the 46,000 jobs these purchases create would probably vanish, creating further burden on the U.S. public assistance system.

- Substitution of a wage credit for Section 936 would raise costs in the high-wage, capital-intensive manufacturing industries responsible for Puerto Rico's recent employment gains.

- With a wage credit instead of Section 936, annual economic growth would decline by perhaps as much as 68%.

- By 2015, output per capita would be as much as 32% lower with a wage credit than it would be without such a policy.

- A wage credit will not significantly reduce labor costs in Puerto Rico. Even with a wage credit equal to 80% of the minimum wage and 30% of higher wages, average compensation in Puerto Rico would remain at least 84% higher than in other countries.

- Substitution of a wage credit for Section 936 tax credits reduces U.S. company investment in machinery and equipment in Puerto Rico and slows the pace of economic growth. There is a strong relationship between investment in machinery and equipment and economic growth.

- Clearly, the substitution of a wage credit for Section 936 tax credits will adversely affect the economy of Puerto Rico. Recent gains in high-wage, capital-intensive industries will be lost, overwhelming the negligible and short-term employment gain in low-wage, labor-intensive manufacturing industries that might result from a wage credit.

- Loss of 936 economic benefits will bring instability to the Caribbean Basin region, where the U.S. policy is to use Section 936 to promote economic development.

- A total of 105 projects were promoted in 12 Caribbean Basin countries, reportedly representing an investment of more than $600 million related to Section 936. These investments, in keeping with U.S. policy for the area, have promoted job creation in these countries.

- Economic development and job creation in these countries decreases the desire of families in these countries to illegally immigrate to the U.S. to seek an improved economic future.

- Furthermore, the North American Free Trade Agreement (NAFTA) will cause further erosion of the region's attractiveness for U.S. investment vis a vis Mexico. This, compounded with the loss of 936 incentives, may enhance the perception of U.S. abandonment of the region.

BUSINESS

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YVLYO Gpho

2.9% growth seen
Planning Board says local economy improving. Page 20

Dow up 8.64 points See Stocks Page 23

Analysts: Drug firms will bolt

Experts agree loss of 936 would prompt exodus

By DOREEN HEMLOCK
Of The STAR Staff

Most pharmaceutical manufacturers in Puerto Rico would leave the island over the next several years if Section 936 tax breaks are slashed, as proposed by President Clinton and Sen. David Pryor, D-Ark.

That's the consensus from separate interviews with drug industry analysts at major brokerage houses in New York.

They said that if Pryor's or Clinton's plan is approved, drug firms would see profitability here tumble.

Most would phase out in Puerto Rico and accelerate investment in other tax havens, such as Ireland, Singapore or Hong Kong.

"Relocation out of Puerto Rico should allow the effective tax rates of most drug companies to remain low," said Jerry Brimeyer, pharmaceutical analyst at Lehman Brothers.

The analysts' opinions come amid politically charged debate in Puerto Rico over the likely impact of the Washington proposals. Pro-statehood politicians have been downplaying a potential industrial exodus, while warnings of a possible pullout by drug companies have been seen as posturing.

Analysts are generally considered to be specialized, independent observers of trends in industry.

They say the likely scenario under the Pryor or Clinton plan would be a halt to new drug company expansions here; next, flight by those companies with smaller fixed investments; and then a departure by firms with larger fixed investments in as little as three years.

"It's a problem for Puerto Rico in the long term, not for the pharmaceutical companies," said Joseph Riccardo, senior managing director and pharmaceutical analyst at Bear Sterns & Co. "They'll just bolt the place. Ireland and Singapore would love to have them."

Added Steve Buermann, a pharmaceutical analyst with Merrill Lynch: "Even those companies that can't leave today may not be there in 2005. Eventually, all

Please see 936, Page 18

936

factories have to be upgraded or replaced."

Analysts said the number of firms that would leave likely would depend on how deep the tax cuts are. A trim of 936 benefits — far less severe than the Clinton or Pryor proposals — would not prompt an exodus, they contend.

"You can haircut the industry a little and not make it leave," said Riccardo. "But I don't know what the breaking point is."

Drug companies are the major investors in Puerto Rico's manufacturing sector today, and they pay the highest salaries on average of any industry here.

Also, drug companies account for slightly more than half the profits earned by 936 companies. That means their deposits account for a significant portion of money in the island's financial system.

Relocation from Puerto Rico would accelerate a trend already underway.

Even with 936, Puerto Rico is starting to lose some factories to Ireland and other sites.

That's partly because those nations offer a more sophisticated package of incentives, including generous research

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Joseph Riccardo
senior managing director and pharmaceutical analyst, Bear Sterns & Co.

and development support. Also, their benefits are more stable.

"The uncertainty over 936, year after year, has companies looking elsewhere," said Lehman's Brimeyer. "If the Puerto Rico government and U.S. government can't stabilize what will happen long-term, it will encourage the companies to pack up and leave."

Still, Puerto Rico remains the favored locale for U.S. drug companies today because of 936, the U.S. Internal Revenue Code provision which lets the U.S. firms send profits from the island to the states without paying federal taxes.

