Saint Louis University Law Journal

Volume 62
Number 1 *The Sanford E. Sarasohn Conference on Critical Issues in Comparative and International Taxation II: Taxation and Migration (Fall 2017)*

Article 11

2017

Exploring the Intersection of Trade Policy, Immigration, and Tax Law: A Coordinated Tax Response to the "Push" Factors Driving the Current Wave of Migration to the United States from Central America

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EXPLORING THE INTERSECTION OF TRADE POLICY, IMMIGRATION, AND TAX LAW: A COORDINATED TAX RESPONSE TO THE "PUSH" FACTORS DRIVING THE CURRENT WAVE OF MIGRATION TO THE UNITED STATES FROM CENTRAL AMERICA

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INTRODUCTION

In recent years, much attention has been given to an unprecedented wave of immigration from Honduras, Guatemala, and El Salvador (the "Northern Triangle" of Central America) to the United States. A 2015 report by the American Federation of Labor and Congress of Industrial Organizations ("AFL–CIO") entitled "Trade, Violence and Migration: The Broken Promises to Honduran Workers"[1] cited a combination of factors, including historic economic policies of the Honduran government (which include tax breaks for foreign manufacturing operations through the *maquiladora* regime and tariff-free export processing zones) and the implementation of the Central American Free Trade Agreement ("CAFTA") in 2006,[2] as drivers for the deteriorating security situation in Honduras,[3] which now has one of the highest murder rates in the world.[4] This climate of violence, together with increasing inequality and lack of economic opportunity, which are present in Guatemala and El Salvador, as well,

* Assistant Professor, Northern Illinois University College of Law. The author wishes to thank Anushi Trivedi for research assistance. And of course many thanks are due to all the organizers and participants at the Sanford E. Sarasohn Conference on Critical Issues in Comparative and International Taxation II: Taxation and Migration. All errors and omissions are the author's own.

1. AFL-CIO, TRADE, VIOLENCE AND MIGRATION: THE BROKEN PROMISES TO HONDURAN WORKERS 1 (2015) [hereinafter AFL-CIO Report], https://aflcio.org/sites/default/files/2017-03/Honduras.PDF [https://perma.cc/6H37-7FJT].

2. In addition to Honduras, the parties to CAFTA are the United States, Costa Rica, El Salvador, Guatemala, Nicaragua, and the Dominican Republic; hence it is sometimes referred to as DR-CAFTA. This Paper will use the acronym "CAFTA" to refer to the agreement. Bureau of Econ. & Bus. Affairs, *2012 Investment Climate Statement - Honduras*, U.S. DEP'T STATE (June 2012), https://www.state.gov/e/eb/rls/othr/ics/2012/191162.htm [https://perma.cc/H2FD-BGW9].

3. AFL-CIO Report, *supra* note 1, at 5, 7.

4. Guy Taylor & Stephen Dinan, *Violence Surges in Central America, Threatening New Refugee Flood*, WASH. TIMES (Jan. 10, 2016), http://www.washingtontimes.com/news/2016/jan/10/el-salvador-honduras-guatemala-violence-surges-thr/?page=all [https://perma.cc/8PFE-BT6Y].

appear to be the drivers of the new wave of immigration from the Northern Triangle to the United States.[5]

Honduras, Guatemala, and El Salvador all have severe socioeconomic problems contributing to the current wave of immigration. CAFTA was portrayed as a partial solution to this situation, promising to bring economic development to these countries.[6] This promise has not been fulfilled as of yet; minimal increases in foreign direct investment and economic growth in the Northern Triangle since 2006 have been insufficient to remedy high poverty levels, and growth has been unequally distributed.[7] For the promises of free trade to be fulfilled, further reforms are needed, both internationally and domestically. Among these changes, international tax reforms may play an important role.

This Paper explores the nexus between trade policies, the current wave of immigration from the Northern Triangle countries, and tax policy. Because of the importance of U.S. investment to the economies of the Northern Triangle countries, U.S. international tax laws impacting transactions and investment decisions by U.S. companies may have a significant impact on the "success" of CAFTA in delivering growth through improved free trade between the CAFTA member states. Among other things, the Paper will advocate for the enactment of tax treaties between the U.S. and CAFTA member countries. In addition, the Paper will explore other international tax policy initiatives that could help the Northern Triangle countries raise much-needed tax revenue and alleviate some of the distortions caused by current international tax policy in terms of investment decision-making.

I. EMIGRATION FROM THE NORTHERN TRIANGLE AND ITS CAUSES

Immigration from the Northern Triangle has increased significantly in the second decade of the twenty-first century. Most of this is due to a surge in illegal migration.[8] As of 2013, Guatemala, Honduras, and El Salvador had a combined estimated population of approximately thirty million people.[9] Of this total, it was estimated that approximately 2.7 million people, or 9% of the total

5. AFL-CIO Report, *supra* note 1, at 3, 5, 18. These factors are sometimes referred to as "push" factors in driving immigrants from these countries to the United States (as opposed to "pull" factors, which refer to the climate in the United States itself that attracts migrants to come). *Id.* at 5, 21.

6. *See, e.g.*, AFL-CIO Report, *supra* note 1, at 7 (discussing effects of CAFTA on Honduras).

7. *See, e.g.*, *id.* at 8.

8. Taylor & Dinan, *supra* note 4.

9. *El Salvador: Population, Total*, WORLD BANK, http://data.worldbank.org/country/el-salvador [https://perma.cc/L7P4-GJVR] (showing a 2013 population of 6.2 million); *Guatemala: Population, Total*, WORLD BANK, http://data.worldbank.org/country/guatemala [https://perma.cc/N79X-EFWS] (showing a 2013 population of 15.5 million); *Honduras: Population, Total*, WORLD BANK, http://data.worldbank.org/country/honduras?view=chart [https://perma.cc/N5JL-FTUM] (showing a 2013 population of 8.6 million).

populations, were living in the United States.[10] This was an increase of 80% (up from approximately 1.5 million) since 2001.[11] Many more Northern Triangle nationals have tried to reach the United States and failed.[12] Around the end of the first decade of the twenty-first century, the number of asylum and refugee applications from the Northern Triangle also surged.[13] The number of people from the three Northern Triangle countries requesting asylum in the neighboring countries of Belize, Costa Rica, Mexico, Nicaragua, and Panama increased by "1,179% from 2008 to 2014, while asylum requests increased by 370% for the United States over the same time period."[14]

Clearly, the usual mix of "push" and "pull" factors that has fed a steady but small stream of immigrants from the Northern Triangle over decades has shifted dramatically, and the statistics appear to indicate that it is the "push" factors—what is happening on the ground in these countries—that is causing the exodus. Numerous sources have identified poor economic conditions and job prospects for the young, coupled with rising levels of violent crime and gang activity, as the primary causes.[15] The majority of unauthorized migrants from the Northern Triangle countries are young, poorly educated, and male.[16] In addition, many

10. Danielle Renwick, *Central America's Violent Northern Triangle*, COUNCIL ON FOREIGN REL. (Jan. 19, 2016), http://www.cfr.org/transnational-crime/central-americas-violent-northern-triangle/p37286 [https://perma.cc/MG57-TAG7].

