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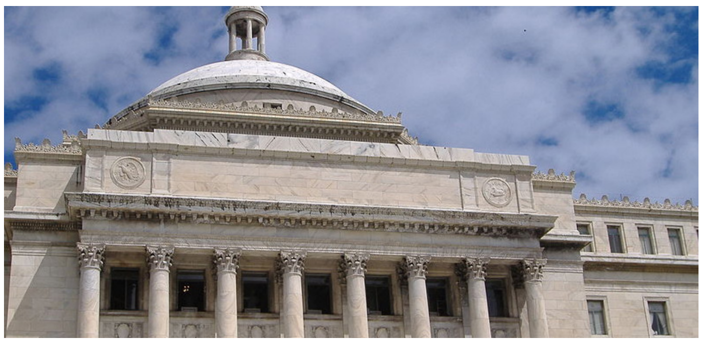
FEATURED Q&A

Would Tax Benefits Bring New Business to Puerto Rico?



Some critics say elimination of a U.S. tax code provision several years ago led to economic problems in Puerto Rico, whose capitol is pictured above. // File Photo: Mtmelendez via Creative Commons.

Q Puerto Rico, which has struggled with crushing levels of debt, has also faced multiple economic shocks in recent years, including hurricanes, earthquakes and now the Covid-19 pandemic. The U.S. territory's financial situation has led to calls for the reinstatement of Section 936 of the U.S. tax code, which was enacted in 1976 and allowed U.S. manufacturers to avoid corporate income taxes on profits made in the country's territories, including Puerto Rico. However, the provision was phased out beginning in 1996, and factory closures and job losses followed. To what extent did Puerto Rico's economic difficulties result from the end of the provision? Should Section 936 be revived, and how much of an economic impact would its return have on the U.S. territory? How likely is the provision to return?

A Sila M. Calderón, president of Inter-American Global Links and former governor of Puerto Rico: "Section 936 was phenomenally successful in bringing back to the United States billions of dollars that had accumulated in European banks since World War II. This section of the tax code allowed companies with subsidiaries in Puerto Rico to invest their profits on the island and deposit them in local banks belonging to the U.S. banking system. In addition, it created close to 150,000 well-paid jobs at more than 2,000 U.S. manufacturing companies. It allowed them to send profits back to their holding companies, largely free of U.S. and Puerto Rican corporate income taxes. From then on, the U.S. banking system had billions of dollars coming to banks established on the island. Section 936 generated an immense

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TODAY'S NEWS

POLITICAL

Demonstrators For, Against Bolsonaro Take to Streets in Brazil

Demonstrators both for and against President Jair Bolsonaro protested in São Paulo and Rio de Janeiro. Bolsonaro himself addressed a rally of his supporters in Brasília.

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ECONOMIC

El Salvador's Bukele Vows to Veto Measure to Reopen Economy

Salvadoran lawmakers passed a measure to gradually reopen the economy, but President Nayib Bukele vowed a veto, saying the country must remain locked down to fight coronavirus.

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ECONOMIC

Maduro Rolls Back Venezuela Fuel Subsidy

Venezuelan President Nicolás Maduro said he was rolling back a longstanding fuel subsidy and privatizing service stations.

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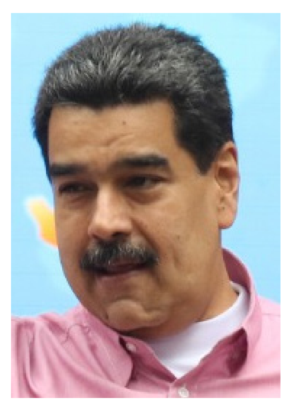

Maduro // File Photo: Venezuelan Government.