Analysts have estimated 936 benefits contribute about 5 percent to 33 percent a year in earnings for beneficiaries.

In 1991, eight major U.S. firms cut corporate tax rates on average by 7 percentage points and boosted earnings on average by 10 percent, said Brimeyer, who tracked American Home Products, Bristol-Myers, Eli Lilly, Merck, Pfizer, Schering-Plough, Upjohn and Warner Lambert.

Congressional studies claim that drug companies here get tax breaks of about $70,000 a year for each manufacturing employee under Section 936.

Pryor has proposed to repeal 936 and replace it with a wage-credit, with a tax break up to maximum $8,000 per worker per year.

Clinton has proposed to limit 936 tax breaks to 65 percent of compensation paid. Pharmaceutical salaries now average between $25,000 to $30,000 a year.

Brimeyer used the example of Schering-Plough to show the proposals' impact.

Schering was the first drug company to announce it would reassess its Puerto Rico presence if Pryor's proposal was adopted.

Last year, under 936, Schering got $65 million in tax benefits here. Under Pryor's plan, it would have received $11 million and under Clinton's plan, $39 million, said Brimeyer.

Brimeyer said Schering already has started reducing its reliance on Puerto Rico and 936. It now makes its new and most profitable products in Ireland, with Puerto Rico now making mostly older, less profitable goods.

In 1989, Puerto Rico helped cut Schering's corporate tax rates by 9 percent. Last year, they lowered the tax rate by 6.8 percent, he said.

If the Pryor or Clinton plan goes through, the company would further diminish its exposure in Puerto Rico, he said.

An exodus of pharmaceutical plants would hit Puerto Rico hard.

The industry directly accounts for about 18,000 direct jobs in Puerto Rico, and it creates thousands more indirect jobs in businesses that produce packaging materials and other supplies, transport products and offer support services.

Effects of Clinton plan go beyond 936

Economic program will have a wide impact on islanders

By JOHN MARINO
Of The STAR Staff

The national economic program that President Clinton unveiled last week will affect the island well beyond its proposal to cut Section 936, according to economic experts.

While Clinton's quest to tie 936 benefits to workers' compensation will have the largest impact, ripples from his detailed spending program and tax increases also will be felt.

His plans for 936 aside, however, Clinton's economic package may be felt most in what it lacks for Puerto Rico.

One of the plan's key components, granting various incentives to small businesses designed to spur their growth, comes in the form of federal tax credits and, therefore, won't apply here.

The incentives aimed at small companies, which are defined as those with total capitalization of under $25 million, include a 7 percent federal tax credit for purchasing equipment, which drops to a 5 percent credit after 1994.

Investors holding stock in these companies for five years will also escape federal taxes on half of any gains made.

"It's a double whammy," said Elías Gutiérrez, an economist and vice president of Corplan Inc. "Section 936 is attacked and because Puerto Rico is not covered by federal tax laws, the incentives won't apply."

While the Commonwealth government could, in theory, replicate some of the federal incentives, most economic experts don't see that happening.

Such incentives would cost the government revenue, at a time when the public purse faces chronic budget deficits.

Also, Gutiérrez notes that 85 percent of the Commonwealth budget is committed in salaries and fixed costs, leaving little room for the administration to grant more fiscal incentives to business.

"The Commonwealth government has gotten itself in a corner," he said. "There's very little that any administration can do."

Clinton's plan also gives the Rosselló administration an opportunity to drop a pledge to provide residents in the top tax bracket with some relief. That may be

Please see CLINTON, Page 20

AP Photostream

President Clinton

From Page 19

Clinton

welcome, with the fiscal pressure to fulfill costly campaign promises.

During his campaign, Gov. Rosselló pledged to lower the top income-tax rate of 36 percent to even with the top federal level. Clinton's plan, however, increases the top U.S. tax rate of 31 percent to the Puerto Rican level.

"I think Gov. Rosselló will be in need of additional revenues," said Mohinder Bhatia, president of Puerto Rico Management and Economic Consultants, Inc. "In the past, we have tried to retain tax rates that follow the federal government. The federal government expects us to follow them."

Despite repeated attempts, Commonwealth officials with knowledge of the matter could not be reached, however.

Clinton's broad-based energy tax proposal could be more bad news for islanders. The tax, based on the amount of heat generated by an energy source, would be levied on producers of oil, natural gas, coal and other fuels.

While federal excise taxes not do not imports most of its oil to produce e[illegible]tricity from Venezuela, so electric [illegible] should not go up.

But Commerce Department figu[illegible] from 1990 indicate that more than [illegible] percent of the island's oil comes from [illegible] United States, so some impact at th[illegible] pumps should be felt.

Liquified petroleum gas, which is use[illegible] as a substitute heat source, is also heavil[illegible] imported from the states, Gutiérrez sai[illegible] Some 65 percent of island families use th[illegible] fuel, and hospitals also use it for sterilizi[illegible]tion procedures, he added.

Clinton's plan holds out some goo[illegible] news for the island, however.

His economic stimulus package boos[illegible] government spending on transportatio[illegible] infrastructure, and Puerto Rico is expec[illegible]ed to receive an additional $18.7 millio[illegible] above what was previously authoriz[illegible] said Dr. Carlos Pesquera, the secretary [illegible] Transportation and Public Works.