11. *Id.*

12. Reports indicate that nearly 500,000 people from the Northern Triangle were apprehended in Mexico between 2010 and 2015. RODRIGO DOMINGUEZ VILLEGAS & VICTORIA RIETIG, MIGRATION POLICY INST., MIGRANTS DEPORTED FROM THE UNITED STATES AND MEXICO TO THE NORTHERN TRIANGLE: A STATISTICAL AND SOCIOECONOMIC PROFILE 5 (2015). 100,000 Northern Triangle nationals were apprehended in the United States and Mexico in 2010, and more than 340,000 were apprehended in 2014. *Id.*

13. Renwick, *supra* note 10 ("Between 2009 and 2013, the United States registered a sevenfold increase in asylum seekers at its southern border, 70 percent of whom came form the Northern Triangle." (citation omitted)).

14. Silva Mathema, *They Are Refugees: An Increasing Number of People Are Fleeing Violence in the Northern Triangle*, CTR. FOR AM. PROGRESS (Feb. 24, 2016, 12:35 PM), https://www.americanprogress.org/issues/immigration/news/2016/02/24/131645/they-are-refugees-an-increasing-number-of-people-are-fleeing-violence-in-the-northern-triangle/ [https://perma.cc/Q9XG-D473]. The refugee and asylum requests are primarily based on claims of persecution by gangs and cartels, which the police and government forces are either unwilling or unable to stop. *See* Dennis Stinchcomb & Eric Hershberg, *Unaccompanied Migrant Children from Central America: Context, Causes, and Responses* 34 (Am. Univ. Ctr. for Latin Am. & Latino Studies Working Paper Series, Paper No. 7, Nov. 2014).

15. *See* AFL-CIO Report, *supra* note 1, at 5; *see also* PETER J. MEYER ET AL., CONG. RESEARCH SERV., R43702, UNACCOMPANIED CHILDREN FROM CENTRAL AMERICA: FOREIGN POLICY CONSIDERATIONS 24 (2016), https://fas.org/sgp/crs/homesec/R43702.pdf [https://perma.cc/AT5X-XQ6U] [hereinafter CRS Report].

16. VILLEGAS & RIETIG, *supra* note 12, at 12–13 (noting that most deportees to the Northern Triangle, which is assumed to be representative of unauthorized migrants overall, are between ages 20–29, with other significant numbers in the age range 30–39; deportees are 83 percent male; more

are unemployed or work in agriculture or other unskilled employment.[17] The demographic profile of the immigrants is in keeping with the "push" factors identified by the various sources.

II. THE TRADE-IMMIGRATION NEXUS AND THE ROLE OF TAXATION IN FREE TRADE AND DEVELOPMENT

The socioeconomic problems facing the Northern Triangle countries are deep-seated and long-standing. In the early part of the twenty-first century, the administration of George W. Bush worked extensively to promote free trade in the Western Hemisphere, and one much-touted (but unproven) benefit of these policies was that they would bring economic development to depressed Latin American economies.[18] CAFTA, negotiated, signed, and implemented against this background, was in part based on the 1994 North American Free Trade Agreement ("NAFTA"), but the economic profile of CAFTA countries, which are among the poorest in the Western Hemisphere, was quite different from those of Canada and Mexico at the time NAFTA was signed ten years earlier. For example, while U.S. investment in Mexico was fairly broad even before the implementation of NAFTA, U.S. investment in Honduras is more limited and highly concentrated in the manufacturing (*maquila*) sector and in wholesale trade,[19] yet still represents approximately 70% of the country's foreign direct investment.[20] The *maquiladora* industry flourishes in part because of its ability to attract foreign investment with tax breaks and exemptions for large companies.[21] At the same time, Honduras, Guatemala, and El Salvador all suffer

than 80 percent of deportees from Guatemala and Honduras have a secondary education or less; migrants from El Salvador are slightly better educated, but still only 35% have finished high school or more).

17. *Id.* at 14 (noting that based on a survey of deportees, only 14% had any kind of skilled employment experience).

18. Grant D. Aldonas, *The FTAA: Mapping the Road to Economic Growth and Development*, 7 ECON. PERSP. 17, 17 (2002) ("Implementing a Free Trade Area of the Americas (FTAA) 'is critical at this juncture in the history and development of the Western Hemisphere' . . . . In addition to increasing economic prosperity throughout the hemisphere, the FTAA would open the door to long-term social and political initiatives that will strengthen democracy and regional stability." (quoting Commerce Under Secretary for International Trade, Grant Aldonas)).

19. U.S. DEP'T OF STATE, 2015 INVESTMENT CLIMATE STATEMENT: HONDURAS 3 (2015), https://www.state.gov/documents/organization/241799.pdf [https://perma.cc/95BF-CETD].

20. *See id.* (showing approximately 900 million USD of U.S. foreign direct investment in 2014); *Honduras: Foreign Investment up 5% in 2015*, CENTRALAMERICADATA.COM (Mar. 11, 2016), https://en.centralamericadata.com/en/article/home/Honduras_Foreign_Investment_Up_5_in_2015 [https://perma.cc/8CBC-4D6S] (showing a total of 1.2 billion USD in foreign direct investment into Honduras for 2015).

21. *See* AFL-CIO Report, *supra* note 1, at 5 (explaining how the maquiladora industry in Honduras offers "incentives such as tax exemptions, duty-free imports of raw materials and machinery, and the ability to repatriate profits" and focuses on attracting foreign investment rather than supporting small businesses).

from insufficient government revenue and regressive tax systems.[22] These factors also exacerbate conditions for the working poor, and contribute to inequality, which is associated with higher levels of violence, furthering a vicious cycle that discourages foreign investment and inhibits development.[23]

CAFTA has not been the economic panacea it was promised to be.[24] In order to reduce incentives to migrate, reforms are needed to bring economic growth to the Northern Triangle, increase wages, and reduce inequality. The governments will also need revenue and other assistance to combat crime and instability. Lack of economic opportunity and inequality, together with other factors leading to violent crime, further exacerbate violence and the power of organized criminal gangs in the drug trade and other "underground" economic activities.[25] While addressing all these issues is well beyond the scope of this Paper, this Part will focus on the role of free trade in bringing economic development to the Northern Triangle, as well as the role of international taxation in promoting and supporting that development.

A. Trade-Immigration Nexus?

CAFTA, like NAFTA before it, was publicly hailed as a boon for the economies of the member states, a measure that would improve the economies of developing countries, thus reducing illegal immigration to the United States.[26] However, such predictions have not yet come to pass for the Northern Triangle countries in the wake of CAFTA.[27]

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22. *See* PETER J. MEYER ET AL., CONG. RESEARCH SERV., R43702, UNACCOMPANIED CHILDREN FROM CENTRAL AMERICA: FOREIGN POLICY CONSIDERATIONS 25 (2016).

23. *Id.* at 24.

24. *See, e.g.*, AFL-CIO report, *supra* note 1, at 7–8.

25. Scott Rempell, *Credible Fears, Unaccompanied Minors, and the Causes of the Southwestern Border Surge*, 18 CHAPMAN L. REV. 337, 354–55 (2015) (discussing the militarization of Central America as a result of violent civil wars in the 1980s, weak governments powerless to effectively control organized crime, and the role of economic marginalization in the creation of Central American gangs).

26. *See, e.g.*, AFI-CLO Report, *supra* note 1, at 7, 18 (discussing anticipated goals of CAFTA for Honduras); *see also* Taylor & Dinan, *supra* note 4 (showing that as of 2013, more than 1.2 million Northern Triangle nationals are living in the United States illegally).

