International Lawyer

Volume 22 | Number 2 | Article 4

1988

Expanding the Concept of Coproduction beyond the Maquiladora: Toward a More Effective Partnership between the United States and Mexico, and the Caribbean Basin Countries

Abelardo L. Valdez

Abelardo L. Valdez*

Expanding the Concept of Coproduction Beyond the *Maquiladora*: Toward a More Effective Partnership between the United States and Mexico, and the Caribbean Basin Countries†

Over the past two decades, American manufacturers have sought creative new ways to compete in world markets. Some U.S. companies have met global competition and expanded profit margins by decreasing production costs. Certain producers have reduced costs by transplanting entire operations abroad. A growing number of U.S. corporations, however, have opted to reduce production costs through coproduction operations.[1] Coproduction is a system whereby part of the manufacturing process is performed in the United States and part in another country. The two countries combine forces to utilize their human and natural resources. In many instances, the United States contributes capital to such ventures, and the other nation, usually a developing one, provides the

*Partner, Laxalt, Washington, Perito & Dubue, Washington, D.C. Member of the District of Columbia Bar and the State Bar of Texas; former U.S. Ambassador and Chief of Protocol for The White House (1979-81); Assistant Administrator for Latin America and the Caribbean, U.S. Agency for International Development (USAID) (1977-79). J.D., Baylor University (1970); LL.M., Harvard University (1974). The views presented herein are solely those of the author. The author is grateful for the valuable assistance provided by Mr. Jay Lerner.

†The Editorial Reviewer for this article is James A. DeMent, Jr.

1. *See* J. Grunwald & K. Flamm, The Global Factory Foreign Assembly in International Trade 2 n.2 (1985). Coproduction, literally, means production by operations conducted in more than one country. Generally speaking, however, the definition provided in the text is adequate. Coproduction is a joint effort by two or more nations. The concept of coproduction also may be referred to as "production sharing," "twin-plant operations," or "in-bond plants." All of these terms describe the combined efforts of the capital and labor in varying degrees of two countries.

labor input. For most projects, the raw materials or component parts originate in the United States and are exported to a foreign country where they are assembled or processed; the finished products then are reexported to and sold in the United States.

Coproduction arrangements between the United States and Mexico have been especially successful in recent years. Both governments encourage such cooperative ventures. The Mexican Government grants tariff exceptions[2] to American companies participating in cooperative factories, while the U.S. Government levies a duty solely on the value added to the product while in Mexico.[3] As a result of such government incentives, the growth of these *maquiladora* operations has skyrocketed at an unprecedented rate in the last five years.[4] Coproduction facilities offer employment opportunities to Mexican workers and provide U.S. firms with low-cost labor and transportation. *Maquiladora* operations offer mutual benefits to the participating countries.

Partly because of the success of the *maquiladora* industry, a proposal has been submitted before the Congress of the United States to increase incentives for coproduction through the establishment of a Free Trade and Coproduction Zone. The proposal, introduced by Congressman William Richardson (D-NM), is currently pending before the House of Representatives.[5]

The basic concept behind this proposal is to authorize the President to negotiate an agreement with the Mexican Government to establish a Free Trade and Coproduction Zone. This proposal seeks to expand the scope of coproduction operations between the two countries and allow the United

2. *See infra* notes 35-36 and accompanying text. The Mexican Government does not charge a tariff on input materials or equipment used in coproduction operations.

3. *See infra* notes 10-13 and accompanying text. Under Tariff Schedules of the U.S. Item Numbers 806.30 and 807.00, the U.S. Government assesses a tariff only on the value added while the product was in a foreign country, i.e., Mexico. No duty is charged on the U.S.-source content. Like the Mexican incentives, this special treatment encourages coproduction efforts.

4. *See infra* notes 18-24 and accompanying text. In recent times, U.S. corporations have sought new and better ways to compete in global markets. This trend is the major impetus behind the *maquiladora* ventures in Mexico.

5. *See* H.R. 1006, 100th Cong., 1st Sess., 133 CONG. REC. H592 (daily ed. Feb. 4, 1987). *See also infra* notes 48-59 and accompanying text. The initial proposal for a U.S.-Mexico Free Trade and Coproduction Zone was developed and drafted by the author of this article. *See also* A. Valdez, A Proposal for a U.S.-Mexico FreeTrade and Coproduction Zone Submitted to the U.S. International Trade Commission (Mar. 24, 1986). Presidential Report on North American Trade Agreements Prepared by the Office of the U.S. Trade Representative (Aug. 4, 1981); House Resolution 486, 98th Cong., 2d Sess. (1984). *See generally,* Austin, *Needed: Free Trade Zone Along the Entire Border,* TEX. BUS., July 1981; Dallas Morning News, Feb. 26, 1985, at 7A; Houston Chronicle, Feb. 26, 1985, at 15; Kansas City Times, Mar. 26, 1981; Los Angeles Times, San Diego County, Nov. 8, 1985, at K2; N.Y. Times, Apr. 5, 1981, § 4, at 1; col. 1; Wall Street J., May 26, 1981, at 22.

States and Mexico to combine resources to enhance investment opportunities, create jobs, and improve product competitiveness. A close partnership between the United States and Mexico would be formed in the process. Both partners will benefit from the fusion of efforts, skills, and materials.

Cooperative ventures offer similar opportunities in Caribbean Basin countries. For many years, the Internal Revenue Code section 936[6] has granted tax incentives for U.S. corporations to invest in U.S. possessions. Section 936 permits a U.S.-based corporation to avail itself of the Possessions Tax Credit if the corporation meets certain criteria. This section applies primarily to investments in Puerto Rico.[7] Recently, however, section 936 had encountered resistance in the United States, and Congress had threatened its repeal.

Governor Colon of Puerto Rico, in an effort to save section 936 and the fate of the Puerto Rican economy, proposed an amendment to the tax credit. He advocated a solution that would permit a certain amount of section 936 funds, formerly used in Puerto Rico, to be diverted for use in countries qualified under the Caribbean Basin Initiative (CBI).[8] Such a compromise would retain the benefits of section 936 for Puerto Rico and, at the same time, provide support for U.S. policy in the Caribbean and the economic development of CBI countries.

The CBI, adopted in 1983, provides tariff incentives for U.S. corporations to invest in "beneficiary countries."[9] The CBI, like section 936, has encountered some difficulties in its implementation. Governor Colon's proposal, therefore, was well received by Congress as providing an infusion of funds to the faltering CBI program. In the Tax Reform Act of 1986, Congress adopted certain amendments to section 936. These amendments provide additional incentives for coproduction investments between Puerto Rico and beneficiary countries of the CBI. A corporation in Puerto Rico may receive a section 936 credit if it operates a twin-plant venture in a CBI beneficiary country. Expanded coproduction operations

6. *See* 26 U.S.C. § 936 (as amended in 1986); *see also infra* notes 78-98 and accompanying text.

7. The Possessions Tax Credit, as its name implies, applies to all U.S. possessions. This list also includes the Virgin Islands and American Samoa.