That's on top of $83.3 million previou[illegible]ly authorized for highway and road co[illegible]struction and public transportation fo[illegible] fiscal year 1993.

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Please see CLINTON, Page 20

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Clinton's broad-based energy tax proposal could be more bad news for islanders. The tax, based on the amount of heat generated by an energy source, would be levied on producers of oil, natural gas, coal and other fuels.

While federal excise taxes not do not apply here, this tax, since it is being levied on energy producers, will be passed on to the consumer in the form of higher costs.

At this point, a U.S. Treasury official said, exports are not excluded from the tax proposal, meaning that Puerto Rico would have to pay it on oil and other fuels purchased stateside.

Gasoline prices are expected to rise 7.5 cents per gallon stateside.

"The tax will get built into the pricing structure, so we will be impacted like anybody else," Bhatia said.

Most of the island's oil is imported from areas outside the United States, so many of the energy products here may not go up in price. The Puerto Rico Electric Power Authority, for example, imports most of its oil to produce electricity from Venezuela, so electric bills should not go up.

But Commerce Department figures from 1990 indicate that more than 3 percent of the island's oil comes from the United States, so some impact at the pumps should be felt.

Liquified petroleum gas, which is used as a substitute heat source, is also heavily imported from the states, Gutiérrez said. Some 65 percent of island families use the fuel, and hospitals also use it for sterilization procedures, he added.

Clinton's plan holds out some good news for the island, however.

His economic stimulus package boosts government spending on transportation infrastructure, and Puerto Rico is expected to receive an additional $18.7 million above what was previously authorized, said Dr. Carlos Pesquera, the secretary of Transportation and Public Works.

That's on top of $83.3 million previously authorized for highway and road construction and public transportation for fiscal year 1993.

The construction sector should receive another shot in the arm by Clinton's proposals to increase housing funds, particularly for low-cost housing. This could translate into $283 million more in federal housing funds this year.

And increased funds for the Community Development Block Grant program should help island construction even further. Twenty-three island municipalities are seeking $458 million to fund 150 construction projects, which could generate 15,000 jobs.

Under Clinton's plan, more of these projects should receive approval.

And the boost to the construction sector will give a kick to the island's economy as a whole, said Augusto Amato, an economist. Increased construction activity has a multiplier effect, spurring pick-ups in industries from cement manufacturers to retail furniture outlets.

The threat to 936

A critical issue for Puerto Rico and for all of the Caribbean Basin

By MANUEL A. CASIANO JR.
President of Casiano Communications
and Editor in chief of CARIBBEAN BUSINESS

The heavy-barreled attack against Section 936 that is now taking place in Washington needs a similarly powerful defense. Yet one important group of beneficiaries – the Caribbean Basin Initiative (CBI) countries – has been surprisingly silent. It behooves the Rossello administration to move swiftly to inform CBI leaders of the importance of their support.

Under the Tax Reform Act of 1986, Puerto Rico was committed to an annual investment of $100 million of 936 funds to eligible CBI countries – those that signed Tax Information Exchange Agreements (TIEA) with the United States. As of December 31, 1992, according to information released by the Caribbean Development Program, financial institutions in Puerto Rico have disbursed $678 million in 936 funds as loans for projects in eight countries plus the U.S. Virgin Islands.

Although the Tax Reform provision was enacted in 1986, the first loans were not disbursed until 1988, because of the extended period of time it took for the United States Treasury to write the CBI regulations and for individual CBI-designated countries to complete their TIEA negotiations. To date, only 10 countries have signed TIEAs so that Puerto Rico could lend them 936 funds.

From the time these technicalities were completed in 1988, Puerto Rico has moved quickly to make 936 loans to CBI countries. Loans of $678 million have already been disbursed, an average of more than $135 million per year in five years (1988-1992). Puerto Rico has exceeded its 936 lending obligation by $178 million in actual disbursements and, in addition to the loans, has helped create thousands of jobs in our neighbor CBI countries through promotion of twin plants.

The benefits of 936 were and are intended to stimulate investment in Puerto Rico and to generate expanded employment on this island. As industries have become more sophisticated in Puerto Rico and, in many cases, more capital-intensive, the number of jobs created have been declining at the same time profits have increased. This is what has led to the periodic attacks on 936 in the U.S. Congress. The 936/CBI Strategy was devised to deflect these attacks and pacify Washington with support for U.S. foreign policy in the Caribbean and CBI – a particular concern of then-president Ronald Reagan.

At the beginning of the program, twin plants created many jobs in Puerto Rico. In the last few years, very few jobs have been created here with 936 monies loaned to Caribbean and Central American Countries. Yet, Puerto Rico has not stopped lending its 936 funds. Hundreds of millions of dollars have gone to loans that have created many jobs and have helped our CBI neighbors to develop their economies.

The $678 million already disbursed to countries such as Jamaica, Trinidad and Tobago, Dominican Republic, Barbados, Honduras, Dominica, and Costa Rica do not include another $300 million that have been approved up to December 31, 1992, but have not yet been disbursed.