27. *See, e.g.*, AFI-CLO Report, *supra* note 1, at 7–8, 18 (stating that CAFTA has only "exacerbated the desperation and instability in Honduras" and that migration is a means "to escape violence or seek employment opportunity"). Similar statements had been made surrounding NAFTA, and a popularly held expectation for NAFTA was that it would reduce immigration from Mexico. *See* Jagdeep S. Bhandari, *Migration and Trade Policies: Symmetry or Paradox?*, 6 HOFSTRA J. INT'L BUS. & L. 17, 18 n.4 (2007). In the first fifteen or so years following NAFTA, however, there was actually an increase in Mexico-U.S. immigration, which only slowed in the aftermath of the 2008 financial crisis. Felicity Lawrence, *Trump Is Right: Nafta Is a Disaster. But US Workers Aren't the Big Losers*, GUARDIAN (Nov. 18, 2016), https://www.theguardian.com/commentisfree/2016/nov/18/trump-nafta-us-workers-not-big-losers-mexican-workers-suffer-most [https://perma.cc/6D6F-A7JG]. Some observers did predict at least a short-term increase in

The empirical and scholarly work on the interrelationship between trade and immigration indicates some nexus between the two.[28] Some frameworks indicate that trade liberalization may increase wage disparities between a "core" country trading partner and the "periphery," and thus contribute to increased migration.[29] More recently, work focused on NAFTA predicted a short-term "migration hump" in the aftermath of trade liberalization. On this theory, long-term impacts of trade liberalization may eventually reduce illegal immigration, but in the short-term will serve to increase it. In fact, this appears to be what happened in Mexico.[30] To some extent, this "migration hump" may describe the phenomenon occurring with the Northern Triangle countries, but twelve years after the signing of CAFTA, with immigration only increasing, it is clear that significant changes need to occur to slow the exodus from the Northern Triangle and deliver on the promises of CAFTA to improve economic conditions in Central America.

Focusing specifically on certain aspects of the economies of Northern Triangle countries, it appears that trade policy over the past two decades has had a negative impact on jobs and economic opportunity in the region. CAFTA has caused significant "adjustment costs" in the sensitive agricultural sector, which historically employs significant numbers of workers in the Northern Triangle.[31]

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migration from Mexico in the wake of NAFTA, however. Philip Martin, *Mexico-US Migration, in* GARY CLYDE HUFBAUER ET AL., PETERSON INST. FOR INT'L ECON., NAFTA REVISITED: ACHIEVEMENTS AND CHALLENGES 441, 449 (2005) (explaining why NAFTA was accompanied by an increase in Mexico-US migration).

28. Bhandari, *supra* note 27, at 34; *cf.* Margaret E. Peters, *Open Trade, Closed Borders: Immigration Policy in the Era of Globalization*, 67 WORLD POL. 114, 121, 149 (2015) (discussing research tending to show that open trade policy is generally accompanied by restricted immigration policies, noting the substitutability of trade in goods and trade in labor; however, the article does not address any link between illegal immigration and trade liberalization). There is much scholarly discussion of the economic hypothesis that trade in goods and migration (i.e., trade in labor) are substitutes. *See, e.g.*, Kevin R. Johnson, *Free Trade and Closed Borders: NAFTA and Mexican Immigration to the United States*, 27 U.C. DAVIS L. REV. 937, 965 (1994) ("Labor migration and capital flow are related to international trade . . . [and] . . . 'in the absence of protectionism, trade among countries with different factor endowments is a substitute for migration.'" (quoting Dolores Acevedo & Thomas J. Espenshade, *Implications of a North American Free Trade Agreement for Mexican Migration into the United States*, 18 POPULATION & DEV. REV. 729, 730–31 (1992))).

29. Bhandari, *supra* note 27, at 32; *see also* PAUL R. KRUGMAN, GEOGRAPHY AND TRADE 2 (1991).

30. "[T]he number of unauthorized Mexicans living in the United States rose from an estimated 2.5 million in 1995 to 4.5 million in 2000, representing an annual increase of 400,000 a year." Martin, *supra* note 27, at 449. However, more recently there appears to have been no net migration to the United States from Mexico. *See, e.g.*, Ana Gonzalez-Barrera, *More Mexicans Leaving than Coming to the U.S.*, PEW RES. CTR. (Nov. 19, 2015), http://www.pewhispanic.org/2015/11/19/more-mexicans-leaving-than-coming-to-the-u-s/ [https://perma.cc/XAC8-P2QK].

31. *See* J.F. HORNBECK, CONG. RESEARCH SERV., R42468, THE DOMINICAN REPUBLIC-CENTRAL AMERICA-UNITED STATES FREE TRADE AGREEMENT (CAFTA-DR): DEVELOPMENTS

Increased competition from the U.S. agricultural industry has driven prices down, and trade policy has not generally compensated for this by creating sufficient jobs in other sectors.[32] For example, the phase-out of the Multi-Fibre Arrangement ("MFA"), a multilateral agreement imposing quotas on textiles and clothing that could be imported from developing countries, appears to have contributed to a decline in the number of textile and clothing exports from Central America.[33] The phase-out of the MFA was completed in 2005; between 2005 and 2012, textile exports from the CAFTA countries declined by 14%.[34] This appears to be due, at least in part, to increased competition from the textile industries in Asia in the aftermath of the MFA.[35] Thus, the loss of agricultural jobs has pushed rural workers toward the cities in search of new opportunities, but such opportunities are often lacking. Large numbers of under- and unemployed workers concentrated in urban centers are easy prey for gangs, drug-traffickers, and other criminal operations seeking additional manpower.

Pre-dating CAFTA, the *maquiladora* policies adopted in the Northern Triangle have also contributed to migration from the region to the United States.[36] The implementation of CAFTA has only cemented the importance of *maquilas* to the manufacturing industry in these countries. Economic evidence indicates that the *maquiladora* system has benefited the economies of countries in the Northern Triangle.[37] However, this has not necessarily helped the working class in the region. Foreign direct investment in manufacturing attracted by the *maquila* system has not led to the same positive spillover effects in Central

IN TRADE AND INVESTMENT 4 (2012) ("[A]gricultural sectors bear most of the trade adjustment costs . . . .").

32. *See, e.g.*, AFL-CIO Report, *supra* note 1, at 8 (discussing effects of CAFTA on Honduras); *see also* Samuel Morley, Eduardo Nakasone & Valeria Piñeiro, *The Impact of CAFTA on Employment, Production and Poverty in Honduras* 31, 45 (Int'l Food Policy Research Inst., Discussion Paper No. 00748, Jan. 2008) (noting a small impact on employment and economic growth from CAFTA trade liberalization, with most of the growth attributable to the *maquila* sector, and estimating this would result in modest reductions in poverty by 2020).

33. STACEY FREDERICK, JENNIFER BAIR & GARY GEREFFI, DUKE CTR. ON GLOBALIZATION, GOVERNANCE & COMPETITIVENESS, NICARAGUA AND THE APPAREL VALUE CHAIN IN THE AMERICAS: IMPLICATIONS FOR REGIONAL TRADE AND EMPLOYMENT 4 (2014).

34. *Id.* at 4. However, there is some variation within the CAFTA region, and the Northern Triangle. While market share declined for all Northern Triangle countries between 2005 and 2012, El Salvador and Honduras have seen a slight increase in the overall value of exports in spite of their market share decline, while Guatemala has experienced a decrease in export value. *Id.* at 5.

35. *Id.*

36. *See* PETER A. CRETICOS & ELEANOR SOHNEN, WILSON CTR. & MIGRATION POLICY INST., MANUFACTURING IN THE UNITED STATES, MEXICO, AND CENTRAL AMERICA: IMPLICATIONS FOR COMPETITIVENESS AND MIGRATION 1 (2013) (noting that immigrants from Mexico and the Northern Triangle "make up 8 percent (1.3 million people) of the US manufacturing force").