8. In 1985 Governor Colon, at his inaugural address, suggested this idea. Colon "pledged to make $700 million of these funds that are redeposited in [the] Government Development Bank available to finance twin-plant projects in Puerto Rico and CBI countries." Colon, *The Fate of Section 936 Is Linked to the Caribbean,* 11 P.R. Bus. Rev. 12 (1986). Governor Colon "offered this financing on concessionary terms to companies that will use their own resources to invest in complementary manufacturing in CBI countries." *Id. See infra* note 64 for a listing of CBI countries.

9. *See* Caribbean Basin Economic Recovery Act (CBERA), Pub. L. No. 98-67, 97 Stat. 384 (1983) (codified as amended in 19 U.S.C. and 26 U.S.C.).

in these countries will spur economic growth in Puerto Rican industries and help to develop the CBI economies.

This article analyzes tariff and tax incentives to encourage coproduction arrangements between Mexico, Caribbean Basin nations, and the United States. The first section generally describes the incentive programs provided by the U.S. government to coproduce. The next section explains the current *maquiladora* industry in Mexico and its successes. The third section advocates expansion of the scope of U.S.-Mexican coproduction through the establishment of a Free Trade and Coproduction Zone. The fourth section discusses the development and subsequent deterioration of the CBI and section 936 of the Internal Revenue Code. The fifth section describes the recent section 936 amendments in relation to the CBI and its potential for growth. This article then concludes that expansion of coproduction ventures represents a trend that will grow in the future and that should be encouraged through incentive programs. These operations will prove fruitful for U.S. and foreign businesses alike. Such expansion will promote global economic integration and development.

I. U.S. Incentives for Coproduction

The U.S. Government promotes and facilitates coproduction operations through various incentive programs. For instance, customs laws provide special tariff treatment on certain coproduced items. An article of metal may receive such treatment if it is manufactured in the United States, exported for further processing, and reimported into the United States for finishing and, perhaps, sale.[10] For articles of metal that qualify under Item Number 806.30 of the Tariff Schedules of the United States (TSUS), an import duty is levied solely on the amount of value added while the product was processed in a foreign country.[11] Similar treatment may be granted under TSUS Item Number 807.00 to fabricated components that have been assembled abroad.[12] The tariffs assessed are based upon "the full value of the imported articles less the cost or value of such products of the U.S."[13]

This special tariff treatment encourages U.S. corporations to set up a coproduction factory in a foreign country in order to utilize the low-cost labor in certain regions. In this way, the American manufacturer may avail itself of relatively inexpensive labor, and avoid paying duties on the

10. 19 U.S.C. § 1202, Tariff Schedules of the United States, Schedule 8, Part 1-B, Item Number 806.30 (as amended Nov. 1986).

11. *See id.*

12. *Id.*, Item Number 807.00.

13. *Id.*

U.S.-source content (that portion of the good produced in the United States) upon reentry into the U.S. Such incentives make coproduction an especially attractive investment opportunity for U.S. corporations.

The U.S. Government also maintains a self-sustaining agency called the Overseas Private Investment Corporation (OPIC) to encourage private investments in developing countries. OPIC provides a variety of services, such as funds for feasibility studies and training, loans, loan guarantees, and political risk insurance. OPIC assists U.S. corporations in every phase from inception until liquidation; however, OPIC services are only available for certain developing nations. A significant portion of OPIC assistance in the Caribbean region is in the form of underwriting loans. "During the first year of the program OPIC provided $119 million in financial support for 168 [Caribbean] projects and wrote $406 million in insurance."[14] Through OPIC assistance programs, U.S. corporations are able to reduce the political risk in their foreign investments.

II. Coproduction Operations in Mexico

In 1965 the Government of Mexico adopted the Border Industrialization Plan.[15] The Plan's purpose was to foster the economic development of Mexico, provide jobs along the U.S.-Mexican border, and promote foreign exchange of goods and currency. Through this Plan the Mexican Government intended to expand foreign exchange capability, to attract new investors, and to upgrade Mexico's manufacturing capacity.[16] As a result, the *maquiladora* coproduction industry emerged. The major objectives of the *maquiladora* industry are to reduce transportation costs, provide jobs for agricultural workers and generate foreign exchange.[17]

The *maquiladora* industry has proven to be quite successful, currently constituting Mexico's second largest source of foreign exchange.[18] "Mexico's *maquiladora* industry ranks as the country's most rapidly expanding industrial sector."[19] In 1983, *maquiladoras* earned more than $1.4 billion

14. Bush, *CBI Nations Look for Ways to Solve Their Problems*, 11 P.R. Bus. Rev. 10 (1986).

15. *See* Turner, *Mexico's In-Bond Industry Continues Its Dynamic Growth*, 7 Bus. Am., Nov. 26, 1984, at 26.

16. *See* Turner, *Mexico Turns to Its In-Bond Industry as a Means of Generating Exchange*, 6 Bus. Am., Nov. 28, 1983, at 27.

17. *See* Turner, *supra* note 15 at 26. "The intent of the Mexican government in authorizing this [*maquiladora* industry] was to utilize the expanded operational base to encourage industrial integration/domestic sourcing in Mexico." Turner, *supra* note 16, at 27.

18. The *maquiladora* industry is second only the petroleum/hydrocarbons industry. *See* Turner, *supra* note 15, at 26.

19. *Id.*

from the United States in Mexican foreign exchange.[20] The industry currently employs almost 250,000 workers in 800 *maquiladoras*.[21] The Bank of Mexico estimates that the *maquiladora* industry will account for over $10 billion in value added by the end of the century and will employ almost one million workers.[22]

Mexico currently is the third most valuable trading partner of the United States.[23] U.S. exports to Mexico totaled $13 billion, while Mexican shipments to the U.S. reached $18.9 billion.[24] Mexico represents the largest source of all U.S. imports from coproduction facilities abroad. Moreover, the Mexican *maquiladora* industry is an innovative leader in international coproduction.

The *maquiladora* industry operates in a simple manner. A U.S. manufacturer must register with the Mexican Secretariat of Commerce and Industrial Development (SECOFIN).[25] Following approval, the manufacturer may operate its plant facilities in Mexico by utilizing Mexican laborers.[26]

A. Advantages to U.S. Firms

Much of the *maquiladora* industry's success may be attributed to its relatively low-cost labor and close proximity to the United States.[27] The Mexican workforce provides favorable conditions in which U.S. coproducers may operate.[28] The minimum wage in Mexico is low, and labor

20. *See* Turner, *supra* note 16, at 27.

21. *See* O'Reilly, *Business Makes a Run for the Border*, FORTUNE, Aug. 18, 1986 at 70. These numbers increased 53% and 12%, respectively, in comparison to corresponding 1982 figures. Turner, *supra* note 15, at 26.

22. *See* O'Reilly, *supra* note 21, at 70; Turner, *supra* note 15, at 26.

23. United States International Trade Commission, The Impact of Increased United States-Mexico Trade on Southwest Border Development xiv (Nov. 1986).

24. *Id.* These shipments to the United States represent 70% of Mexico's total exports.

25. *See* Turner, *supra* note 16, at 28.

