

Statement by  
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President of the Senate of the  
Commonwealth of Puerto Rico

on the  
Proposal of the President of the United States  
to Establish a Caribbean Basin Initiative

Executive Summary

January 18, 1982

## I. STATEMENT OF OBJECTIVES

The Commonwealth of Puerto Rico supports President Reagan's objective of encouraging politically stable Caribbean nations. Political stability requires economic strength and growth. While Puerto Rico may disagree with some of the specific recommendations in the proposed Caribbean Basin Initiative, we do agree that the use of incentives to free enterprise is an appropriate approach to insuring both the economic and political strength and independence of Caribbean nations.

The economic strength of the Caribbean as a whole depends on the strength of each of the individual countries, including Puerto Rico. Since Puerto Rico already has gone through the first stages of economic development that most Caribbean countries are now undertaking, we are aware of the numerous internal reforms required to support such development and of the economic dislocations and changes that will occur. We can, therefore, offer assistance and support to other Caribbean nations.

Similarities in geography, economy, and language should enhance Puerto Rico's ability to provide support. But, such assistance is possible only to the extent that the growth of other Caribbean countries is not attained at the expense of Puerto Rico and as long as Puerto Rico is in a position to restructure and rebuild its own economy.

## II. POSITION OF PUERTO RICO'S ECONOMY

The economy of Puerto Rico is very weak. Unemployment stands at its highest level ever, 27.6 percent. This includes the 61,000 who have stopped looking for work, but excludes those who are underemployed. Per capita GNP has been falling since the oil crisis of 1973/74.

This economic situation is not a cyclical phenomenon, not just the manifestation of the general recession in the United States. Instead, our economic problems are structural. Unemployment is chronic, ranging from 10 to 11 percent in good years to over 20 percent in recession years. Moreover, the level of real gross fixed domestic investment in Puerto Rico declined throughout the 1970's, so that the prospects for expanding GNP in the near future are poor.

Puerto Rico is trying to restructure its own economy to provide employment and growth opportunities. But to do this, we need time. We need, also, the ability to provide incentives for investment in new industries and the capacity to protect both these industries in their development stages and older industries as they are cut back or phased out.

RELATIVE STAGE OF DEVELOPMENT

While the economy of Puerto Rico is structurally weak, the Commonwealth has made more economic progress than most of its Caribbean neighbors. But Puerto Rican development certainly is still below that of the mainland United States. Comparison of per capita GNP, unemployment, and dependence on external trade shows that Puerto Rico is closer to other Caribbean countries than to the mainland.

The development of other Caribbean countries, Puerto Rico's neighbors and competitors, should not be at the expense of Puerto Rico. We ask that any measures proposed to aid Caribbean countries be evaluated to assure that the measures raise the economic level of all Caribbean countries, including Puerto Rico. A weakened Puerto Rico means a weakened Caribbean as a whole.

#### PUERTO RICO'S ECONOMIC DISADVANTAGES

Although Puerto Rico's stage of development is somewhat more advanced than other Caribbean countries, there are aspects of the Puerto Rican economy that put Puerto Rico at a competitive disadvantage when competing with these countries. Several of these disadvantages arise from Puerto Rico's relationship to the United States. Examples include the major cost components for industry and agriculture: labor, energy, and transportation.

1. Labor Costs are higher in Puerto Rico than in other Caribbean countries primarily because most Puerto Rican industries must pay federal minimum wage levels.
2. Energy Costs are higher in Puerto Rico. This is explained, in part, by United States petroleum policy, which impacts the price of imported crude oil. Other Caribbean countries generally do not have similar petroleum policies.

A second reason why other Caribbean countries have a decided advantage over Puerto Rico in the cost of energy is the Mexican/Venezuelan oil facility under which Venezuela and Mexico make available to Caribbean Basin nations long-term credit for up to 30 percent of petroleum purchases from Mexico and Venezuela.

3. Transportation Costs are higher for Puerto Rico than for Caribbean countries unrelated to the United States because trade between Puerto Rico and the mainland must be conducted in vessels made, owned, and registered in the United States.

4. Other Federal Regulations, such as the various environmental protection acts, increase the cost of producing in Puerto Rico compared with other Caribbean countries. While Puerto Rico understands the need for and desirability of such provisions, we also know from local industries how compliance impedes our ability to sell.