37. For example, in 2008, *maquila* manufacturing contributed eleven percent of El Salvador's GDP. *Id.* at 4.

America as it has in other regions such as East Asia.[38] This may be in part because traditional *maquiladora* manufacturing dissociates the manufacturing process from R&D and innovation.[39] Further, the manufacturing jobs in the *maquilas* are extremely low wage, paying approximately the average wage rate for all workers in the local economy.[40] While low- or unskilled manufacturing jobs are considered low wage in the United States, U.S. manufacturing wages are still significantly higher than the wages for similar work in the Northern Triangle.[41]

While the Northern Triangle countries appear to have experienced positive GDP per capita growth since CAFTA, the gains are modest[42] and are unevenly distributed, as evidenced by severe income inequality in the region.[43] Of course, the myriad economic problems facing the Northern Triangle have explanations that go well beyond trade policy. Nonetheless, the foregoing discussion shows the importance of considering the impacts of trade policy, especially in light of the stated goals of agreements such as CAFTA with respect to development and immigration. As the liberalization of trade has not yet had a positive impact on outward migration from the Northern Triangle, other policy reforms should be considered. The following Section turns to the role of taxation, with a focus on how tax policy furthers or undermines the goals of relevant trade policy.

B. The Role of Taxation

Among the most important purported benefits of free trade agreements such as CAFTA is that they facilitate foreign direct investment ("FDI").[44] Because trade agreements between developed and developing countries often result in a decline in the agricultural sector for the poorer country, the promised investment

38. *Id.*

39. *Id.* at 7.

40. *Id.* at 8.

41. CRETICOS & SOHNEN, *supra* note 36, at 8.

42. *See GDP Per Capita: Guatemala, Honduras, El Salvador*, WORLD BANK http://data.worldbank.org/indicator/NY.GDP.PCAP.KN?locations=HN-GT-SV&year_high_desc=true [https://perma.cc/V5JY-2ZSK].

43. *See, e.g.*, Raiesa Ali, *Income Inequality and Poverty: A Comparison of Brazil and Honduras*, COUNCIL ON HEMISPHERIC AFFAIRS (July 1, 2015), http://www.coha.org/income-inequality-and-poverty-a-comparison-of-brazil-and-honduras/#_ftnref15 [https://perma.cc/DZH7-YYDE] (describing Honduras as one of the most unequal countries in Latin America in terms of distribution of income); Maynor Cabrera, Nora Lustig & Hilcías E. Morán, *Fiscal Policy, Inequality, and the Ethnic Divide in Guatemala*, 76 WORLD DEV. 263, 263 (2015) (describing Guatemala as one of the most unequal countries in Latin America).

44. *See, e.g.*, Anthony J. Venables, *Regional Integration Agreements: A Force for Convergence or Divergence?* 20 (The World Bank Policy Research Grp., Policy Research Working Paper No. 2260, Dec. 1999), http://documents.worldbank.org/curated/en/397421468766807036/pdf/multi-page.pdf [https://perma.cc/4VQ7-RL4P] (recognizing that free trade agreements "typically promote foreign direct investment").

can make up for this through providing manufacturing and other jobs for displaced rural and agricultural workers.[45] However, this does not always occur, and is much less likely in the case of free trade agreements between low-income and high-income countries. Even where new free trade does result in increased FDI, such investment may concentrate in low-wage industries, such as, in the case of Honduras, the *maquiladoras*. While the *maquila* industry employs significant numbers of people, such jobs are criticized for offering only subsistence wages,[46] and government revenue from the programs is limited as a result of tax breaks to foreign nationals and the removal of tariffs through free trade agreements and export processing zones.[47] At the same time, the local tax breaks may not always operate as intended, thanks to the worldwide taxation of U.S. businesses under the federal income tax code.[48]

In spite of the failure of CAFTA so far to deliver on the promise of increased FDI in a meaningful way, there may be tax reforms that could help attract beneficial FDI.[49] These changes can be both local and bilateral or multilateral. From a local taxation perspective, the Northern Triangle countries struggle with effective taxation. In all three countries, rates of tax evasion are high.[50] Tax

45. *See* Morley et al., *supra* note 32, at 20.

46. *See* Elvia R. Arriola, *Voices from the Barbed Wires of Despair: Women in the* Maquiladoras*, Latina Critical Legal Theory, and Gender at the U.S.-Mexico Border*, 49 DEPAUL L. REV. 729, 731 n.3 (2000) (generally discussing low wages for *maquiladora* workers). "[*Maquiladoras* are] in-process assembly plants owned by transnational corporations that operate primarily in the export market. They are not manufacturing plants but rather processors or assemblers of component parts produced in the home country of the corporation." *Id.* (citation omitted).

47. AFl-CIO Report, *supra* note 1, at 7.

48. CONG. BUDGET OFFICE, OPTIONS FOR TAXING U.S. MULTINATIONAL CORPORATIONS 2 (2013) ("The U.S. government taxes both the domestic and foreign income of businesses that are incorporated in the United States and that operate abroad."). Thus, while U.S. interests doing business in the Northern Triangle may enjoy lower local taxes, they still face the same level of U.S taxation when any profits they earn overseas are repatriated to the United States. *Id.* at 9. Furthermore, the U.S. tax credit system essentially ensures that U.S. companies operating overseas ultimately pay the higher of the foreign or the U.S. tax rate on their income. *Id.* Thus, foreign tax breaks are only valuable to the extent of the availability of deferral of the U.S. tax.

49. However, recent scholarship has challenged the conventional wisdom that attracting FDI is the best way to improve economic conditions in developing countries, and that using tax incentives to do so may be counter-productive. *See, e.g.*, Yariv Brauner, *The Future of Tax Incentives for Developing Countries*, *in* TAX, LAW AND DEVELOPMENT 25, 26, 32 (Yariv Brauner & Miranda Stewart eds., 2013).

50. *See, e.g.*, *Instituciones, Impuestos, y Desigualdad en Guatemala [Institutions, Taxes, and Inequality in Guatemala]*, WOODROW WILSON CTR. UPDATE ON THE AMS. (Wilson Ctr., Wash. D.C.), Sept. 2013, at 2, https://www.wilsoncenter.org/sites/default/files/Guatemala%20V2.pdf [https://perma.cc/J8WU-QP3S] (explaining how Guatemala has the lowest levels of tax collection in the Latin American region); *see also* ORG. FOR ECON. CO-OPERATION & DEV. [OECD] ET AL., REVENUE STATISTICS IN LATIN AMERICA AND THE CARIBBEAN: 1990-2014, at 32 (2016) (explaining that high levels of informality in tax systems exclude many people from paying taxes

revenues are insufficient to support government spending on effective anti-poverty programs, a social safety net, or infrastructure and other reforms that could improve job opportunities and economic outlook generally. In addition, the governments often provide tax breaks in order to attract foreign investment, as in the *maquila* industry.[51] This is evidence of the dilemma faced by many developing countries: tax incentives are used to attract investment but fail to generate significant revenue for the government.