26. *See id.* Approval for a new application requires one to two months, and it must be renewed every two years. Requests for expansion of existing operations require two to three weeks. The National In-Bond Registry provides the firm with a code number. The basic SECOFIN application is the Industria *Maquiladora - 2* (IM-2). It requires a proposal of what is to be produced, the amount of capital to be invested, the number of jobs to be created, and the percentage of Mexican content to be input. *See id.* Every six months, an applicant must submit an IM-3 listing components and materials expected to be processed and exported. *See id.* An IM-4 also must be submitted every six months listing tools, fixtures, spare parts, equipment and instruments to be used. *See id.*

27. There are many benefits to Mexico including "improved access to foreign-source technology; growth of Mexican supplier industries, . . . and increased jobs and technical training for Mexican workers." Turner, *supra* note 15, at 26-27.

28. *Maquiladora* plants often employ 350 to 500 workers, including production and technical and administrative personnel. These plants usually are operated by Mexican and U.S. managers. *See* Turner, *supra* note 16, at 27.

costs are relatively inexpensive.[29] Mexican workers at *maquiladora* operations receive generous fringe benefit awards free of taxes.[30] These tax-exempt benefits add approximately eighty percent to the minimum wage levels.[31] This built-in government tax expenditure saves money for the employer and financially assists the employee. In addition to other benefits, currency exchange rates between the U.S. dollar and the Mexican peso have also proven profitable to U.S. employers.[32] The dollar has recently shown great strength against the devalued peso. U.S. employers, therefore, spend fewer dollars to reach the same or greater value in peso wages. The average wage rate for unskilled Mexican labor is one-sixth of that in Japan and slightly more than half of that in Singapore, South Korea, Hong Kong, and Taiwan.[33] Mexico therefore, is a highly competitive location for U.S. coproduction efforts.

Furthermore, the two-thousand-mile border between the United States and Mexico provides *maquiladoras* with nearby access to U.S. markets. Products need to be transported only a short distance across the border. This fact of geography cuts down on travel costs and time delays. The finished products are transported by land; there is no need to send goods by ship or airplane. American manufacturers, therefore, save on transportation costs. These factors make Mexico a favorable location for coproduction, as compared with most Far East countries.[34]

B. Mexican Incentives

The Government of Mexico recognizes the potential growth in its *maquiladora* industry and, as a result, facilitates expansion through various incentive programs. Mexico encourages cooperative business ventures through the use of relaxed duty assessments.[35] Input materials, equip-

29. As of February 1988, the Embassy of Mexico reported that the current minimum daily wage is approximately U.S. $3.46 (7,700 pesos).

30. Benefits required by Mexican federal law include: vacation and Christmas bonuses; seven paid holidays; and payroll contributions for social security, education, maternity leave, employee housing, day-care assistance and state withholding taxes. The law also entitles a worker to 90 days severance pay plus twelve days' pay for each year (or fraction thereof) that is worked. *See* Turner, *supra* note 15, at 29-30.

31. "The combination of required and company-sponsored fringe benefits provides workers with tax-free financial benefit about 80 percent above the minimum daily wage levels. The minimum daily wages and required benefits of each worker are exempt from tax." Turner, *supra* note 15, at 30.

32. The three peso devaluations of 1982 and Mexico's sliding peg exchange rate system have lowered the daily wages of workers from U.S. $11.00 per day to slightly more than U.S. $4.40 for unskilled labor. *See* Turner, *supra* note 15, at 28. This rate converts to approximately 56 cents per hour. *Id.* at 30.

33. *See* O'Reilly, *supra* note 21, at 72.

34. *Id.*

35. *See* Turner, *supra* note 16, at 27.

ment, and machinery for use in the *maquiladora* industry enter into Mexico free of customs duties.[36] The Mexican Government invites such imports into the country for processing and subsequent reexportation of the finished articles back to the United States. The special tariff treatment encourages U.S. coproduction efforts in Mexico.

Two other Mexican programs assist U.S. companies in establishing a *maquiladora* operation.[37] First, the Mexican shelter program[38] aids U.S. companies in complying with registration requirements and customs clearances. Mexican corporations, usually coproducers, help in this capacity. These corporations also may supply necessary production workers and plant facilities.

The second program, subcontracting,[39] assists U.S. companies in coproduction ventures. Under this system, an existing Mexican *maquiladora* operation assembles a product for an American manufacturer and then charges the manufacturer a fee for each product finished. The U.S. firm supplies the raw materials, special equipment, drawings, and guidelines, while the subcontractor provides the labor and customs clearances. These programs emphasize the ease and convenience of coproduction in Mexico, thereby encouraging U.S. investments in such operations.

C. Restrictions in Mexico

The Government of Mexico generally permits much flexibility among *maquiladora* operations. The government allows foreign investors to provide up to one hundred percent of the capital for such ventures.[40] The Mexican Government also permits manufacturers to locate plant facilities virtually anywhere in Mexico, although it encourages location in interior regions.[41] Because Mexico imposes few restrictions upon the type of

36. *See id.*

37. Industrial parks also offer incentives for coproducers. Unlike the other programs, these coproducers may obtain exclusive use of the property and the building in Mexico. At the border, manufacturers may use the property under a 30-year beneficial trust agreement. In the interior of the country, the company may own the building and property outright under an "industrial permit." Alternatively, a firm may lease the building for six to ten years. *See* Turner, *supra* note 16, at 28-29; O'Reilly, *supra* note 21, at 70.

38. *See* Turner, *supra* note 16 at 28–29. A U.S. company, however, operating within the shelter program is not recognized as a legal entity in Mexico.

39. *Id.*

40. *See* Turner, *supra* note 15, at 30. Mexico's National Foreign Investment Commission reaffirmed this resolution on August 30, 1984.

41. "[A]lmost 90 percent of all in-bond facilities are located at the border today." *See id.* at 27. Mexico's National Development Plan gives priority to plants in the interior of the nation. *Id.* This government interest is influenced by the need for greater industrial development and a growing workforce. Wage scales are lower in the interior of the country, and employee turnover is not a serious problem there, as it may be in borderland regions. Zones of high-industrial concentration, such as the Federal District (Mexico City), are restricted

product that an operation may assemble and reexport,[42] intrusion into private business affairs is not likely. U.S. manufacturers, therefore, do not feel encumbered by overly restrictive regulation by the Mexican Government.

The Government, however, does restrict the sale in Mexico of goods produced in a *maquiladora* plant. Currently, the *maquiladora* industry sells only five percent of its products in Mexico.[43] In 1983 the Government established a ceiling of domestic sales at twenty percent of the output from a coproduction facility.[44] The Government created this ceiling in an effort to avoid competition between Mexican and U.S. firms and suppliers. The Mexican Government wants American capital to enter its markets, but not at the expense of Mexican businesses. Several conditions must, therefore, be met before a finished product may be sold in Mexico. The coproduction facility must not harm the Mexican enterprises. In essence, a U.S. company may coproduce only in markets where Mexican companies are insufficient. Guidelines from SECOFIN emphasize the transfer of technology from U.S. firms to Mexican suppliers.[45] A coproducer, therefore, is more likely to gain government approval for an electronic

---

for use in coproduction facilities. *See id.* Target cities are ones that are medium-sized and sufficiently developed to support American manufacturers, such as Chihauhau, Hermosillo, Saltillo, and Torreón. Most border plants do not have unions; however, plants in the interior in Matamoros, Reynosa, and Nuevo Laredo are unionized. *Id.*, at 27-28.