It does not include another $76 million loan just approved by Chase Bank for a telephone project in Honduras and another one for $88 million to Honduras which is about to be approved by Citibank– a total of $160 million to that country alone.

The country of Trinidad/Tobago is the leader in receipt of 936 loans with over $275 million, followed closely by Jamaica and then the Dominican Republic. Considering that only 10 CBI countries out of 24 have signed TIEAs with the U.S., Puerto Rico has really come through.

When you total all the loans, in just a little over five years Puerto Rico will have loaned these 10 CBI countries and the U.S. Virgin Islands almost $1.1 billion – an average of $220 million dollars per year.

Puerto Rico has shown a major interest in helping its neighbors far above the commitment of $100 million per year made to the U.S. Congress in 1986. The government of Puerto Rico has enthusiastically endorsed the twin plant and 936 lending program throughout the Caribbean and Central America and has pursued it with the above described results. The economic stimulus to our neighbors created with twin-plant jobs and 936 loans has also helped to increase trade between CBI countries and Puerto Rico.

Over the next few months, Puerto Rico will be facing one of the toughest fights it has ever had in Washington to save 936. There is no question it could use all the help it can get. There is no doubt that the CBI countries, either individually or as members of CARICOM and other organizations, can help Puerto Rico influence the Clinton administration and other key people in Washington.

The Rossello administration through Secretary of State Baltazar Corrada del Rio should contact each and every one of the CBI countries in the Caribbean and Central America and ask for their active support. These countries in turn should do everything within their power to influence Washington not to make any changes in 936. Section 936 is much too important for Puerto Rico to be tampered with at this time and it has proven to be a very important source of funds to the CBI countries, funds that will unlikely be available from any other source if Puerto Rico's 936 program is changed by Washington. ■

Puerto Rican Businesses Are Terrified Of Clinton Plan to End Tax Exemption

By JOSE DE CORDOBA
Staff Reporter of THE WALL STREET JOURNAL

President Bill Clinton's proposal to curtail a $3 billion-a-year federal tax exemption for companies doing business in Puerto Rico has terrified the business community of that U.S. commonwealth and created a political dilemma for its newly elected government.

Last week, in defense of his economic plan, President Clinton signaled he wants to replace a federal tax provision that exempts from federal taxes income earned by corporations based in Puerto Rico and other U.S. territories. President Clinton would replace the provision, Section 936 of the Internal Revenue Code, by a 65% tax exemption on wages paid by the corporations to their employees.

Two days earlier, Sen. David Pryor, calling Section 936 "the most abusive of all tax shelters – maybe of all time," weighed in with a Senate bill that would replace the tax exemption with a 40% tax exemption on wages paid by corporations to their employees up to $20,000. Sen. Pryor, perhaps President Clinton's closest friend in Congress, said Section 936 had become "a gigantic tax windfall for the pharmaceutical industry."

'Disproportionate Share'

In a draft of its tax proposals, the Treasury said that while Section 936 was enacted to foster economic development in Puerto Rico and other U.S. possessions, repeated studies indicate that a "disproportionate share" of its funds go to industries "that create relatively few jobs." The Treasury says that in 1989, for instance, U.S. taxpayers spent $66,081 for every job that pharmaceutical companies – an industry that reaped half the benefits of Section 936 – created in Puerto Rico.

Going along with Treasury recommendations, the Clinton proposal would limit the tax breaks companies get to 65% of employee wages subject to Social Security taxes – and save the federal government more than $7 billion over the next six years, according to Mr. Clinton's defense of his proposal. (Puerto Rican businessmen say that those projected savings are illusory because many companies would move offshore.)

Section 936 and previous similar tax legislation have been the motor of Puerto Rico's modern development, pulling the island from a poverty that once was worse than in Haiti, to what for Latin America and the Caribbean is relative prosperity. (Still, with a per capita income of $6,033, Puerto Ricans, who are U.S. citizens but don't vote in U.S. elections, have roughly half the income of Mississippians, the U.S.'s poorest state.)

About 520 so-called 936 companies employ about 115,000 Puerto Ricans directly and, it is estimated, account for more than 200,000 more indirect jobs. All together, about one-third of all the jobs on the island, where unemployment hovers around 15%, depend on Section 936.

A Key Part

Funds from 936 companies are a key part in the island's financial system. They account for about one-third, or $6 billion of all funds on deposit in Puerto Rican financial institutions. The 936 funds keep borrowing costs low, says Terrence Wadsworth, president of the Puerto Rico Bankers Association and general manager of the Chase Manhattan Bank's Puerto Rico unit. The 936 companies also supply about $500 million to $600 million in tax revenue to the island's government.

Funds from the program are also important for the Caribbean region as a whole. Since 1986, close to $900 million of 936 funds has been invested in economic development projects in 10 Caribbean basin countries, creating 120,000 jobs in the region, says Baltasar Corrada del Rio, Puerto Rico's secretary of state.

Most Puerto Rican business leaders believe that a wage credit, on the lines of those proposed by President Clinton or Sen. Pryor, wouldn't work. As it is, they say, Puerto Rico has relatively high business costs. Without the Section 936 tax exemption, the high costs would make it difficult for Puerto Rico to attract new investments or retain old ones. The business leaders foresee an economic catastrophe in the making for the island, which is already feeling squeezed by competition for investment from lower wage countries, especially Mexico.