From an international perspective, the existence of a treaty network can be important. The economic literature on the relationship between tax treaties and FDI is somewhat inconclusive.[52] However, there are some persuasive studies that show a positive correlation between existence of a tax treaty and FDI, at least where other economic indicators favoring FDI are also present.[53] Tax treaties also serve a signaling role, with membership in the "treaty club" offering the promise of remedying potential double taxation and providing certainty for multinationals considering local investment.[54] In contrast to the situation in North America at the time NAFTA was signed,[55] no tax treaty network was implemented before, during, or after the signing of CAFTA between its member countries. Honduras and El Salvador are not parties to any bilateral income tax treaty. Guatemala signed its very first such treaty in 2015, with Mexico.[56]

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and Guatemala and Honduras have among the highest rates of informality in Latin America); Instituto Centroamericano de Estudios Fiscales (ICEFI), *El Salvador*, PERFILES MACROFISCALES DE CENTROAMÉRICA [MACRO-FISCAL PROFILES OF CENTRAL AMERICA], Dec. 2016, at 31, 33–34, http://icefi.org/sites/default/files/perfiles_macrofiscales_ca_7_0.pdf#page=32&zoom=auto,-74,585 [https://perma.cc/X5BQ-UCWX] (discussing problems of tax evasion and tax collection in El Salvador, and noting fairly stagnant tax revenues in recent years).

51. *See* Rafael E. de Hoyos, Maurizio Bussolo & Oscar Núñez, *Exports, Gender Wage Gaps and Poverty in Honduras*, 40 OXFORD DEV. STUD. 533, 534 (2012).

52. *See* Bruce A. Blonigen & Ronald B. Davies, *The Effects of Bilateral Tax Treaties on U.S. FDI Activity*, 11 INT'L TAX & PUBLIC FIN. 601, 601 (2004) (Neth.); Eric Neumayer, *Do Double Taxation Treaties Increase Foreign Direct Investment to Developing Countries?*, 43 J. DEV. STUD. 1501, 1502, 1505 (2007) (U.K.).

53. Neumayer, *supra* note 52, at 1505.

54. Tsilly Dagan, *Tax Treaties as a Network Product*, 41 BROOK. J. INT'L L. 1081, 1088 (2016).

55. The current bilateral tax treaty between the United States and Canada was signed in 1980 and amended numerous times since; the United States and Mexico signed a bilateral income tax treaty in 1992 that entered into force in 1993; Mexico and Canada first entered into an income tax treaty in 1991 (which was Mexico's first comprehensive income tax treaty). Catherine Brown & Christine Manolakas, *Corporate Reorganizations and Treaty Relief from Double Taxation Within the NAFTA Block*, 59 LA. L. REV. 253, 258, 298 (1998).

56. *Guatemala and Mexico Sign Double Taxation Treaty*, ERNST & YOUNG (Mar. 26, 2015), http://www.ey.com/Publication/vwLUAssets/Guatemala_and_Mexico_sign_Double_Taxation_Treaty/$FILE/2015G_CM5330_Guatemala%20and%20Mexico%20sign%20Double%20Taxation%20Treaty.pdf [https://perma.cc/MFT2-B8C2].

III. TAX REFORMS TO REDUCE THE FORCE OF MIGRATION "PUSH" FACTORS

As the foregoing discussion relates, opening to international trade has thus far failed to improve economic conditions in the Northern Triangle, and may in fact have exacerbated the economic problems faced by unskilled and agricultural laborers—those most likely to emigrate. This Part of the Paper will seek to address a few tax reforms that could aid in removing certain barriers to foreign direct investment and economic growth in the Northern Triangle countries. Of course, fundamental domestic tax reform in the Northern Triangle countries, including collection and enforcement rules and practices, are necessary and are beyond the scope of this Paper, though support of domestic reforms by the U.S. government and international tax experts should be made a priority.[57] Further, in order to protect the most vulnerable members of the population from the negative impacts of trade liberalization and increased foreign investment, non-tax reforms will be necessary, including labor reforms and social safety net spending.[58] Nonetheless, this Paper will seek to assess the potential for certain pro-development international tax reforms that may be feasible, including development of a tax treaty network that draws on provisions of the United Nations Model Double Taxation Convention ("UN Model Treaty").

A. Tax Treaties

As noted above, CAFTA introduced new trade liberalization measures to the Northern Triangle but did not address other structural issues that could make the parties to the agreement more competitive at attracting investment. For example, close to the same time NAFTA was signed, the United States and Mexico entered into a comprehensive income tax treaty.[59] This was not the case with CAFTA, and the CAFTA countries have failed to implement any bilateral treaties amongst themselves since then. The goal of international tax treaties has always ostensibly been to relieve double taxation, and thus they provide some predictability for international business interests.[60] Tax treaties impact almost

57. All the Northern Triangle countries suffer from inadequate government revenues and rely heavily on regressive consumption taxes. Assisting developing countries in "mobilizing" tax revenue is a problem that has caught the attention of numerous organizations, including the OECD, the G20, and even the European Union. *See, e.g.*, *Tax and Development Programme*, OECD, http://www.oecd.org/ctp/tax-global/tax-and-development.htm [https://perma.cc/HS3V-ZY3C]; Tax Revenue Mobilisation in Developing Countries: Issues and Challenges, EUR. PARL. DOC. (PE 433.849) 19 (2014). *See generally* Int'l Monetary Fund et al., *Enhancing the Effectiveness of External Support in Building Tax Capacity in Developing Countries*, Report Prepared for Submission to G20 Finance Ministers (July 2016) (analyzing how countries can support the developing tax capacity challenges faced by developing countries).

58. *See generally* AFL-CIO Report, *supra* note 1.

59. *See* Brown & Manolakas, *supra* note 55, at 253.

60. Yariv Brauner, *International Trade and Tax Agreements May Be Coordinated, but Not Reconciled*, 25 VA. TAX REV. 251, 261 (2005).

all of the income resulting from the large numbers of cross-border transactions in the world today,[61] but this is not the case for intra-CAFTA flows.

Of course, double taxation is not the primary impediment to attracting foreign investment in the CAFTA countries, but elimination of double taxation can be a factor making investment more attractive in a particular place, especially given that investors typically have a choice among investment locations.[62] Certainly, the lack of a treaty network makes the CAFTA countries less attractive locations for investment as compared with Mexico, a country that shares many of the competitive advantages of the Northern Triangle countries. Thus, elimination of double taxation may help level the playing field for developing countries vis-à-vis other countries that have access to a tax treaty network. One study focusing on the impact of tax treaties on FDI in developing countries found that countries aggressively pursuing the implementation of tax treaties with developed countries saw notable increases in FDI following conclusion of the treaties.[63]

Thus, tax treaties may be an important implement in the tax policy toolbox for attracting foreign investment. However, the current treaty regime is viewed as problematic for developing countries in particular because it tends to limit source-based taxation in favor of residence-based taxation, which curtails the ability of low-income countries to tax gains from foreign investment.[64] In addition, the revenue-dampening impacts of tax treaties, such as reducing opportunities for tax avoidance, may be especially significant in lower-income countries that traditionally have limited tax enforcement capabilities and may have historically facilitated more-or-less legal tax avoidance strategies.[65]

Most modern tax treaties are based on the OECD Model Tax Convention on Income and on Capital ("OECD Model Treaty"), first published unofficially in 1963.[66] However, the United Nations published an alternative model treaty in 1980, based in large part on the OECD Model Treaty, but with modifications favoring source-based taxation in order to alleviate concerns about the OECD's preference for residence-based taxation.[67] Some countries are prepared to adopt

61. Kim Brooks, *Canada's Evolving Tax Treaty Policy Toward Low-Income Countries*, *in* GLOBALIZATION AND ITS TAX DISCONTENTS: TAX POLICY AND INTERNATIONAL INVESTMENTS 189, 189 (Arthur J. Cockfield ed., 2010).