The turnover rate for highly-skilled in-bond workers is 3-5 percent. *See id.* at 28. The turnover rate, however, for production workers is considerably greater. A coproducer in Nogales may experience 35 percent turnover monthly. This high turnover rate is due in part to the fact that 75-80 percent of production workers are young women of childbearing age. This demographic group often experiences high employee turnover rates. *See* Turner, *supra* note 16, at 29. Inadequate housing, impersonalized management, and inadequate public transportation also may contribute to the turnover rate. *See* Turner, *supra* note 15, at 28–29. Poor plant siting and inadequate worker benefits also have been cited as reasons for such turnover. *Id.*

42. *Maquiladora* operations generally are best suited for assembly of mature products where the labor input is 30 percent of the production cost. *See* Turner, *supra* note 16, at 27. Electronics, ceramics, automotive parts, and toys are suitable products for the Mexican production-sharing industry. On the other hand, foundry and other heavy-duty production is less suited for border coproduction operations. *Id.* "The Mexican government would like greater concentration in capital goods production, to improve domestic capability in this area." *See* Turner, *supra* note 15, at 26.

43. *See* Turner, *supra* note 15, at 26.

44. *See* Turner, *supra* note 16, at 29. An application, IM-5, must be filed with SECOFIN before this 20 percent option may be implemented. *Id.* Permission from SECOFIN for the 20 percent option must be renewed every 12 months. It may be revoked by SECOFIN at any time if local producers challenge a U.S. manufacturer successfully. This mechanism may operate as a protectionist measure against U.S. corporations.

45. "Ultimately, the government's goal is to combine imported technology, job training and domestic content to generate non-traditional exports." Turner, *supra* note 16, at 27.

facility in Mexico than for a textile plant. In addition, all domestic sales must be consistent with Mexico's foreign investment priorities.[46]

D. Criticisms of *Maquiladoras*

The *maquiladora* industry in Mexico has without doubt been successful thus far. It has created thousands of jobs for Mexican workers, while improving the competitiveness of coproduced articles. In addition to the advantages Mexico gained, U.S. manufacturers have reaped profits from their capital investments. Both the United States and Mexico have benefited from *maquiladora* operations.

Nevertheless, strong criticisms of the *maquiladora* system come from both sides of the border.[47] In one view, the U.S. companies exploit cheap Mexican labor to the detriment of Mexico and its development. The *maquiladora* industry rarely utilizes Mexican investment capital, and U.S. manufacturers usually do not reinvest earnings into Mexican markets. American corporations often return home to U.S. markets with their earnings. The labor force attracts U.S. dollars into the economy, but not much U.S. capital remains in Mexico from the *maquiladora* program. The economy of Mexico, therefore, never receives the full potential benefit from the *maquiladora* industry.

Moreover, U.S. labor organizations have harshly criticized the *maquiladora* industry. In their view, the Mexican workers rob Americans of vital employment opportunities. U.S. laborers lose out on jobs because of the comparatively low wage scales in Mexico. The battle for jobs is especially competitive in the borderland areas where unemployment may run as high as twenty or twenty-five percent on the U.S. side. U.S. labor organizations, therefore, fight hard to gain and protect crucial jobs for their constituents. For the most part, however, the *maquiladora* industry has been successful and has provided benefits for both countries.

III. Expansion of Coproduction in Mexico and the United States

The success of the *maquiladora* industry provides a basis for expanding the scope of coproduction between the United States and Mexico. In this

46. SECOFIN will consider other factors as well in its approval process, such as the standing of the *maquiladora* plant, the company's past foreign exchange record, and the fulfillment of a local content requirement. *See* Turner, *supra* note 16, at 29-30.

47. Some criticisms of the *maquiladoras* involve Mexico's laws. Customs laws often cause delays at checkpoints. *See* Turner, *supra* note 15, at 27. Also, Mexican law requires that trucks on federal highways be driven by Mexican carriers. This requirement can become costly especially when Mexican carriers have insufficient rolling stock. *Id.* In addition the Mexican infrastructure is inadequate in certain areas. "[S]ufficient electric power, water and sewage lines, and convenient access to an international airport, may not always be available." *Id.* at 28.

way, development of coproduction industries will reap even greater benefits that can be shared equitably by the capital and labor from both countries.

This idea is the subject of a proposal pending before Congress. On February 14, 1981, Congressman William Richardson (D–NM) introduced a bill entitled the U.S.-Mexican Border Revitalization Act.[48] The bill authorizes the President "to negotiate with the Government of Mexico, on a reciprocal and mutually beneficial basis, for the purpose of developing and entering into a bilateral agreement to establish a United States-Mexico free trade and coproduction zone."[49] If an agreement can be achieved between the President and the Mexican Government, this program will enhance the concept of coproduction ventures between the two nations.

According to this plan, both the United States and Mexico combine their unique skills and resources to coproduce various articles. The program utilizes the raw materials, technology, marketing expertise, wage scales, and capital from both countries. The combination of these resources increases investment opportunities for Mexican and U.S. corporations. The purposes of the proposal are to "increase job creation, support economic development, improve competitiveness,"[50] and increase export performance. Such coproduction operations may take the form of a partnership, a trading company, a subcontracting relationship, a joint venture, or any other feasible association. These cooperative business ventures can only strengthen ties between the labor and capital of both nations.

Under this proposal, coproduction ventures may be located on either side of the border. Raw materials and component parts used in coproduction would receive duty-free treatment across the border, regardless of where they originated.[51] Both countries would take an active role in the production of each item. After the article is coproduced, it could be sold in either country without tariff assessments. The product also could

48. *See* H.R. 1006, 100th Cong., 1st Sess., 133 CONG. REC. H592 (daily ed. Feb. 4, 1987).

49. *Id.* § 3.

50. *Id.* § 2.

51. During the 99th Congress, Congressman Richardson introduced a bill similar to that of H.R. 1006. H.R. 3199, 99th Cong., 1st Sess., 131 CONG. REC. H7199 (daily ed. Aug. 1, 1985). The H.R. 3199 bill did not win congressional approval. Congressman Richardson proposed a similar concept, however, as an amendment to an immigration bill. This amendment passed the House, but its progress was halted in the House-Senate Conference. *See* H.R. 3810, 99th Cong., 1st Sess., 132 CONG. REC. H9708, H9722 (daily ed. Oct. 9, 1986); 8 U.S.C. § 1001 (Supp. 1987). H.R. 3199 included two requirements that are no longer present in the current bill, H.R. 1006. First at least 50 percent of the value of the finished product must originate from the Zone. Second, at least 35 percent of the product must have been manufactured by the coproduction facility. H.R. 1006 encourages the basic concepts underlying these provisions; however, it does not require such rigid rules.

be sold in a third country. This program would be implemented through the use of tax incentives and special tariff treatment.[52] Various tax credits or deductions would encourage businessmen from both countries to invest in such coproduction operations.

This proposal is advantageous to both the United States and Mexico. The bill requires the "optimal use of labor and capital from both the United States and Mexico."[53] Both U.S. and Mexican capital would be invested in such ventures. As a result, Mexico would develop greater investment markets, while U.S. investors would profit as well. As an additional advantage, these venturers would employ laborers from both countries, thereby answering criticisms from American labor organizations and reducing unemployment on both sides of the border.