POLITICAL NEWS

Demonstrators For, Against Bolsonaro Protest in Brazil

Both supporters and opponents of Brazilian President Jair Bolsonaro took to the streets in rival demonstrations over the weekend amid an escalating death toll from the novel coronavirus and as the Supreme Court continued its investigation of a misinformation scheme allegedly run by allies of the president. On Sunday in São Paulo, police said they used tear gas to disperse hundreds of demonstrators as pro-and anti-Bolsonaro protesters came close to clashing, the Associated Press reported. The anti-Bolsonaro protest, which included several members of soccer fan clubs wearing black, appeared to be the largest protest against Bolsonaro in months, the wire service reported. Alvaro Batista Camilo, the executive secretary of the military police, said officers fired tear gas in order to keep the Bolsonaro opponents away from a group of the president's supporters who were carrying what he described as a neo-Nazi flag, the AP reported. Police also fired tear gas at anti-Bolsonaro demonstrators who clashed with supporters of the president in Rio de Janeiro. In Brasília, Bolsonaro himself greeted demonstrators from a helicopter flying over a rally before landing and then getting onto a police horse in front of the protesters, Bloomberg News reported. Bolsonaro was not wearing a mask despite a local government decree requiring their use in public in order to curb the spread of Covid-19. Some of the protesters at the rally Bolsonaro attended carried banners blasting the Supreme Court and even calling for military action against it and Congress, Bloomberg News reported. In addition to the Supreme Court's investigation into the misinformation ring, in which social media was purportedly used to promote fake news and personal attacks, the high court also authorized an investigation into allegations raised by former Justice Minister Sérgio Moro, who accused Bolsonaro of trying to meddle in police investigations. Also on Sunday, hundreds of demonstrators gathered in the square facing the government palace in Rio de Janeiro, protesting crimes committed by police against black people in the city's favelas, the Voice of America reported. Demonstrators chanted, "I can't breathe! I can't breathe!" in reference to George Floyd, the black man who died in police custody after a white police officer knelt on his neck for several minutes in the U.S. city of Minneapolis. The incident has also led to protests in cities across the United States in recent days. The protests in Brazil have been happening at the same time that the country's Covid-19 cases and related deaths have been escalating. On Saturday, the South American country's reported death toll from the disease surpassed that of France to give Brazil the fourth-highest death toll in the world. As of this morning, more than 29,000 people in Brazil are reported to have died of the disease, after only the United States, the United Kingdom and Italy, according to a tally by Johns Hopkins University. Brazil has the more than 514,000 confirmed cases, the second-highest in the world after the United States, which has more than 1.7 million.

ECONOMIC NEWS

Venezuela's Maduro Announces Rollback of Fuel Subsidy

Venezuelan President Nicolás Maduro announced the rollback of a longstanding fuel subsidy and the privatization of service stations, in a historic shift in policy as the Andean nation struggles with a sharp gasoline shortage, The Wall Street Journal reported Sunday. Under the measures, which are set to take effect today, Venezuelans will be limited to 32 monthly gallons of fuel at a subsidized price of nearly 10 cents a gallon. However, they can purchase unlimited quantities of gasoline at a price of $1.90 per gallon, which will be sold at a network of 200 gas stations that the government has privatized to unspecified businessmen. The government said the measure will make fuel supply more efficient, but the move

NEWS BRIEFS

At Least 14 Killed as Tropical Storm Hits Guatemala, El Salvador

Tropical Storm Amanda lashed El Salvador and Guatemala on Sunday, killing 14 people in El Salvador and causing power outages and flooding, Agence France-Presse reported. Salvadoran Interior Minister Mario Durán warned that the death toll could rise. Amanda, the Pacific's first named storm of the season, knocked down trees and triggered flash floods and landslides, damaging some 200 homes, William Hernández, the head of El Salvador's Civil Protection Service, told AFP.

Colombian Central Bank Cuts Key Interest Rate to Record Low

Colombia's central bank on Friday cut its key interest rate to a record low in an effort to stimulate the economy as the finance ministry forecasts the deepest recession in the country's history, Bloomberg News reported. The bank cut the rate by 50 basis points for the third consecutive month, to 2.75 percent. The decision was in line with expectations. Five policymakers voted in favor of the cut, while two argued for a more modest cut of 25 basis points. The central bank expects output to contract by between 3 percent and 7 percent this year.