62. *See* Neumayer, *supra* note 52, at 1504.

63. *See id.* at 1515.

64. *See id.* at 1504 ("[T]he OECD model treaty clearly favours residence taxation . . . ."); *see also* Brooks, *supra* note 61, at 190. Generally, this regime works well in treaties entered into between developed countries, since each will act as host and home country to a more-or-less equal extent, but in treaties between developed and developing countries, this places the poorer country at a distinct disadvantage. *See* Allison D. Christians, *Tax Treaties for Investment and Aid to Sub-Saharan Africa: A Case Study*, 71 BROOK. L. REV. 639, 650–51, 650 n.36 (2005).

65. *See* Neumayer, *supra* note 52, at 1501–02.

66. Brooks, *supra* note 61, at 190.

67. *Id.* at 191.

aspects of the UN Model Treaty in negotiating tax treaties with developing countries.[68]

Among the primary modifications offered by the UN Model Treaty is an expansion of the scope of what constitutes a taxable permanent establishment. This is accomplished in numerous ways. First, the UN Model Treaty reduces the amount of time required for a project to be considered a permanent establishment.[69] It also expands the definition of permanent establishment to include furnishing of services through employees or other personnel for the same or a connected project lasting six months or more.[70] It also modifies the OECD Model Treaty's list of circumstances excluded from the definition of permanent establishment, even where a fixed place of business exists, by removing "delivery of goods" from the exclusion list.[71] The UN Model also expands the concept of dependent agent as compared to the OECD Model Treaty such that it is easier to find a permanent establishment based on the activities of an agent.[72] It also adds a scenario where the activities of an independent agent will cause the principle to be treated as having a permanent establishment.[73] Finally, it expands the definition of a permanent establishment to include insurance activities, if the insurance company collects premiums or insures risks in the country through an employee or dependent agent in that country.[74]

Additionally, the UN Model Treaty departs from the OECD Model Treaty in several other ways that would be beneficial to capital-importing, low-income source countries.[75] It expands the amount of profits that will be allocated to entities with a permanent establishment in the source country, through alignment with the "force-of-attraction" principle, and it denies a deduction for head-office expenses that are payments for royalties, fees, interest, and certain other management services.[76] It also makes other modifications that allow taxation of certain types of business income, even where no permanent establishment is found, and permits higher withholding tax rates for passive income.[77]

68. *Id.*

69. *Id.* at 196.

70. *Id.* at 197.

71. Brooks, *supra* note 61, at 197.

72. *Id.* at 198.

73. *Id.* ("[I]f the [independent] agent's activities are wholly or almost wholly devoted to the enterprise and if the conditions of the agent's relationship differ from those that would have been made between independent enterprises.").

74. *Id.* at 198–99.

75. *See id.* at 194.

76. Brooks, *supra* note 61, at 199–200.

77. *See, e.g.*, *id.* at 200–01 (discussing how Canada, who uses the UN Model Treaty, has taken advantage of these allowances).

It is clear that a tax treaty is not a necessary prerequisite for attracting FDI.[78] Nonetheless, the lack of a tax treaty with the United States seems problematic in light of the stated aims of CAFTA to encourage additional U.S. investment in Central America, and given the "signaling" value of tax treaties for multinational enterprises choosing among locations for investment. Adopting a standard treaty based on the OECD Model Treaty, however, would not necessarily make up for the loss of tax revenue to developing countries that can result from the conclusion of the treaty.[79] Accordingly, treaty negotiations should require inclusion of modifications in favor of source-country taxation. The United States has been resistant to this so far, but Canada, among other countries, has historically expressed a willingness to include such measures in its treaties with developing countries.[80] In the interest of following through on the promises made in connection with implementation of CAFTA, as well as reducing immigration inflows from the Northern Triangle, the United States should revisit this stance with respect to treaties with less developed strategic partners such as Guatemala, Honduras, and El Salvador.[81]

Certain hurdles to implementing a tax treaty network with CAFTA countries will need to be surmounted. Typically, the United States will not enter into income tax treaties with countries that cannot effectively implement exchange of information agreements and source rules.[82] The Northern Triangle countries

78. *See, e.g.*, Deborah Toaze, *Tax Sparing: Good Intentions, Unintended Results*, 49 CAN. TAX J. 879, 887 (2001) (discussing the example of Brazil, which has no U.S. tax treaty but nonetheless is a significant location for U.S. foreign direct investment, as well as trade in goods and services).

79. *See* Neumayer, *supra* note 52, at 1504 ("[T]he OECD model treaty clearly favours residence taxation . . . .").

80. Brooks, *supra* note 61, at 195. In the past, Canada has been "willing to negotiate a tax treaty with a low-income country that lowered the threshold of activity required before a non-resident would be subject to tax on business activities in that country." *Id.*

81. Of course, this approach is disfavored by the United States because it potentially shifts tax revenue to the other country, but the United States is already making financial outlays to support the Northern Triangle countries, which have thus far not proven effective. For example, the Alliance for Prosperity Plan allocated $750 million to the Northern Triangle countries to aid in attracting FDI and support various security initiatives. Office of the Press Secretary, White House, *Fact Sheet: The United States and Central America: Honoring Our Commitments*, OBAMA WHITE HOUSE ARCHIVES (Jan. 14, 2016), https://obamawhitehouse.archives.gov/the-press-office/2016/01/15/fact-sheet-united-states-and-central-america-honoring-our-commitments [https://perma.cc/EA8R-N9UA]. However, the plan has been criticized because it "could end up harming, rather than aiding, Central Americans in the long term." Mercedes Garcia, *Alliance for Prosperity Plan in the Northern Triangle: Not Likely a Final Solution for the Central American Migration Crisis*, COUNCIL ON HEMISPHERIC AFFAIRS (Mar. 3, 2016), http://www.coha.org/alliance-for-prosperity-plan-in-the-northern-triangle-not-a-likely-final-solution-for-the-central-american-migration-crisis/ [https://perma.cc/5ZUP-UWK5].

82. *See* 2016 U.S. Model Income Tax Treaty art. 26(1) ("The competent authorities of the Contracting States shall exchange such information as is reasonably relevant for carrying out the provisions of this Convention . . . .").

will need significant support to carry out administrative reform before being able to meet those requirements.[83] Nonetheless, the promise of more benevolent tax policy by the United States with respect to investment in these countries, and other incentives, should make the governments willing to carry out the needed reforms, and the United States certainly has expertise to offer in aiding with tax administration reform.[84]

B. Targeted Tax Sparing

Numerous scholars have noted the significance of revenue from taxing cross-border investments for low-income and developing countries.[85] Such countries thus face a conundrum: providing a favorable tax regime for international investment, whether in the form of low statutory rates or some kind of targeted tax incentive, is often a prerequisite to attracting the type of foreign investment such countries seek for their economic development. On the other hand, offering too much in the way of tax incentives or too low of a statutory tax rate on such investments bereaves the government of needed revenue. U.S. tax policy in this regard has not helped the dilemma faced by developing countries in attracting investment from the United States, since the United States taxes worldwide income of its corporations and citizens, and typically relies on foreign tax credits to alleviate potential double taxation;[86] thus, tax incentives by developing countries are only beneficial to U.S. investors to the extent that the investors are able to defer U.S. taxation. In addition, the current U.S. deferral system does not offer any advantages to those who choose to invest in developing countries as opposed to developed countries with tax incentives.[87] While deferral is often possible, there are reforms that could be undertaken to

83. Notably, however, both Guatemala and El Salvador have signed the OECD Convention for Mutual Administrative Assistance in Tax Matters, in 2012 and 2015, respectively. Chart of *Jurisdictions Participating in the Convention on Mutual Administrative Assistance in Tax Matters*, OECD (Sept. 12, 2017), http://www.oecd.org/tax/exchange-of-tax-information/Status_of_convention.pdf [https://perma.cc/FYF4-XBF2].