The proposal would place no geographic limitations upon coproduction efforts; however, "[t]he zone would include, but not be limited to, the United States-Mexico borderlands."[54] The borderlands naturally would be the most advantageous region for coproduction ventures. The region would include such cities as San Diego, Phoenix, Albuquerque, San Antonio, Monterrey, Saltillo, and Chihuahua. In this region, the two countries maintain similar cultures, language, geography, and entrepreneurial spirit. Resources may combine efficiently, therefore, and coproduction facilities may utilize the comparative strengths of both countries.

The plan will ease the burdens of the trade deficits in both countries. Sales between Mexico and the United States will help generate greater export profits. In addition, sales to third-party countries will enhance export performance. The coproduced article will be more competitive in world markets, and therefore will expand sales and production from export industries. In particular, Mexican marketing expertise will be able to assist U.S. manufacturers in creating and enlarging markets in the developing nations. These markets show great growth potential, and Mexico, with its firsthand knowledge of the concerns of developing countries, will be able to target these buyers effectively.

Through this cooperative program, Mexico can achieve its development goals. By working closely with skilled U.S. laborers, the Mexican workers will gain additional experience and training. The expansion of coproduction facilities also will lead to a more developed economic structure in Mexico and improved capital markets.

As development progresses, Mexican citizens will have less incentive to cross the border illegally. The problem of undocumented aliens is, at its core, an economic one. More than fifty percent of all illegal immigrants

52. *See* H.R. 1006, *supra* note 48, § 4(a).
53. *Id.* § 4(b).
54. *See id.* § 3.

into the United States come from Mexico.[55] The proper solution to this problem is Mexico's economic recovery. "If the United States does not work with other countries, such as Mexico, to address their severe economic problems, we will not be able to stop effectively the flow of illegal aliens into this country."[56] The Zone proposal is, by no means, a panacea. It will improve, however, the immigration situation because Mexican economic development will help reduce the poverty that drives an illegal alien across the border. The Zone proposal promotes Mexico's economic development.

The proposal has been lauded by its many supporters. The U.S. Chamber of Commerce showed its support for the Zone proposal in the following policy statement:

> The Chamber supports the concept of authorizing the President to negotiate with the Government of Mexico, on a reciprocal and mutually beneficial basis, the establishment of a Free Trade and Co-Production Zone that would include the U.S.-Mexico borderlands, as a first step to achieving a free-trade area between the United States and Mexico over the long term; and providing liberalized trade and favorable tax incentives to U.S.-Mexico joint ventures located within the Zone to promote co-production of articles.[57]

Furthermore, President Reagan has cited the proposal as one alternative approach towards improving U.S.-Mexican trade relations.[58] The reaction of public media has treated the proposal favorably, as well.[59] The United States and Mexico may establish a Free Trade and Coproduction Zone through bilateral negotiations which would effectively coordinate their resources and talents so as to maximize their mutual and reciprocal benefits.

IV. Incentives for Coproduction in the Caribbean Basin

United States interests are inextricably "linked to the economic and political health of the Caribbean region."[60] "[The Caribbean] region rep-

55. R. WARREN & J. PASSEL, ACCOUNT OF THE UNCOUNTABLE: ESTIMATES OF UNDOCUMENTED ALIENS COUNTED IN 1987 U.S. CENSUS, Demography table II (1987). Mexicans accounted for approximately 55% of the estimated 2.1 million illegal aliens living in the United States in 1987.

56. *See* Hon. W. Richardson, Remarks Upon Introduction of the United States-Mexico Border Revitalization Act (Feb. 4, 1987).

57. Statement of the Chamber of Commerce of the United States of America Endorsing the Concept of a U.S.-Mexico Free Trade and Coproduction Zone (Nov. 13, 1985).

58. Office of the U.S. Trade Representative, Presidential Report to Congress on North American Trade Agreements 83–84 (Aug. 4, 1981). The U.S. Trade Advisory Committee prepared this Presidential Report on North American Trade Agreements.

59. *Understanding the Border,* Wall St. J., May 26, 1981, at 22, col. 2; *An Idea to Think About,* Dallas Morning News, Mar. 20, 1981, at A28, col. 1; *Administration Ignores Hispanics' Leadership Potential,* El Paso Herald Post, Sept. 24, 1984, at A6, col. 4; *Trade Zone Would Help Both U.S. and Mexico,* San Antonio Light, Mar. 10, 1985, at K2, col. 2.

60. Bush, *supra* note 14.

resents a significant market for U.S. exports ($6.3 billion in 1982), and the United States is the dominant trading partner for the region as a whole, accounting for 24 percent of their imports and 46 percent of their exports."[61] The United States has "an overwhelming stake in the development of vigorous, free market economies in the region."[62]

A. THE CARIBBEAN BASIN INITIATIVE

The Caribbean Basin region consists of parts of Central and South America and all the islands in the Caribbean Sea.[63] The United States has been very involved in this area since the turn of the century and has provided some assistance to these countries since World War II. The U.S. Government also encourages development in these countries through special tariff treatment and tax benefits.

The CBI[64] was adopted in 1983 to counteract the economic woes of this region. Congress enacted the CBI to strengthen the economies of this area "by providing trade benefits in the region."[65] It received broad

61. SUBCOMM. ON WESTERN HEMISPHERE AFFAIRS OF THE HOUSE COMM. ON FOREIGN AFFAIRS, THE ENGLISH-SPEAKING CARIBBEAN; CURRENT CONDITIONS AND IMPLICATIONS FROM U.S. POLICY, H.R. DOC. NO. 51–695, 99th Cong., 1st Sess. 32 (1985) [hereinafter THE ENGLISH-SPEAKING CARIBBEAN].

62. Bush, *supra* note 14.

63. *See* THE ENGLISH-SPEAKING CARIBBEAN, *supra* note 61, at 2 ("[T]he Caribbean stretches from Belize in Central America in an arc through Cuba, Jamaica, Haiti, the Dominican Republic, and Puerto Rico, and then on through the smaller islands of the Eastern Caribbean and on to Guyana, Suriname, and French Guyana in South America."). Many of the countries in the Caribbean Basin have similar and interrelated characteristics and problems. The countries of this region therefore, often are grouped together as a unit.

64. Caribbean Basin Economic Recovery Act (CBERA), Pub. L. No. 98-67, 97 Stat. 384 (1983) (as amended in 19 U.S.C. and 26 U.S.C.); *see also* Zagaris, *A Caribbean Perspective on the Caribbean Basin Initiative*, 18 INT'L LAW. 563, 564 n.5 (1984). According to the CBI, 19 U.S.C. § 2702(b) (1983), the following are beneficiary countries: Anguilla, Antigua and Barbuda, the Bahamas, Barbados, Belize, British Virgin Islands, Caymen Islands, Costa Rica, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Montserrat, Netherlands Antilles, Nicaragua, Panama, Saint Christopher-Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Trinidad and Tobago, and the Turks and Caico Islands.

There are also tax provisions in the CBI. These provisions deal primarily with deductions for business conventions in the Caribbean Basin. Business deductions are permitted so long as two conditions are met: (1) the CBI country does not discriminate against conventions held in the United States, and (2) the country has filed an exchange-of-information agreement with the United States (Tax Information Exchange Agreement). Many CBI countries object to such exposure, and therefore reject the CBI and its potential benefits. 26 U.S.C. § 174(h)(6)(A) (1983).