#### TARIFF INFLEXIBILITY

Puerto Rico lacks not only crude oil, but almost all other natural minerals and metals required for industrial development. If Puerto Rico were independent, these essential products could be imported duty-free. But, as party to the United States tariff system, our imports are tariffed to protect mainland producers. For many products made in Puerto Rico, the result is higher costs of materials used.

Federal economic programs and policies geared to the more developed stage of the U.S. mainland industries than to the Puerto Rican economy impede agricultural production also. For example, under the Generalized System of Preferences (GSP), over 140 developing economies are eligible to export about 2,850 products to the United States, duty-free. For example, in 1981, the government of Jamaica, a Caribbean Basin country, petitioned the United States for duty-free treatment for 27 products, most of which are agricultural products. Some, such as fresh pineapple, compete directly with Puerto Rican exports to the United States. Just as important, however, are the agricultural products on which Puerto Rico is concentrating to reduce Puerto Rico's dependence on imported food. (Currently, Puerto Rico imports over 80 percent of its food.) Most of these products are in Jamaica's petition for duty-free treatment.

It is our understanding that the Trade Policy Committee recommends that Jamaica's petition be granted. By doing so the federal government opens Puerto Rican markets, as well as mainland markets, to imports. The impact on Puerto Rico may be substantially greater than on the mainland as a whole or on any one state. One reason is that Puerto Rico's farming sector is in a developing stage and is less efficient. Second, since Puerto Rico is geographically smaller, distribution and marketing are less complex.

A pointed example of the disproportionate impact on Puerto Rico of federal import policies is the effect of the Meat Import Law of 1964. When the United States limits its beef imports from every country, the Central American countries are more likely to ship their quota to Puerto Rico than to the mainland. This occurred in 1975 when import restrictions were imposed.

By directing a large proportion of Central American beef exports to Puerto Rico, the U.S. meat quota regulations adversely affect Puerto Rican production. With virtually no control over beef imports, the Commonwealth is unable to protect its own beef market from foreign imports in order to give its industry an opportunity to grow and become more productive.

The potential for further injury to Puerto Rico's agricultural sector could be far greater if imports from all Caribbean countries of all products were duty-free under the Free Trade Area proposed in the Caribbean Basin Initiative.

### III. COMMENTS ON SPECIFIC ASPECTS OF THE CARIBBEAN BASIN INITIATIVE

Specific aspects of the proposed Caribbean Basin Initiative could increase Puerto Rico's disadvantage vis-à-vis other Caribbean countries in cases where we now have a competitive advantage that will be offset or eliminated. This can be illustrated with respect to investment funds, rum, and industrial restructuring.

#### LOSS OF INVESTMENT FUNDS

Much of the early success of the Puerto Rican economic development program has been attributed to the availability of investment funds from corporations based on the U.S. mainland. One proposal in the Caribbean Basin Initiative is to extend Section 936 tax incentives to U.S. corporations investing in participating Caribbean countries. The proposal is even more favorable to investment in other Caribbean countries since the costs of training would be tax deductible. These are not deductible in Puerto Rico, so that extending tax exemptions to other Caribbean countries would more than offset the direct advantage firms have had in investing in Puerto Rico.

The adverse impact of this potential diversion of investment capital would come at a particularly bad time since under the federal government's present and proposed budget cuts, Puerto Rico is losing several other sources of financing.



We might note that Puerto Rico cannot anticipate an increase in private funds flowing from the reduction in personal income taxes since Puerto Ricans pay Commonwealth rather than federal income tax. Moreover, it is likely that our local taxes will have to be increased to offset losses of federal aid.

One very important advantage that Puerto Rico has maintained in attracting investment is political and monetary stability. The Caribbean Basin Initiative would dilute this advantage by insurance programs to reduce political risk elsewhere. Under one proposal, the United States would take the lead in organizing several alternative programs to reduce the cost and improve the effectiveness of insurance coverage for political risk in Caribbean countries. The effect could be to reduce the cost of capital to these countries and to improve their investment position relative to Puerto Rico.

The overall effect of the extension of Sec. 936 provisions to investment in Caribbean countries combined with the increased political and currency convertibility risk insurance is certainly to be a diversion of investment capital from Puerto Rico. Given our current negative rate of personal savings, our declining rate of real investment, and the reduction in federal funds, the economy of Puerto Rico could not only stagnate, but regress. Puerto Rico will be in no position to aid its own development and stability, no less support initiatives in other Caribbean countries.

LOSS OF TAX REVENUE: RUM

Puerto Rico's production and sale of rum represent an excellent case study of how the Commonwealth's economy could be injured by particular aspects of the Caribbean Basin Initiative. The excise taxes collected on sales of Puerto Rican rum accounted for 10 percent of the Commonwealth government's 1980 revenues.