Costa Rica Keeps Borders Closed Until June 30

Costa Rica will extend the closure of its borders until June 30, Health Minister Daniel Salas said on Friday, Reuters reported. The measure, which seeks to curb the spread of coronavirus, was due to expire June 15. However, the Central American nation will begin reopening its tourism industry for domestic travel, with tourist buses allowed to circulate and hotels able to reopen at 50 percent capacity starting today, Salas said.

is a gamble for Maduro in a country that has long provided gasoline basically free of charge. A similar move decades ago pushed the nation into protests. "In Latin America, removing energy subsidies is a form of political suicide, and when they're done badly, they result in chaos," said Giorgio Cunto, a statistics professor and economist with consulting firm Ecoanalítica in Caracas. The announcement came just hours after more fuel from Iran began to arrive in Venezuela on Saturday, Reuters reported. The fifth cargo of an Iranian flotilla was expected to reach Venezuelan waters on Sunday.

El Salvador's Bukele Vows to Veto Measure to Reopen Economy

El Salvador's Legislative Assembly on Saturday passed an emergency bill to gradually begin reopening the country's economy, though President Nayib Bukele has vowed to veto it, Reuters reported. Legislators voted 56 to 6, with one abstention, in favor of a bill that would establish guidelines to resume production, outline workers' rights and regulate lockdowns. Bukele argues it is too risky to reopen businesses, a move he says will lead to a spike in coronavirus infections. "They know that this bill will be vetoed. Their interest is not to reactivate the economy. They are even less interested in people's lives and health," Bukele wrote on Twitter, referring to lawmakers. "Their job is to trip up the government," he added. The president had asked Congress to extend quarantine measures for another 15 days, saying economic activity could restart once the extension expired. It is the second emergency bill to reopen the economy that the Legislative Assembly has passed that Bukele has promised to veto, EFE reported. The president recently clashed with the Legislative Assembly over how to approach the pandemic. Lawmakers and rights groups have blasted Bukele for using the health crisis to justify what they call authoritarian tendencies. The Central American nation has registered a total of 2,517 confirmed cases and 46 deaths related to it.

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amount of investment in Puerto Rico and stimulated the development of high-technology, high-value-added and high-wage industries. Unfortunately, the pro-statehood local government in the 1990s, led by Governor Pedro Rosselló, lobbied Congress for the elimination of Section 936. It was eliminated with a 10-year phase-out period. Most U.S. companies left Puerto Rico and went to China, India, Mexico and Ireland. The urgent question to address now is whether the U.S. Congress will resurrect and reinstate Section 936, or something similar, with the same purpose: to bring back profits that U.S. companies have overseas and place those investments into the U.S. banking system and to bring jobs back to Puerto Rico."

A **Jorge Heine, research professor at the Frederick Pardee School of Global Studies at Boston University and Wilson Center global fellow:** "The island's economic downturn clearly resulted from the end of Section 936. In the late 1980s and early 1990s, Puerto Rico was flourishing. Today, the island is bankrupt, having declared bankruptcy in 2017, unable to pay a $72 billion debt. Also, it is governed by a fiscal control board appointed by the U.S. Congress. The island entered a spiral of negative growth in 2007, with manufacturing employment falling by 4 percent a year from 2007-2017. Much of the U.S. pharmaceutical industry left the island, mostly to Ireland, China and India. Puerto Rico has the skilled labor force, the managers and the business climate to bring the pharmaceutical and medical devices industry back to the U.S. market, of which it is part. Restoring Section 936 would be a win-win proposition. U.S. companies cannot be exempt from federal taxes within the jurisdiction of the 50 states. Yet, this does not apply to Puerto Rico, a U.S. territory. This would be a swift way of bringing these companies back to the United States and avoiding the fragility of the U.S. medical supplies system, which the current pandemic has exposed. It would allow the United States to be ready for the next pandemic. White House advisor Peter Navarro has called on Congress to do this, as has Senator Marco Rubio. Restoring Section 936 would be highly beneficial not just to the island, but also to the United States as a whole, as part of the industrial reshoring agenda."