65. *See* Bush, *supra* note 14, *see also* SUBCOMMITTEE ON OVERSIGHT OF THE COMM. ON WAYS AND MEANS, REPORT ON THE COMMITTEE DELEGATION MISSION TO THE CARIBBEAN BASIN AND RECOMMENDATIONS TO IMPROVE THE EFFECTIVENESS OF THE CARIBBEAN BASIN INITIATIVE, 100th Cong., 1st Sess. 1 (1987) [hereinafter THE PICKLE REPORT].

bipartisan support in Congress. Economic development and political stability were two major goals for the CBI.[66] The CBI permits the President to grant duty-free treatment to imports from qualified Caribbean Basin nations.[67] The CBI goes one step past TSUS Item Numbers 806.30 and 807.00[68] by granting entirely duty-free treatment for eligible goods entering the United States from beneficiary countries. "By giving most businesses in the Caribbean full and free access to the U.S. market, CBI gives the region's nations a powerful tool for attracting foreign investment and for fostering domestic private investment."[69]

Under the CBI, goods are allowed into the United States free of tariffs. U.S. corporations, therefore, are encouraged to organize plants in the Caribbean, to utilize the relatively inexpensive labor, and to reexport the tariff-free goods to U.S. markets. In this way, manufacturers may increase profits by reducing labor costs and expanding sales markets. Such profitable behavior has no added costs because no duties are paid on goods

---

66. Other development projects exist in the region. The Caribbean Project Development Facility (CPDF) was created under the auspices of the United Nations Development Program to help identify new, promising investment projects in the Caribbean Basin and to assist Caribbean firms and business people in the preparation of such projects. CPDF does not finance the projects; however, it does maintain close relations with national and international lending and investing institutions. The CPDF is funded by grants from development agencies and international organizations. The Economic Development Administration of Puerto Rico (FOMENTO) also helps interested parties obtain financing at concessionary rates. It aids promotion efforts of the local industry. FOMENTO encourages production sharing, especially in agro-industrial projects.

67. "Prior to enactment of the CBI, approximately 80 percent of Caribbean Basin nonpetroleum exports could enter the United States duty-free." THE PICKLE REPORT, *supra* note 65, at 2.

68. *See supra* notes 10-13 and accompanying text. One recommendation that the Pickle Report suggests is that "[l]egislation should be enacted to provide that articles assembled or processed from American-made parts or components enter the United States from CBI beneficiary countries totally duty-free." THE PICKLE REPORT, *supra* note 65, at 37. The Report further explains:

> [C]urrently, the value of the American-made parts or components, sent to CBI beneficiary countries for assembling or processing, reenter the United States duty-free. Duty is paid, however, on the value-added portion of the article, when returned to the United States . . . .
>
> CBERA [The Caribbean Basin Economic Recovery Act, referred to as the CBI] beneficiaries can also take advantage of the partial duty exemption on the value of U.S.-content which is provided to imports from any source under items 806.30 and 807.00 of the Tariff Schedules of the United States. These provisions are especially meaningful for the importation of products excluded from coverage under CBERA or GSP [General System of Preferences] or in situations where value added is not sufficiently high to meet the origin requirements.

Id. at 37, 49–50.

69. *See* Bush, *supra* note 14.

manufactured outside the United States. These benefits only add to the incentives provided by the governments of Caribbean Basin countries.[70]

Because of the CBI incentive, The U.S. Government hoped the Caribbean Basin nations would flourish. Unfortunately, however, the CBI has confronted difficulties. "Despite this preferential treatment, the value of U.S. imports from [CBI] beneficiaries declined 23.7 percent from 1983

70. Haiti, for example, provides many benefits to U.S. coproducers. *See* CARIBBEAN CENTRAL-AMERICAN ACTION, INVESTING IN HAITI (1986). Two types of incentive programs are offered in Haiti. First, generally speaking, a corporation receives full exemption from customs duties on raw materials and machinery, so long as the corporation is qualified under the system of preferences. *See id.* Second, eligible companies are entitled to a full tax exemption for at least the first five years of operation. Additional exemptions are granted depending upon the location of the operation.

Another CBI country, the Dominican Republic, also provides incentives for U.S. manufacturers to coproduce. Qualified firms receive exemptions from income taxes and import duties on raw materials, machinery, equipment, and packaging materials. *See* CARIBBEAN-CENTRAL AMERICAN ACTION, INVESTING IN DOMINICAN REPUBLIC (Mar. 1986). *See generally* PRICE WATERHOUSE, DOING BUSINESS IN THE DOMINICAN REPUBLIC (June 1986); PRODUCTS INVESTMENT AND TRADE INFORMATION, COMMERCIAL NEWS DOMINICAN REPUBLIC (July 1985).

Costa Rica also provides incentives to U.S. coproducers. Many U.S. corporations legally own equity in Costa Rican companies. These plants operate at high efficiency and low cost, primarily in the apparel and electronics industry. Duty exemptions are permitted on imported machinery, equipment, and raw materials. Income tax exemptions are allowed for profits from export industries. The labor force is highly skilled and literate. Minimal regulations are placed upon repatriation of profits. *See generally* COSTA RICAN COALITION OF DEVELOPMENT INITIATIVES, COSTA RICA: THE BEST PLACE FOR INVESTING (June 1984).

The Guatemalan Government, likewise, has welcomed foreign investments and has interfered infrequently in the private economic sectors. All business enterprises, except banks and utilities, may be entirely foreign-owned. The Law on Incentives For Exporting-Producing Companies (Decree 21-84) offers duty-free entry on materials, supplies, machinery, spares, and accessories. Tax incentives also exist for U.S. manufacturers in Guatemala. In order for this law to apply, plant must be registered with the Santo Tomas de Castilla Free Zone for Industry and Trade (ZOLIC). *See generally* ARTHUR ANDERSEN & CO., A BRIEF GUIDE FOR DOING BUSINESS IN GUATEMALA (1984).

The Jamaican Government also offers the Kingston Free Zone. Import licensing is reduced to a minimum for products entering the zone; there are few restrictions on repatriation of capital.

Panama provides distinct advantages over other CBI countries. For instance, Panamanians utilize U.S. currency, which reduces the risks frequently associated with foreign investments. Also, Panama is located at a point of international, maritime, aviational, and political importance. Certain areas of Panama, in addition, provide a well developed infrastructure in terms of water supply communications and transportation. Export promotion programs of Panama provide exemptions for income taxes, capital gains taxes, and import and export duties. *See generally* PEAT, MARWICK, MITCHELL & CO., INVESTMENT IN PANAMA (1983).