84. *See* Samuel C. Thompson, Jr., Commentary, *The Case for Tax Sparing Along with Expanding and Limiting the Subpart F Regime*, 35 GEO. WASH. INT'L L. REV. 303, 307 (2003) (discussing implementation of information exchange agreements with developing countries).

85. Brooks, *supra* note 61, at 190.

86. *See supra* note 48 and accompanying text.

87. For example, many U.S. companies have chosen to invest in Switzerland, which will often negotiate low tax rates with foreign multinationals. *See, e.g.*, MAJORITY STAFF OF PERMANENT SUBCOMM. ON INVESTIGATIONS, 113TH CONG., REP. ON CATERPILLAR'S OFFSHORE TAX STRATEGY (Aug. 28, 2014) (discussing how Caterpillar negotiated an effective corporate tax rate of 4% to 6% with Switzerland). In recent years, Ireland has been able to attract significant foreign investment due to its relatively low corporate tax rate (12.5%). *See* Int'l Trade Admin., U.S. Dep't of Commerce, *Ireland – Openness to and Restriction on Foreign Investment*, EXPORT.GOV (Feb. 22, 2017), https://www.export.gov/article?id=Ireland-Openness-to-and-Restriction-on-Foreign-Investment [https://perma.cc/N9ZV-PXJ2].

give developing countries more of the benefits sought through their tax incentive programs.

Given the purported value of FDI to developing countries,[88] many have enacted incentives to encourage such development.[89] As noted above, Guatemala, Honduras, and El Salvador all use various tax sparing devices such as export processing zones.[90] Honduras offers special incentives for development in the tourism industry,[91] and Guatemala has targeted incentives for its textile industry and foreign investment in call centers servicing international customers.[92] El Salvador and Honduras both offer incentives for certain development related to renewable energy production.[93]

One question that arises in relation to these tax incentives is whether the home countries of investors should enact what are typically referred to as "tax sparing" policies to help stimulate FDI in the developing countries. These policies are "designed to promote the effectiveness of local tax incentives for foreign investment," typically by adjusting the tax credit procedure to account

88. *See* E. Borensztein, J. De Gregorio & J-W Lee, *How Does Foreign Direct Investment Affect Economic Growth?*, 45 J. INT'L ECON. 115. 117–18 (1998) (discussing the positive results from FDI for developing countries). "[A] one-dollar increase in the net inflow of FDI is associated with an increase in total investment in the host country of more than one dollar . . . ." *Id.*

89. James R. Hines Jr., *Tax Sparing and Direct Investment in Developing Countries*, *in* INTERNATIONAL TAXATION AND MULTINATIONAL ACTIVITY 40 (James R. Hines Jr. ed., 2001).

90. It is worth noting that in February 2016, the Guatemalan Congress issued a law that would curtail or eliminate some of the free trade zone incentives, while offering new expanded incentives for call centers and investments in the textile industry. *See Guatemala Enacts New Tax Incentive Regimes Law*, ERNST & YOUNG (Apr. 8, 2016), http://www.ey.com/gl/en/services/tax/international-tax/alert—guatemala-enacts-new-tax-incentive-regimes-law [https://perma.cc/882Q-A6HY].

91. *Honduras: Incentives for Investment in Tourism*, CENTRALAMERICADATA.COM (July 20, 2017), https://www.centralamericadata.com/en/article/home/Honduras_Incentives_for_Investment_in_Tourism [https://perma.cc/BG73-6ZNE].

92. Bureau of Econ. & Bus. Affairs, *2017 Investment Climate Statements – Guatemala*, U.S. DEP'T STATE (June 29, 2017), https://www.state.gov/e/eb/rls/othr/ics/2017/wha/270072.htm [https://perma.cc/NT5U-75U9].

93. *El Salvador's Congress Approves Expansion of Tax Incentives to Promote Renewable Energy Use in Electricity Generation*, ERNST & YOUNG (Oct. 28, 2015), http://www.ey.com/Publication/vwLUAssets/El_Salvadors_Congress_approves_expansion_of_tax_incentives_to_promote_renewable_energy_use_in_electricity_generation/$FILE/2015G_CM5908_El%20Salvadors%20Congress%20approves%20expansion%20of%20tax%20incentives%20to%20promote%20renewable%20energy%20use%20in%20electricity%20generation.pdf [https://perma.cc/2Y4U-P9DP] (discussing the incentives offered by El Salvador); *Incentives Law for Renewable Energy Generation*, INT'L ENERGY AGENCY (Feb. 27, 2017), http://www.iea.org/policiesandmeasures/pams/honduras/name-161265en.php?return=PG5hdiBpZD0iYnJlYWRjcnVtYiI-PGEgaHJlZj0iLyI-SG9tZTwvYT4gJnJhcXVvOyA8YSBocmVmPSIvcG9saWNpZXNhbmRtZWFzdXJlcy8iPlBvbGljaWVzIGFuZCBNZWFzdXJlczwvYT4gJnJhcXVvOyA8YSBocmVmPSIvcG9saWNpZXNhbmRtZWFzdXJlcy9yZW5ld2FibGVlbmVyZ3kvIj5SZW5ld2FibGUgRW5lcmd5PC9hPjwvbmF2Pg,,&s=dHlwZT1yZSZzdGF0dXM9T2s [https://perma.cc/8WZM-7U3E] (discussing the incentives offered by Honduras).

for the intended incentive benefit.[94] Studies have generally found that tax sparing is effective at stimulating FDI.[95] For example, in a study looking at Japanese tax sparing policies,

> [t]he results indicate that "tax sparing" is effective in stimulating FDI. Japanese firms locate a much higher fraction of their foreign investment in countries with whom Japan has tax sparing agreements than do American firms. Furthermore, host governments appear to grant Japanese firms significant tax reductions that are not available to their American counterparts. All other things equal, tax sparing agreements are associated with 140% to 240% higher FDI levels and 23% lower tax rates on FDI.[96]

The findings related to tax sparing indicate that adoption of targeted tax sparing policies could increase the amount of U.S.-source FDI to host country beneficiaries of the tax sparing provisions.[97]

A different but related policy approach has been proposed by Professor Karen Brown, who has advocated a targeted exemption scheme for income to U.S. residents from investment in certain developing countries in Africa.[98] The proposed exemption would begin at the time of implementation of a tax treaty with the particular country and would last for an initial experimental period of ten to fifteen years.[99] The treaty would include safeguards delineating the type of foreign-source income eligible for the exemption, for example, income from manufacturing activities, natural resource exploration, or research and development.[100]

These proposals face hurdles to implementation in the United States, which has historically rejected tax sparing. One obstacle to tax sparing has been the policy focus on neutralities, including capital export neutrality, which dictates that tax policy not distort incentives to invest in one location or another (i.e., that tax policy should be *neutral* with respect to the location of the investment).[101]

94. Hines Jr., *supra* note 89, at 40 ("[T]ax sparing often takes the form of allowing firms to claim foreign tax credits against home-country tax liabilities that *would* have been paid to foreign governments . . . .").