A **Cate Long, founder of the Puerto Rico Clearinghouse:** "According to the Puerto Rico Department of Economic Development and Commerce, the island is currently one of the most important biopharmaceutical manufacturing centers in the world, with more than 50 years of experience in pharmaceutical manufacturing and 30-plus years of experience in sterile pharmaceutical manufacturing. With 49 FDA-approved pharmaceutical plants scattered across the island, Puerto Rico is home to operations of top multinational companies, including AstraZeneca, Abbott-Abbvie, Bristol-Myers Squibb, Merck, Pfizer and Eli Lilly. When Section 936 was sunset by Congress in 2006, many other types of light manufacturing left Puerto Rico for Asia, but a strong core of pharma and medical technology remained. Puerto Rico taxes these U.S. corporations about $2 billion a year, although they annually book in excess of $40 billion of income on the island. This minimal level of taxation has led directly to Puerto Rico's insolvency as it issued debt to cover government spending. Notably the pharma companies were able to credit 100 percent of taxes paid to Puerto Rico against their federal tax liability prior to the 2017 federal tax reform. This resulted in at least one case where a U.S. company paid negative federal income taxes in 2018 due to this island credit. Puerto Rico also annually gives approximately $17 billion in tax incentives to pharmaceutical companies and others, which also contributed to the island's insolvency. Reshoring pharmaceutical manufacturing is critical for the United States, but this must be balanced with these

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companies' need to pay taxes to Puerto Rico and the federal government. Otherwise, the island will remain perpetually insolvent. Threading this needle will be an important objective for Congress."

A **Ariadna Alvarez, partner at Holland & Knight:** "The enactment of Section 936 of the U.S. tax code led many U.S. companies to establish manufacturing operations in Puerto Rico. In addition to creating high-quality jobs for residents, the arrival of these companies spawned many small businesses (such as restaurants, cafeterias and equipment repair companies) in surrounding areas to provide services to the companies and their employees. When Section 936 was repealed, the effects were seen and felt almost immediately, as many of these companies began leaving Puerto Rico. This caused mass layoffs and severe economic turmoil for many employees and their families, and it indirectly affected the owners of the small local businesses that provided services to these companies. It is reasonable to anticipate that a significant number of U.S. corporations would establish operations in Puerto Rico in order to take advantage of the favorable tax treatment if Section 936 is reinstated. Many of these companies historically paid high wages, and the reintroduction of high-paying jobs would expand the tax base in Puerto Rico. The trickle-down effect this could potentially have on the small businesses cannot be understated. The United States could also benefit from helping U.S. corporations establish operations in Puerto Rico. In the age of Covid-19, shifting the manufacturing of products consumed in the United States to a jurisdiction that is subject to U.S. laws can provide safety and peace of mind. In the end, the reenactment of Section 936 could benefit both the Puerto Rican economy and that of the United States as a whole."

A **Emilio Pantojas García, director of the Institute for Caribbean Studies at the Río Piedras campus of the University of Puerto Rico:** "It is ironic that the proposed solution to the Puerto Rican Great Depression is to turn 180 degrees and return to the past: a revised edition Section 936. To reinstate a preferential tax regime is tantamount to admitting failure of both the federal and the Puerto Rican government to steer the economy in a new direction. The repeal of Section 936 in 1996 and the entrance of China to the World Trade Organization in 2001 marginalized the Puerto Rican economy from global value chains. The island was the leading American jurisdiction in the production of pharmaceuticals. It was the link in a global value chain in charge of assembly and distribution of medicines with a patent. Federal tax advantages and phytosanitary restrictions made this a highly profitable endeavor—all medicines consumed in U.S. territories had to be produced in U.S. phytosanitary-regulated jurisdictions. After 14 years of economic contraction and three major disasters, politicians in both San Juan and Washington are proposing restoration of the old regime. But it may be too late: the government is broke, and disasters have deepened the crisis. The Fiscal Oversight and Management Board (FOMB) have only managed to save money for debt service at the expense of economic growth and reconstruction of infrastructure. And any project takes two years to go through Congress; this being an election year. The FOMB has a stash of $9 billion; it should use that for reconstruction, and any move in Congress should be part of a strategic plan for reconstruction and development."

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at **gkuleta@thedialogue.org**.

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