The Government of Trinidad and Tobago provides special preference for foreign investment in chemical, metals, and manufacturing industries. Fiscal incentives for foreign investments include duty and income tax exemptions for up to ten years. The Export Development Corporation of Trinidad and Tobago provides market development grants and manages export development programs. *See generally* TRINIDAD & TOBAGO INDUSTRIAL DEVELOPMENT CORPORATION, COUNTRY PROFILE (Oct. 1985).

to 1985."[71] Exports of sugar and bauxite, two of the Caribbean's basic commodities, have declined.[72]

Other barriers have impeded the progress of the Caribbean Basin Initiative as well. The provisions of the CBI are fairly extensive and circuitous. The CBI imposes seven criteria in order for an eligible country to receive special treatment.[73] Eleven other factors may affect a country's eligibility status.[74] At least thirty-five percent of the cost or value of an eligible product must be produced within Caribbean Basin countries.[75]

Even if all of the above conditions are met, the CBI still excludes certain items from favorable treatment. Items such as textiles, apparel, footwear, tuna, petroleum, and watches are all exempted.[76] The reason for these exceptions is protection of U.S. industries. Congress did not want the stronger Caribbean Basin industries to compete in these product lines

71. THE PICKLE REPORT, *supra* note 65, at 94. "In 1985, U.S. imports from the CBERA-beneficiary nations amounted to nearly $6.7 billion, a 22 percent decline over 1984 imports of slightly under $8.6 billion." *Id.* at 104. The results indicated that even in import-sensitive industries, such imports from the Caribbean Basin countries to the United States are negligible as compared to imports from the Far East. For example, textiles and apparel for the entire CBI region in 1985 amounted to $649 million as compared to approximately $3.3 billion from Hong Kong, $2.4 billion from Taiwan, and $2 billion from Korea. *Id.* at 6.

72. *See* Bush, *supra* note 14.

73. 19 U.S.C. § 2702(b) (1983). The six conditions in order for a country to receive beneficiary status are: (1) a country must not be Communist; (2) a country must not fail to recognize arbitral awards in favor of U.S. citizens or corporations; (3) a country must not grant preferential treatment to another developed country having an adverse impact on U.S. commerce; (4) a country must not permit infringement upon broadcasts of U.S.-copyrighted materials; (5) a country must extradite U.S. citizens, and (6) a country must not seize ownership of or impose heavy conditions on U.S. corporations.

74. *Id.* § 2702(c). These eleven provisions are:

- expression of a desire to be so designated;
- economic factors;
- provision of access to markets and basic commodity resources;
- compliance with the GATT and other trade agreements;
- degree to which export requirements or local contact requirements are imposed;
- degree to which the country's trade policies contribute to the revitalization of the region;
- degree to which the country promotes its own economic development;
- workplace conditions and the allowance of collective bargaining;
- safeguarding of intellectual property rights for foreigners;
- safeguarding of U.S. copyrighted broadcast material;
- cooperation with the United States in the administration of this title.

75. *Id.* § 2702(a)(1)(B). United States possessions, like Puerto Rico and the Virgin Islands, may be included as beneficiary countries for purposes of the 35% requirement. In order to count towards the 35%, the CBI country must substantially manufacture the product. Mere repackaging or combining does not constitute production.

76. *Id.* § 2703(b); *see also* THE PICKLE REPORT, *supra* note 65, at 5, 37–38.

with U.S. producers. These strong CBI industries, however, offer the greatest potential for growth in the economies of beneficiary countries. Congress specifically excluded the industries that may prove most beneficial to the Caribbean development efforts.[77]

Many U.S. corporations also fear investing in Caribbean countries because of their lack of development. Many CBI nations fail to maintain the infrastructure necessary for efficient manufacturing. Because of the uncertain economic environment, lenders in these countries tend to be overly conservative. Creditors often charge exorbitant interest rates or require one hundred percent collateral. As a result, investors maintain the status quo and stick to basic staple commodities, rather than explore innovative opportunities. In this way, U.S. corporations, even with current CBI incentives, have avoided investments in the Caribbean Basin nations.

B. The Possessions Tax Credit

Since 1921 the U.S. Government has granted preferential tax treatment to investments to U.S. possessions. In 1948 Puerto Rico and Mexico, in conjunction with the United States, established a program called "Operation Bootstrap." This program extended tax exemptions to U.S. corporations investing in Puerto Rico. Operation Bootstrap raised the annual per capita income level in Puerto Rico from $120 to more than $4,000.[78]

Section 936 of the Internal Revenue Code grants a federal tax credit to U.S. corporations investing in Puerto Rico.[79] For many years, the island has reaped benefits from this incentive program. In 1986 "[a]pproximately $7 billion earnings from the section 936 companies [were] on deposit in [Puerto Rican] banks."[80] In the 1970s, however, section 936 came under harsh criticism as American corporations invested their profits in foreign banks outside Puerto Rico. Few investments were placed in the hands of Puerto Rican banks. "Moreover, the Puerto Rican authorities have been concerned that these funds are being invested outside Puerto Rico (primarily in the Eurodollar market)."[81] This trend, in essence, defeated the purposes of section 936. Relatively few U.S. dollars trickled into Puerto Rico's economy, inhibiting its development efforts.

---

77. The Pickle Report suggested that Congress should entact legislation that would "provide for duty-free treatment of dutiable 'exempt list' products exported from CBI beneficiary countries where the article is not produced or is in short supply in the United States." The Pickle Report, *supra* note 65, at 37.

78. Colon, *supra* note 8.

79. *See* 26 U.S.C. § 936 (as amended in 1986).

80. Colon, *supra* note 8.

81. S. Rep. No. 99-313, 99th Cong., 2d Sess. at 449 (1986).

The Tax Act of 1976 amended section 936 and limited its coverage.[82] The amendment granted preferential treatment only to "qualified possession source investment income" (QPSII).[83] QPSII is income derived "from sources within a possession of the United States in which a trade or business is actively conducted."[84] Under the 1976 Act, no credit was permitted unless fifty percent of the total income of a section 936 company was from the active conduct of a trade or business within a possession of the United States. That fifty percent requirement has been amended to sixty-five percent in the Tax Equity and Fiscal Responsibility Act of 1982[85] and further amended to seventy-five percent in the Tax Reform Act of 1986.[86] Any interest gained from QPSII is exempt from the payment of federal taxes.

Recently, however, many U.S. corporations, especially those in the high technology industries (particularly pharmaceuticals), discovered and exploited a loophole in the operations of section 936. These companies first researched and developed patented processes in the United States, receiving a deduction for such expenses.[87] Then, the corporations would send such processes to their Puerto Rican counterparts for use there and receive the benefits of the section 936 tax credit.

Congress viewed the exploitation of this loophole as unfair and inequitable. As a result, the Tax Equity and Fiscal Responsibility Act of 1982[88] set out amendments to limit the tax-free treatment of intangible property. After 1982 U.S. corporations found it more difficult to transfer patented processes to their Puerto Rican subsidiaries free of taxes.

V. 1986 Amendments to Section 936: The Puerto Rico-Caribbean Twin-Plant Program

Even after the 1982 amendments, Congress still received criticisms about section 936 from executive officials. The Treasury Department felt that the possessions tax credit should be abolished because it cost the federal government too much money in lost tax revenues. "According to Treasury statistics, the possessions tax credit amounted to over $22,000

82. Tax Reform Act of 1976, Pub. L. No. 94-455 (as amended at 26 U.S.C. § 936).
83. 26 U.S.C. § 936(a)(1) and (d)(2) (1976).
84. *Id.* § 936(d)(2) (1986).
85. *Id.* § 936(a)(2)(B) (1982).
86. *Id.* § 936(a)(2)(B) (1986).
87. *Id.* § 174 (1982).
88. Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. No. 97–248, 26 Stat. 324 (codified at 26 U.S.C. § 936).

per possessions corporation employee in 1982, more than 150 percent of the earnings of an average employee in that year ($14,210). Fourteen possessions corporations received tax credits in excess of $100,000 per employee in 1982."[89] The credit was complex and difficult to administer; therefore, section 936 was ineffective in the achievement of its goals.