Puerto Rico is the largest supplier of rum to the United States mainland. A likely reason is the high U.S. duty on imported rum.

Under the Caribbean Basin Initiative, the duty could be eliminated on rum imports from Puerto Rico's major competitors. If this drastic cut led to a substantial shift to imported rum, as might well be expected from a 30 percent price reduction, Puerto Rico's revenues would drop precipitously. Employment and income would be lost if rum production shifted to other Caribbean countries.

The potential for such a shift is greater for rum than most other products because of the nature of the distribution system that has evolved in the United States. The largest rum producer in Puerto Rico is Bacardi. In Puerto Rico, Bacardi has the advantage of duty-free shipments to the mainland and tax-exempt investment under Section 936. If both of these advantages were given to other Caribbean countries, along with increased political risk insurance coverage, Bacardi would have a high economic incentive for producing in and importing from whatever country is the lowest cost producer. Sales in the United States would continue through its same, well-established distribution system.

REDUCED ABILITY TO RESTRUCTURE ECONOMY

An essential element in Puerto Rico's program to move its economy from stagnation to growth is a restructuring of industry. If the Commonwealth is now put at an economic disadvantage in competing with its Caribbean neighbors, this program could be thwarted and a stimulus to economic growth severely curtailed. One example of the potential for this is in the shift from concentration on textiles and apparel to industries such as electrical and electronics equipment and scientific instruments.

Puerto Rico recognizes that its textile and apparel industries are likely to continue to decline in importance as contributors to Commonwealth income and employment. Nevertheless, Puerto Rico needs time to find jobs in new industries for the 38,500 workers now employed. Allowing duty-free imports of apparel into the United States, including the Puerto Rican market, from other Caribbean countries could deny us this time, increase unemployment from our already intolerable level of 27.6 percent, and cause severe economic hardship.

Two industry sectors which Puerto Rico is trying to develop as new sources of employment and income are the manufacture of electrical and electronics equipment and scientific and professional instruments. These industries have continued to expand since the mid-1960's, and now employ over 30,000 workers.

Shipments to the United States by these two industries have been the impetus to their development and growth. Further growth could be stifled if the Caribbean Basin Initiative resulted in shifts of new investment from Puerto Rico to other Caribbean countries.

IV. RECOMMENDATIONS FOR FEDERAL POLICIES  
DESIGNED TO MAKE PUERTO RICO MORE COMPETITIVE  
VIS-À-VIS CARIBBEAN BASIN NATIONS

I have been pointing out Puerto Rico's major economic disadvantages vis-à-vis Caribbean Basin nations. Each of these disadvantages taken separately may be sufficient to move investment from Puerto Rico to these nations. Should the cost advantages enjoyed by the Caribbean nations be augmented by the the special trade and investment incentives proposed under the Caribbean Basin Initiative, ensuing product market and investment competition could have a devastating effect on the Commonwealth's economy. It is critical, therefore, that the administration adopt policies which not only assist Puerto Rico to maintain its current competitive position vis-à-vis Caribbean Basin nations, but also provide an environment in which Puerto Rico can restructure its own economy for growth.

It is not sufficient for the administration simply to offset the negative effects on Puerto Rico of the Caribbean Basin Initiative. To do so would keep us at a net disadvantage relative to other Caribbean countries and would accelerate economic decline in the Commonwealth. It is imperative, therefore, that the administration adopt measures that will actively promote increased trade with and investment in Puerto Rico.

Here, I would like to state our recommendations to the federal government which are designed to meet these objectives. I will summarize the recommendations and refer you to my full statement which provides a rationale for each.

RECOMMENDATIONS FOR TRADE POLICIES AND CUSTOMS PRACTICES

1. Allow Puerto Rico to set its own tariff rates on materials imported from foreign countries for use in manufacturing.
2. Allow Puerto Rico to set its own tariffs and import controls on agricultural products.
3. Allow Puerto Rico interim relief for its agricultural sector from mainland competition, particularly poultry and eggs.
4. Do not grant trade preferences and duty reductions to Caribbean and other nations under the Generalized System of Preferences (GSP) or other mechanisms when the adverse impact on Puerto Rico is greater than the benefits received by other Caribbean countries.
5. Do not remove tariff on rum imported from Caribbean Basin nations.