95. Thompson, Jr., *supra* note 84, at 305.

96. *Id.* (quoting Hines Jr., *supra* note 89, at 41).

97. *Id.* at 306.

98. Karen B. Brown, *Missing Africa: Should U.S. International Tax Rules Accommodate Investment in Developing Countries?*, 23 U. PENN. J. INT'L ECON. L. 45, 51–52 (2002) (advocating that "income derived from investment in sub-Saharan nations" should not be subject to U.S. income taxation).

99. *Id.* at 52.

100. *Id.* Each such treaty would also need to include information exchange provisions and what Professor Brown called "sovereignty preserving" provisions requiring the host nation to implement minimum standards relating to natural resource preservation, labor protection, and infrastructure development. *Id.*

101. *See* David A. Weisbach, *The Use of Neutralities in International Tax Policy* 2, 3 (Univ. of Chi. Law Sch., Coase-Sandor Inst. for Law & Econ. Working Paper No. 697, 2014). This will cause

Both Professor Brown's exemption proposal and tax sparing policies generally explicitly reject capital export neutrality in order to actively encourage investment in a particular location or region, to achieve certain policy goals. Given the dire economic situation in the Northern Triangle, and the clear U.S. interest in remedying that situation, this would be an opportune juncture to reconsider capital export neutrality.

Nonetheless, there are legitimate concerns about the benefits of tax sparing in general (which may also apply to Professor Brown's more far-reaching proposal). Other criticisms have noted that tax incentives to attract foreign investment can actually be counter-productive in the long term, causing unintended economic distortions, encouraging inefficient tax planning, introducing complexity and uncertainty, consuming scarce resources without generating much revenue, and furthering harmful tax competition.[102] However, to the extent that developing countries use tax incentives anyway, as is the case with the Northern Triangle countries, there are arguments in favor of using carefully crafted, targeted, non-reciprocal tax sparing provisions in relevant tax treaties.[103] Given that tax sparing has been used by other developing countries, there is some evidence and a model to look to in implementing such policies vis-à-vis the Northern Triangle countries. Care should be taken, however, to avoid potential pitfalls of tax sparing, such as short-term investment designed to take advantage of the tax benefits and repatriation encouraged by tax sparing without engaging in real, long-term investment in the developing country.[104] In light of these hazards and the general question about the value of tax incentives, it seems that including tax sparing provisions in any tax treaties negotiated with the Northern Triangle countries should not be a priority. Offering support in tax administration reform and other related areas would likely be a more effective way that the United States could assist these countries in raising much-needed revenue.

CONCLUSION

The problems of poverty, inequality, gang violence, and instability in the Northern Triangle are complex and stem from intertwining multi-factored causes. Some of the tax reforms noted above may strengthen prospects for foreign direct investment and provide much-needed revenue for the government

investors to "choose the location of their investments based on where they can get the highest pre-tax return." *Id.* at 3.

102. *See, e.g.*, Kim Brooks, *Tax Sparing: A Needed Incentive for Foreign Investment in Low-Income Countries or an Unnecessary Revenue Sacrifice?*, 34 QUEEN'S L.J. 505, 541-43, 546 (2009) (Can.).

103. *Id.* at 548–49.

104. *See, e.g.*, OECD, TAX SPARING: A RECONSIDERATION 22–23, 26–27, 35 (1998) (urging careful definition of the tax incentives that are made eligible for the tax sparing policies, among other proposals to ensure that tax sparing does not lead to inappropriate tax avoidance schemes).

to aid in efforts to address corruption, crime, inequality, and, ultimately, the violence and poverty plaguing the population. However, there are many challenges ahead for these countries, as well as for the United States and other allies interested in stemming the tide of migrants and remedying the persistent instability of these Central American nations. Nonetheless, it is important to find avenues for cooperation that will benefit all stakeholders.

From a practical perspective, this will require political will that probably does not currently exist in the Northern Triangle governments or the United States. As a report by the Congressional Research Service explains:

> Central American political elites have long benefitted from emigration to the United States, which serves as a "safety valve" that reduces social pressure to address high rates of unemployment and devastation wrought by periodic natural disasters. . . . Moreover, the governments of the northern triangle countries generally have been unable or unwilling to increase revenues, which are currently inadequate to meet public needs. Elites in all three countries have vigorously opposed efforts to raise taxes even though tax rates in the northern triangle countries are comparatively low and regressive.[105]

Additionally, recent political developments in the United States make it unlikely that there will be political will to reform CAFTA, negotiate new tax treaties, or provide support for local tax reform.[106] One possible avenue for cooperation may be Mexico, which arguably has the greatest interest in promoting stability and economic development with its southern neighbors. However, it is also unlikely that Mexico has the necessary international clout, or the resources on its own, to promote the needed reforms successfully.

Nonetheless, it is important to consider approaches to remedying the situation, which is not likely to improve on its own. A hands-off isolationist response by the United States merely delays the inevitable, as the problems will likely continue without strong international coordination and assistance in passing reforms. Tax reforms such as those proposed above, which could be implemented via bilateral tax treaty, may be more politically palatable, and ultimately have better long-term impacts, than grants of direct aid.[107] Finally, it

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105. PETER J. MEYER ET AL., CONG. RESEARCH SERV., R43702, UNACCOMPANIED CHILDREN FROM CENTRAL AMERICA: FOREIGN POLICY CONSIDERATIONS 25 (2016).

106. The Trump administration has generally been critical of free trade agreements and has adopted an "America First" approach to trade and foreign policy in general. *See America First Foreign Policy*, WHITE HOUSE, https://www.whitehouse.gov/america-first-foreign-policy [https://perma.cc/4WGZ-6Y9X]. The tax reform enacted in the United States at the end of 2017 reduced the domestic tax rate on U.S. Corporations and moves the United States closer toward a territorial international tax system. Tax cuts and Jobs Act, Pub. L. No. 115–97, § 11001, 131 Stat. 2054 (2017). However, it is unclear what the impact of these provisions will be on the Northern Triangle countries in terms of U.S. investment.

107. Direct aid programs may be helpful and are certainly common, as illustrated by the Alliance for Prosperity Plan implemented in 2014. *See* Garcia, *supra* note 81 and accompanying text. However, these programs are heavily dependent on political mood and do not provide steady

must be acknowledged that the tax reform proposals considered in this Paper could not be immediately implemented, given the tax treaty negotiation and implementation process, even if the political will to enact them currently existed. Thus, in the short-term, other efforts and support will be required to address the problems driving the current wave of immigration from the Northern Triangle. Ideally, such efforts should not be short sighted. For example, much of the funding from the Alliance for Prosperity has focused on security measures; this approach has been criticized for numerous reasons, including driving up human rights abuses by the Northern Triangle governments.[108] Longer-term reforms will still be needed, and specially tailored tax treaties could be an important tool for the United States to provide assistance in this regard.

flows of income in the way that FDI could. Further, direct aid grants are often dedicated to certain programs and/or conditioned on structural changes that hamper their effectiveness. *See, e.g.*, Brown, *supra* note 98, at 51 (discussing the limited benefit of direct aid programs for Africa and developing countries generally).

108. *See* Laura Iesue, *The Alliance for Prosperity Plan: A Failed Effort for Stemming Migration*, COUNCIL ON HEMISPHERIC AFFAIRS (Aug. 1, 2016), http://www.coha.org/the-alliance-for-prosperity-plan-a-failed-effort-for-stemming-migration/#_ftnref1 [https://perma.cc/K6MN-53TW].