Despite the faults of section 936, the Puerto Rican economic structure relies upon these tax incentives for U.S. investments. When Congress threatened the repeal of section 936, therefore, Puerto Rico responded with a strong lobbying effort to retain the tax credit. In 1985, Governor Colon proposed his "twin-plant" program. Governor Colon offered $700 million of Puerto Rico's section 936 funds to finance twin-plant projects in Puerto Rico and CBI countries.[90] In this way, Puerto Rico could retain section 936 and its benefits, while the CBI economies would get a necessary injection of additional financing.

Congress, in the Tax Reform Act of 1986, amended section 936 along the lines of Governor Colon's proposal.[91] The Act expands the definition of QPSII to include investments in qualified CBI countries. For purposes of the tax credit, investments in "(I) active business assets in a qualified Caribbean Basin country, or (II) development projects in a qualified Caribbean Basin country"[92] would satisfy the requirement as QPSII. In other words, these investments would receive the full benefits of the tax credit. Congress decided to retain section 936 so long as "the Government of Puerto Rico will guarantee $100 million annually of new funds for private direct investment in qualified CBI countries."[93] The Government Development Bank for Puerto Rico must authorize section 936 investments "pursuant to regulations issued by the Secretary of the Treasury of Puerto Rico."[94] Congress also vowed to supervise the implementation of the amendments.[95]

This amendment demonstrates that coproduction efforts in the Caribbean Basin have developed a long way. A corporation may qualify now for a U.S. tax credit under section 936 so long as it invests the profits in CBI-qualified countries. To put it simply, a U.S.- or Puerto Rican-based corporation may invest in CBI development projects and is not obligated

89. H.R. Rep. No. 99–426, 99th Cong., 2d Sess. at 129 (1985).
90. *See* Colon, *supra* note 8.
91. 26 U.S.C. § 936 (as amended in 1986).
92. 26 U.S.C. § 936(d)(4)(A)(i) (as amended in 1986). Under the new tax law, subject to certain conditions, an investment in a financial institution will be eligible for the tax credit, to the extent that the money is used in a financial institution or the Government Development Bank for Puerto Rico or the Puerto Rico Economic Development Bank.
93. H.R. Rep. No. 99–426, *supra* note 89, at 131.
94. 26 U.S.C. § 936(d)(4)(A)(ii) (as amended in 1986).
95. *See* H.R. Rep. No. 99-426, *supra* note 89, at 130.

to pay U.S. income taxes on profits derived from such projects. This incentive program will continue as long as $100 million of new funds are invested in CBI countries annually. The program is a way for the U.S. Government to encourage investments and development programs in the Caribbean Basin, while the U.S. salvages an ailing section 936 program. In addition to the CBI, the U.S. Government provides incentives for section 936 corporations to coproduce in CBI countries and to export to the U.S. In this way, the coproduced articles receive duty-free treatment, under the CBI, upon re-entry into United States zones. Companies, therefore, can receive the benefits of both the section 936 tax credit and the CBI duty-free treatment.

Many observers believe that the amendment to section 936 will promote economic development both in the possessions and in qualified CBI countries. Certainly, the credit will spur economic growth and development in the Caribbean Basin. At least $100 million of new capital funds is virtually guaranteed to be devoted to Caribbean development projects. Coproduction ventures will expand as a result of added incentives. More U.S. firms will invest greater amounts of capital in the Caribbean Basin nations. "The Government of Puerto Rico will promote employment-producing investment in, as well as the transfer of technology to, qualified CBI countries."[96] Unemployment in this region will be reduced by the twin-plant amendment. Under the initiative, "in addition to the 24 plants which have already been developed between Puerto Rico and some Caribbean countries, a further 24 new plant start-ups are projected . . . . and 30 remain in the pipeline under serious consideration."[97]

The enlargement of the coproduction industry also will create numerous investment opportunities for the Puerto Rican economy. Through such investments, the capital markets of Puerto Rico will develop even more. Moreover, Puerto Rican corporations will take advantage of low-cost labor input in the Caribbean Basin countries. These coproduced articles resulting from the twin-plant operation may be more competitive in global markets. Furthermore, estimates claim that the provision will "increase [U.S.] fiscal year budget receipts [from income taxes] by $41 million in 1986, $70 million in 1987, $69 million by 1988, $76 million in 1989 and $83 million in 1990."[98] In general terms, the U.S. and Puerto Rican economies both will benefit greatly from the new section 936.

VI. Conclusion

The United States has a vital interest in the economic development of Mexico and the Caribbean Basin. The fates of these economies are inex-

96. *See id.*
97. Seaga, *A Close Look at CBI and Puerto Rico*, 11 P.R. BUS. REV. 13 (1986).
98. H.R. REP. NO. 99-426, *supra* note 89, at 131.

tricably intertwined with that of the United States. The United States, therefore, must encourage industrial development of these countries. Through coproduction efforts, the United States will promote its foreign policy objectives. Coproduction ventures can help to improve the economies of these countries, improve their economic development, and reduce political instability. This is the proper environment for free enterprise economies to flourish and democratic governments to survive.

Coproduction operations in Mexico have been profitable activities for U.S. enterprises in recent years. Mexico constitutes the third most valuable trading partner of the United States; likewise, the United States is an important trading partner to Mexico's foreign exchange. The two countries have similar interests politically, geographically, and economically. Coproduction operations combine these unique commonalities so as to utilize human talents and resources from both nations for mutual benefit.

The scope of U.S.-Mexican coproduction should be expanded to ensure reciprocal benefits to U.S. and Mexican labor and capital. Currently pending before Congress is a bill (H.R. 1006) proposing such expansion. The Free Trade and Coproduction Zone would enhance economic growth for both the United States and Mexico. Raw materials, labor, capital, technology, and marketing expertise from both countries would be utilized. This proposal would help to achieve the political and economic development goals of the United States and of Mexico.

Similarly, coproduction efforts should be expanded in the Caribbean Basin as well. Recently, Congress extended tax incentives to encourage such activities. The benefits of section 936 tax credits now may accrue to U.S. or Puerto Rican corporations investing in qualified Caribbean Basin countries. This Tax Reform Act amendment will inspire corporations to establish new coproduction ventures in CBI countries. Expansion of coproduction efforts in the region will spur economic growth in Puerto Rico and economic development in the Caribbean Basin countries.

Coproduction operations help to achieve the foreign policy goals of the participating countries. Two countries working together to the mutual benefit of both nations promotes economic development and integration. In view of the continuing tension over trade and investment issues between the United States and Latin America and the Caribbean, coproduction could prove to be the catalyst needed to reignite the engines of development in the Americas, to increase competitiveness, and achieve a balance of trade. Instead of retaliation and protectionism, we need imaginative legal and economic concepts that provide mutual benefits for all the nations of this hemisphere. An expanded and improved coproduction program is such a concept.