RECOMMENDATIONS ON TOURISM

1. Suspend duties on goods purchased by tourists in Puerto Rico.
2. Allow visiting cruise ships to remain in Puerto Rican ports for a reasonable length of time; that is, remove the 24-hour limit on the stay of foreign cruise ships in Commonwealth ports.
3. Do not grant more favorable tax treatment to convention participants in Caribbean countries than to those who attend conventions in other countries.

RECOMMENDATIONS FOR TRANSPORTATION POLICY

1. Place Puerto Rico in the same competitive position enjoyed by other Caribbean Basin nations with respect to maritime transportation costs. Or, at minimum, place Puerto Rican maritime operators in the same competitive position as U.S. mainland operators serving the trade among these nations and the United States. Either one of two alternatives would serve this purpose:

- a. Exempt Puerto Rico from U.S. legislation which requires that ships used in trade between the Commonwealth and the mainland be built in the U.S. yards and operated by U.S. firms.
- b. Provide Puerto Rican ship construction and marine operations with the same construction and operating subsidies and other assistance provided mainland yards, carriers, and investors.

2. Promote the growth and modernization of ship construction and repair in Puerto Rico by having the U.S. Maritime Administration work with the several shipyards in Puerto Rico to improve their capabilities. Also, waive the requirement that vessels financed under Title XI of the Merchant Marine Act of 1936 be constructed, reconstructed, or reconditioned in shipyards within the continental limits of the United States.

3. Eliminate all federal restraints on air transportation to and from Puerto Rico to allow all carriers which meet federal safety standards (a) to fly to and from the island from wherever they choose, be it domestic or foreign, and (b) to set fares without restraint.

RECOMMENDATIONS FOR FEDERAL TAX POLICIES AND PRACTICES

1. Should the United States grant Caribbean Basin nations federal tax concessions concerning business income, repatriated earnings, and business tax deductions, allow Puerto Rican subsidiaries of mainland corporations to compute accelerated depreciation and investment tax credits and to transfer them to their mainland parents.

2. Have the Internal Revenue Service reconsider its position on the tax treatment of transfers between mainland firms and their Puerto Rican subsidiaries. Prompt resolution of the dispute concerning the valuation of intangibles for purposes of determining appropriate transfer prices is highly desirable.

RECOMMENDATIONS FOR ENERGY POLICY

1. Free the Commonwealth of U.S. import restrictions on crude oil.

2. Assist Puerto Rico in participating in the petroleum purchasing facility created by Mexico and Venezuela and available to Caribbean Basin nations.

RECOMMENDATIONS FOR PARTICIPATION IN FEDERAL PROCUREMENT PROGRAMS

1. Target for purchase in Puerto Rico about 1.5 percent of federal purchases of goods and services, or approximately the same proportion Puerto Rico has of total U.S. population.
  
2. Consider Puerto Rico as a site for new and relocated federal government offices and facilities. The Commonwealth should be invited to present its case on the costs and benefits of locating such offices and facilities in Puerto Rico.

RECOMMENDATIONS FOR EDUCATION

1. Promote Puerto Rico as the center of higher education and professional training in the Caribbean.
  
2. Promote Puerto Rico as the center of vocational training in the Caribbean.



## V. SUMMARY

The success of the Caribbean Basin Initiative is predicated in large measure on the economic growth and vitality and political stability of Puerto Rico. There is every need for Puerto Rico to build strong trade and investment relations with countries of the Caribbean. It seems clear, therefore, that the Initiative should not pit the Commonwealth against her neighbors, nor should their success be built on Puerto Rico's decline.

From the outset, the administration needs to adopt the precept that no Initiative action will be taken vis-à-vis Caribbean nations which will affect Puerto Rico adversely -- unless compensatory corrective action is simultaneous. The Commonwealth's economic condition is such that it cannot afford periods of adjustment during which it will be told that market forces must be allowed to work themselves out. Puerto Rico must insist on direct and immediate compensation for each Initiative action which affects its economy and people adversely.

Finally, the Initiative causes Puerto Rico to reflect on the many federal actions, regulations, and restraints which may make sense for the mainland, but surely not for Puerto Rico. Among these are tariff restraints and restrictions on petroleum imports. Then, there are the areas where Puerto Rico is denied freedom of action. The United States has long denied Puerto Rico protection for agriculture despite the fact that the island imports over 80 percent of its food and despite deep poverty in Puerto Rican agricultural communities. It is now time to redress the balance and to allow Puerto Rico to formulate those basic policies which will help assure Puerto Rico's rightful place in the Caribbean.