"It would be a disaster for Puerto Rico," says Daniel Lebron, the president of the Puerto Rico Manufacturers Association, the island's chief business group. Mr. Lebron, who is also president of the Puerto Rico unit of pharmaceutical firm Searle & Co., says that if Section 936 is replaced by a wage credit, in 10 years the island's high-technology industrial base will be "20% of what it is now."

Reassessing Its Presence

Already one pharmaceutical company, Schering-Plough Corp., which has four plants with nearly 2,000 workers on the island, has said that it would "be forced to reassess its presence in Puerto Rico" if Section 936 tax benefits are eliminated or significantly reduced. There are about 50 pharmaceutical companies operating on the island. They account for about 18,000 of Section 936's direct jobs.

"It wouldn't be a giant sucking sound but I do see attrition," says John Stewart, an economist with Puerto Rico's development agency. The danger, says Mr. Stewart, is that Puerto Rico will be caught in a vice, losing jobs at both ends of the wage scale.

On the one hand, says Mr. Stewart, the phasing out of Section 936 would dissuade any new high-tech, high-wage jobs from coming to the island. Meanwhile, spurred by the signing of the North American Free Trade Agreement with Mexico, low-tech, low-wage jobs will continue to migrate south.

In the past, Puerto Rico's government, allied with 936 companies have mounted massive lobbying efforts in defense of the tax exemption. But this time, the government's response has been hesitant and confused. The reasons are both political and philosophical.

Ironically, while the platform of the ruling pro-statehood party calls for the energetic support of Section 936 until the island's economy reaches a level comparable with the U.S., many in the party have a deep and abiding hatred for the law, which they see as a golden chain restraining the island from the statehood status they desire. (Gov. Pedro Rossello has called for a plebiscite on the issue for late this year.)

'Falls Short'

So while Gov. Rossello says that President Clinton's proposal concerning Section 936 now "falls short" with regard to the island's needs for jobs and capital investment, he differs with Puerto Rico's Washington representative, Carlos Romero Barcelo, who thinks the president's proposal is "a good step forward."

[illegible] island's representative and liaison with Congress, Mr. Romero Barcelo, a former governor, would normally be the pointman in the government's efforts to safeguard Section 936.

Not this time. "Its an inferiority complex created because of Puerto Rico's status as a colony," says Mr. Romero Barcelo, referring to the idea that the island can't make it economically without Section 936. Good riddance, he sniffs.

"A lot of vested interests will have it less easy, but that doesn't mean Puerto Rico will have it less easy," he says. "Puerto Rico's interests are not necessarily the same as those companies' vested interests."

California Microwave Offering

SUNNYVALE, Calif. – California Microwave Inc. said it has made a public offering of 2.2 million common shares at $13.25 a share.

The wireless communications company said proceeds will be used to pay down debt. As of Dec. 31, 1992, the company had 9.4 million common shares outstanding.

clip/936

LOCAL NEWS

SmithKline officials testify before Senate on abolishing 936

Drug firm may leave P.R. for another shelter

By IVONNE GARCIA
Of The STAR Staff

Executives from SmithKline Beecham Pharmaceuticals said Wednesday they would consider leaving Puerto Rico for some other tax haven if Section 936 is eliminated.

José L. Rosado, president and general manager of SmithKline Beecham, was the first to testify before the Senate Labor Committee which, along with the Federal Affairs Committee, is investigating the local effects of eliminating Section 936.

Representatives from Brystol-Myers Barceloneta Inc. also were expected to appear Wednesday, but received an extension until Monday.

SmithKline, maker of Tagamet, a brisk-selling ulcer treatment drug, didn't submit the slew of documents requested by committee chairman Sen. Nicolás Nogueras, NPP-at large, but got a reprieve. The company now has until Friday to hand over locally filed documents, including municipal excise taxes paid. It has until Monday to submit other information, including its federal income tax returns for the past 10 years.

"Company officials are gathering the information now," said President and General Manager José L. Rosado. "I was summoned yesterday (Tuesday), and getting together information dating back to 1982 involves going into dead files."

SmithKline is the second 936 pharmaceutical company to publicly admit that with the tax exemption gone they would mull over a pullout. Last week, Schering-Plough said it would be "forced to reassess its presence in Puerto Rico" under such circumstances.

With 936 gone, Rosado said investments into the Puerto Rico plant would likely cease and jobs would be reduced. The company would then evaluate its options, including moving to countries such as Singapore or Ireland which offer similar tax incentives.

"Puerto Rico isn't the only country with tax benefits," Rosado said.

Meanwhile, Brystol-Myers officials took notes of what senators asked and said they would be ready to testify when their turn comes. Other pharmaceutical company officials also were present Wednesday checking out a procedure they will soon go through.

"We want to make sure we submit all the necessary data so we can help legislators understand," said Brystol-Myers Squibb Caribbean Corp. spokeswoman Carmen Judith Vélez.

Also Wednesday, the federal affairs committee subpoenaed 44 more pharmaceutical companies, added to the nine subpoenaed the day before. A total 53 drug makers will have to submit further information to that committee, including lobbying and public relations expenses.

The schism in the New Progressive Party with regards to 936 was evident in the two legislative committees concurrently holding hearings. The labor committee has consistently heard testimony on the problems that would arise if the program were eliminated, while its federal affairs counterpart appeared intent on getting people to testify the effects would be minimal.

"Going to Washington to say 936 can't be touched because Puerto Rico will sink is a barbarity," said economic analyst Ivar A. Pietri, former Government Development Bank executive vice president.

The NPP is split between those who recognize the need to defend the tax exemption for the time being, and those who want to do away with it and pave the way for statehood. Gov. Rosselló made a campaign promise to fight for 936, but resident commissioner Carlos Romero Barceló has not risen to its defense.

STAR photo by Pipo Orejales

José L. Rosado, President and General Manager of SmithKline Beecham Pharmaceuticals, tells members of the Senate Labor and Federal Affairs committees Wednesday that eliminating Section 936 would force the company to cease investments in Puerto Rico and cut jobs. He said the company would consider moving to Singapore or Ireland.

P.R. to ask Caribbean nations to defend 936

By DOREEN HEMLOCK
Of The STAR Staff

Puerto Rico plans to ask the Dominican Republic and other Caribbean Basin countries for help in its lobby to defend Section 936 tax breaks, Secretary of State Baltasar Corrada del Río said Tuesday.

An appeal to the neighbors will have to wait, however, until Puerto Rico figures out its strategy to save the tax breaks, "so we're all speaking the same language," he told a seminar on Dominican trade and investment trends.

Corrada said a strategy linked with the Caribbean Basin must be carefully crafted, because members of Congress are divided over the worthiness of Puerto Rico's efforts to help economic development in the region.

Some members of Congress strongly support Caribbean development and Puerto Rico's lending offshore, while others view the program as promoting export of U.S. jobs overseas, he noted.

Corrada said he expected strong Caribbean support, because Puerto Rico's 936-Caribbean program has helped created more than 30,000 jobs in Caribbean Basin countries.

Puerto Rico has promoted more than $1.1 billion in offshore investments financed through 936 loans or with money from other sources. Loans

Please see CORRADA, Page 23

CARIBBEAN

STAR file photo

Secretary of State Baltasar Corrada del Río said Tuesday that Puerto Rico plans to ask the Dominican Republic and other Caribbean Basin countries for help in its lobby to defend Section 936 tax breaks.

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Corrada

with 936 funds are the largest single source of project financing for some countries, he said.

Section 936 of the U.S. tax code lets U.S. firms in Puerto Rico send profits back to the states without paying federal taxes. Profits deposited in Puerto Rico, known as 936 funds, are loaned at low interest rates for economic development projects in eligible Caribbean Basin countries.

An appeal for Caribbean Basin support for Puerto Rico's 936 lobby would coincide, however, with efforts by the Rosselló administration to cut back on its 936 lending and development efforts regionwide.

Corrada has said he would prefer that Puerto Rico's commitment for lending $100 million a year in 936 funds in the Caribbean be a maximum, not minimum.

And he has talked of plans for a "twin-bed" policy, in which 936 loans for tourism projects in other regional nations would be contingent on developers building the same number of tourist beds in tourism projects here.

Corrada said he sees no contradictions in asking for Caribbean support for a 936 lobby and also revising the program, "because no one is going to try to shoot themselves in the foot."

He said if Puerto Rico had a "open faucet" policy on 936 lending abroad — financing say, $400 million to $500 million in 936 projects abroad a year — then the program might erode the funding that Puerto Rico needs for its own development.

Also, if San Juan loaned indiscriminately for tourism projects abroad, it could hurt Puerto Rico's effort to double the weight of tourism in Puerto Rico's economy this decade, he said.

"We're not being chauvinistic, but realistic," Corrada told more than 50 business and government representatives from Puerto Rico and Santo Domingo.

Corporate attorney Luis Pellerano, of Pellerano & Herrera, a leading Dominican law firm, said Dominican newspapers have been carrying reports of attacks on Puerto Rico's 936 tax breaks.

Yet, business and government leaders have not mobilized on 936, despite widespread support for the program that has spurred twin plants and low-interest lending for the Dominican Republic.

"Puerto Rico has not raised the level of awareness in the Dominican Republic on the issue, so that people are really aware of the scope of the problem," Pellerano said.

Puerto Rico's 936 program is not the only economic challenge on Santo Domingo's plate these days, anyway.

Officials are worried that the North American Free Trade Agreement could divert trade and investment to Mexico.

Also, a team from the U.S. General Accounting Office recently visited Santo Domingo to investigate whether U.S. government funding through the Agency for International Development was promoting "export" of U.S. jobs overseas.

Corrada said Puerto Rico has a role to play as part of the United States in ensuring that Washington's economic policy does not relegate the neighboring Caribbean to a back burner, while it develops NAFTA and other trade agreements with larger hemispheric markets.

The Dominican Republic and other Caribbean Basin countries have lobbied Washington in the past in favor of Section 936. Their support was considered crucial in the mid-1980s to saving the tax break from a proposed phase out.

936 UNDER ATTACK

Proposal to replace 936 faces opposition

Corrada: P.R. would have to be treated as foreign country

By JORGE LUIS MEDINA
Of The STAR Staff

A proposal to replace Section 936 with a scheme using the tax code on foreign investments faces fierce opposition in Congress, Secretary of State Baltasar Corrada del Río said Tuesday.

The plan to use Section 901, which allows U.S. companies to pay taxes abroad and deduct them from their federal tax return, was made this week by Puerto Rican Independence Party president Sen. Rubén Berríos Martínez.

Corrada, a two-term former Resident Commissioner, said any attempt to have Section 901 apply here would be asking Congress to treat Puerto Rico as a foreign country instead of a U.S. territory.

"The problem is that, apart from good intentions, the foreign tax credit is an instrument Congress traditionally designed to deal with its relations to foreign countries, not with domestic areas. It would be like asking that Puerto Rico be treated like a foreign country, which would be unusual," Corrada said.

"There's a great animosity towards the foreign tax credit in Congress ... because of the lost jobs that would go to foreign countries."

Corrada and other members of Gov. Rosselló's 936 task force met Tuesday at La Fortaleza.

While Corrada conceded that the PIP's proposal "should be analyzed," he predicted it would face serious problems in Congress.

Corrada, La Fortaleza Chief of staff Alvaro Cifuentes and Fomento chief Clifford Myatt will travel to Washington today to meet with key congressmen and other groups to lobby for Section 936.

While he would not give specific details, Cifuentes acknowledged he, Corrada, and Myatt would meet with the Puerto Rico U.S.A. Foundation, the lobbyist group that represents 936 companies in Washington.

Cifuentes said the administration's strategy will be to present a unified front in Congress, with the Commonwealth and the other interest groups joining in a common position.

The administration will emphasize how Section 936 benefits Puerto Rico, said Cifuentes.

Meanwhile, the Government Development Bank is updating its Section 936 studies, and the Bankers Association will also update its studies of 936 deposits in local banks.

Studies

The updating is part of the Section 936 task force's plan to defend the section in Congress.

Cifuentes acknowledged that devising a plan of attack has been difficult because the U.S. Treasury Department has little information on how President Clinton's proposal to substitute Section 936 with a 65 percent wage tax credit will be implemented.

cc. DNC

The San Juan Star
Feb 24/93

BUSINESS

N.Y. mayoral hopeful backs Section 936

By DOREEN HEMLOCK
Of The STAR Staff

Puerto Rico's Section 936 tax breaks got a plug Tuesday in New York from City Council President Andrew Stein, who is running for mayor this year.

Stein said significant cuts in 936 tax breaks for U.S. firms in Puerto Rico would hurt the island and therefore affect New York — home to about 1 million Puerto Ricans.

He said slashing 936 would mean a major loss of jobs in Puerto Rico and would prompt more migration to New York City, at a time when the city faces a 13.4 percent unemployment rate.

"Today, Puerto Ricans who might be forced to come to this city will probably have to join the ranks of the unemployed and will have to go on public assistance," Stein said in a prepared statement.

"They will be part of the frustrated working poor struggling to survive in a city, which in the words of councilman José Rivera only provided 'broken promises,'" Stein added.

He also warned cuts in 936 could reduce Puerto Rico's 936 developmental loans to Caribbean Basin countries, and "this too must be taken into account when deciding the future of Section 936."

Caribbean Basin nations — especially the Dominican Republic — are among the major sources of immigrants to the New York City area nowadays.

Stein's remarks coincide with his campaign to woo the Puerto Rican and Latino vote for his mayoral candidacy in New York. He recently sponsored an 'Octavitas in New York' party, complete with bands from the island.

The comments focused specifically to a bill by Sen. David Pryor, D-Ark., which would repeal Section 936 and replace it with a slim wage credit.

Pryor filed the bill last week in an attempt to curb what he called "excessive" profits by pharmaceutical companies who benefit from 936 tax breaks but charge "excessive prices" to consumers.

Section 936 of the U.S. Internal Revenue Code allows U.S. manufacturing companies in Puerto Rico to send profits back to the states without paying federal taxes on them.

Stein suggested that the solution to the drug profit-price issue "is not to change, or eliminate Section 936, but rather set up a commission with the proper authorities in Puerto Rico to investigate the full ramifications of the present effects and proposed changes."

"For me, it is a matter of principle that any change in this, or any other law which so deeply effects the life of Puerto Ricans, must be done only after a thorough consultation with the people of Puerto Rico," he said.

Stein linked the 936 question with the thorny issue of Puerto Rico's political status, noting that any review of the tax breaks program "must be done taking into account the direct implications this would have on the status debate on the island."

In addressing the importance of Section 936 for Puerto Rico, Stein noted that 936 beneficiary firms directly employ about 115,000 people. Indirectly, they are responsible for about 300,000 jobs, about one-third of all island employment.

Stein said he would communicate his position to New York's congressional delegation in Washington and "strongly urge it to lend qualified support to Section 936 in consultation with the Puerto Rican leadership on the island and on the mainland."

A Short History of the 936 Wage Credit

Back in 1982, Sen. **Robert Dole** and Rep. **Dan Rostenkowski** were the first to propose replacing Section 936 with a wage credit. The proposal came during the eleventh hour of Congressional consideration of the Tax Equity and Fiscal Responsibility Act (TEFRA). The final version of the bill was to be hammered out in a conference made up of representatives of the Senate Finance Committee, then chaired by Dole, and the House Ways and Means Committee, chaired, then as now, by Rostenkowski.

The Finance Committee had already approved a provision to forbid the transfer of intangible property to Section 936 companies, as a means of curbing the total amount of credits a company could take. Puerto Rico opposed the change threatening to withhold its approval of the Caribbean Basin Initiative, then before Congress, unless the intangibles provision was dropped.

Such was legislative situation, when Dole and Rostenkowski proposed substituting Section 936 for a wage credit. It was only through the last minute intervention of Rep. **Charles Rangel,** D-NY, a high ranking Democrat on the Ways and Means Committee, that the wage credit was dropped and replaced by a formula that would permit companies to transfer manufacturing, but not marketing, intangibles to Puerto Rico.

In late 1983, with the Federal deficit growing in spite of TEFRA, **Peter Merrill,** the ranking economist on the Joint Tax Committee, delivered a policy paper, entitled *Trains Passing in the Night: Legislating for Puerto Rico,* where he argued in favor of substituting Section 936 with a wage credit. Wrote Merrill:

> A wage credit or similar tax system would be far simpler to administer than the current Section 936 intangible income provisions and would prevent a company from claiming credits far in excess of its payroll in the possessions.... The main comparative advantage of the Puerto Rican economy is its ample labor supply; yet the current tax incentive system encourages capital, relative to labor utilization.

A year later, the wage credit made its second "official" appearance—this time as part of President Reagan's *Tax Reform for Fairness, Simplicity and Economic Growth,* the centerpiece of his second term. Reagan proposed a wage credit set at 60 percent of the federal minimum wage from 1987 through 1992, and then it would be phased out in yearly, 10 percent, increments until it was eliminated in 1998. The companies and Puerto Rico immediately and strenuously opposed the plan. Reagan's proposal would mean a tax credit per employee of $2,801 versus the Section 936 credit per employee in the labor intensive apparel industry of $3,030 and $20,656 per employee for the average Section 936 company.

Under intense lobbying by the industry and Puerto Rico Government, six months later the Reagan Administration modified its proposal. It made the wage credit permanent and applicable to income from any source, not just to income from Puerto Rico. "Now this new incentive had to be taken seriously. The credit would be 60 percent of the minimum wage and 20 percent of any wages paid above the minimum up to a maximum of four times the minimum wage. For companies with other profits against which they could apply the Puerto Rico credits it would have amounted to a handsome new subsidy for hiring workers in Puerto Rico," wrote **Gary Martin,** a Puerto Rico government economist, in a paper he wrote in 1989 for the *Journal of Hispanic Policy.*

However, Martin also pointed out that the new policy had two "important new bias...against local ownership in Puerto Rico and against labor intensive manufacturing in competing U.S. locations." That is, mainland-based manufacturing and Puerto Rican manufacturers would not be able to quality for the wage credit subsidy.

The Reagan wage credit proposal was beaten back through the lobbying efforts of the Puerto Rico Government and the companies. In its place, the Congress opted to "share" Section 936 benefit with the Caribbean by allowing Section 936 funds to be invested tax free in Caribbean development projects.

The wage credit is with us again with the introduction this week of President **Bill Clinton**'s economic plan and Sen. **David Pyror**'s bill.

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NOTES

MAYOR ACEVEDO'S D.O.B. IS P6/(b)(6)
HE WILL BE ACCOMPANIED BY
JOSE ORTIZ-DALIOT, HIS WASHINGTON
REPRESENTATIVE, D.O.B. P6/(b)(6)

THANKS!

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HÉCTOR LUIS ACEVEDO

Mayor of San Juan, Puerto Rico

Héctor Luis Acevedo was elected Mayor of San Juan, Puerto Rico in 1988. Mayor Acevedo graduated from the University of Puerto Rico School of Law in 1972, and has participated in the Education Program for Lawyers offered by Harvard Law School.

Mayor Acevedo has served in a number of posts in his public service career. He began in 1969, as a professor at the University of Puerto Rico, and has also been a professor at the Inter-American University and the Catholic University of Puerto Rico. In 1973, he was appointed Legal Advisor to the Washington Office for Puerto Rico. From 1973 to 1975, he served as Assistant to the Secretary of Justice. In 1975, he accepted an appointment as Assistant to the Governor. From 1976 to 1984, he served as a Commissioner on the Puerto Rico Electoral Commission. From 1985 to 1988, he served as Secretary of State of Puerto Rico.

Mayor Acevedo was elected President of the Inter-American Foundation of Cities in September, 1990, during the organization's meeting held in Buenos Aires, Argentina. Mayor Acevedo is also President of the Pan-American AIDS Foundation and Co-Chair of the AIDS Task Force of the U.S. Conference of Mayors.

Mayor Acevedo is a Major in the United States Army Reserve.