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Jamaica: Implications of the Tax Increase on Bauxite

KEY JUDGEMENTS

Jamaica has levied stiff new taxes on the six vertically integrated aluminum companies operating on the island. The tax, which is tied to the posted price of aluminum, will increase Jamaica's bauxite revenues from \$25 million to about \$165 million this year.

Company Reaction

The aluminum companies are heavily dependent on Jamaica as a supply source and have little choice but to accept its demands. Financially, the companies have no pressing reason to resist the new tax. Aluminum demand is strong and the companies will have no trouble passing through increased costs of bauxite.

Jamaican Benefits

New tax revenues will alleviate the balance-of-payments squeeze that has recently plagued the economy and will allow the government to ease restrictive measures that have slowed economic growth.

MICRO  
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Market Impact

Jamaica's action will provoke demands for higher taxes by other bauxite producing countries. Four, Caribbean producers have already initiated or threaten similar action. The aluminum companies probably will turn to countries that currently are not major producers to develop new supply sources over the next several years. Even these countries are expected to follow Jamaica's example, however, once they become exporters.

Bauxite Substitutes

Substitutes set a long-term ceiling on bauxite prices but are not likely to become important sources of aluminum during the next decade.



DISCUSSION

Jamaica's Tax Action

1. Jamaica's tax action followed two months of inconclusive negotiations with the aluminum companies. These were initiated by the government in March to renegotiate company contracts that still have another ten to twenty years to run. Kingston demanded sharply increased bauxite revenues, equity participation in the companies' Jamaican subsidiaries, and reversion to the state of unexploited company bauxite reserves in excess of 25 years' needs. The revenue demands were strongly resisted by the companies' who made only small counter offers. Kingston broke off the talks and in June enacted legislation unilaterally imposing the revenue increase. Consideration of the remaining issues was postponed until this fall.

2. The action imposed a 55 cents per ton\* royalty and an initial \$11.69 per ton tax on bauxite production retroactive to 1 January 1974, compared with a previous combined royalty and tax payment of \$2 per ton. A novel feature is calculation of the tax as a share (7.5%) of the market value of the average aluminum content of Jamaican bauxite as determined from US posted prices for primary aluminum ingot. This is intended

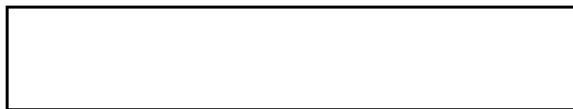
\* Tonnage figures in this paper refer to long tons of 2,460 pounds.

to ensure that Jamaica will benefit from rising aluminum prices. At the same time, the legislation sets a \$11.16 per ton floor under the tax payment to protect Jamaica from aluminum price declines. With the 1 August rise in the US posted aluminum price from 33½ cents a pound to 36 cents, combined tax and royalty payments now amount to \$13.11 per ton. If the US posted price increases to 40 cents by year-end, as expected, payments will rise to \$14.50 per ton.

3. The legislation also established minimum bauxite production rates for each company that total 14 million tons for 1974. This is about 10% above output in 1973 but well below the 15.4 million tons the companies originally planned to produce this year. At quota output levels, company tax and royalty payments in 1974 will total \$165-\$175 million, depending on the timing and magnitude of increases in US aluminum prices later in the year. By comparison, company tax and royalty payments in 1973 amounted to about \$25 million.

Company Situations and Probable Short-Term Reactions

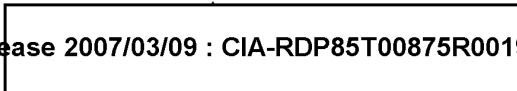
4. In the short term, the aluminum companies have little alternative but to go along with Jamaica's demands. Three -- Alcoa, Kaiser, and Reynolds -- have made formal request for arbitration of the dispute to the World Bank's new International Center for the Settlement of Investment Disputes,



but a decision could take from one to three years to obtain. Meanwhile, the companies have made their first two 1974 quarterly tax payments, though under protest. They undoubtedly will limit their Jamaican production to the quota levels this year, while attempting to expand output elsewhere.

5. The companies have little pressing financial reason for offering more than token resistance to the tax increase. To be sure, the new tax has about doubled the cost of Jamaican bauxite to US smelters -- from \$12 per ton to \$23.11 as of 1 August. But bauxite represents only about 10% of aluminum costs, and the increase therefore has added only about 3 cents a pound to US aluminum costs. The companies should have no difficulty in passing on a cost increase of this magnitude. Strong demand for primary aluminum has boosted US capacity utilization this year to 99.6% from 94% in 1973 and a critical metal shortage is a strong possibility during 1975-76. Moreover, prices for competing materials -- copper, steel, and plastics -- have risen substantially and are in short supply. The 1 August aluminum price increase undoubtedly already reflects in part the higher cost of Jamaican bauxite.

6. The companies would have great difficulty in the short run in shifting a significant part of their Jamaican



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bauxite and alumina operations to alternative supply sources. The Jamaican share of the combined bauxite capacity of the six companies amounts to 42%, and the entire capacity of the two smaller companies -- Anaconda and Revere -- is located there (see Table 1). According to US Bureau of Mines estimates, it would take the companies six months to a year to expand existing operations elsewhere enough to replace as little as one-fourth of Jamaican supplies and at least two years to replace all Jamaican output. To develop recently discovered deposits in such countries as Brazil and Indonesia would take much longer. The difficulty and cost of expanding alumina refining and infrastructure are the main constraints on a rapid shift to other supply sources. Since about 17% of total company alumina refining capacity is located in Jamaica, the companies would have great difficulty under such circumstances in utilizing the large amount of bauxite now in the US strategic stockpile -- at 14 million tons, equal to about 18 month's US supply from Jamaica.

7. The companies also would be highly reluctant to abandon all or even a significant share of their \$850 million investment stake in Jamaica. Even though Jamaica has made no threats, a substantial decline in company operations could also expose their investments to expropriation. US company holdings alone are valued at about

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\$660 million, of which only \$465 million is covered by OPIC political risk insurance.

Impact on the Jamaican Economy

8. Jamaica will benefit greatly from new bauxite tax and royalty revenues. The \$165 million that the government expects to receive in 1974 will eliminate the balance of payments squeeze that has plagued the economy since 1971 when substantial inflows of private capital into the bauxite/alumina industry fell off sharply (see Table 2). Because of balance of payments constraints and measures taken to conserve foreign exchange reserves -- a restrictive monetary policy, devaluation of the Jamaican dollar and import restrictions -- real growth of GDP in 1973 slipped to an estimated 3% compared with the long-term average of 5.2% registered in 1960-72. Even with these measures by the end of 1973 foreign exchange reserves had dropped to \$110 million, equal to less than two month's imports.

9. Improved balance of payments prospects have already allowed the government to ease some of its restrictive measures. Kingston recently relaxed import restrictions, for example. This action should help slow the accelerating rise in consumer prices which climbed at an annual rate of 30% in the first quarter of 1974. Jamaica also will be in a much better position to meet a \$100 million jump in oil import costs



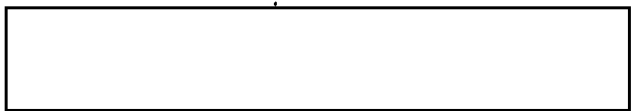
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this year because of higher prices. The new revenues should allow the government to make some modest headway toward its main economic objective of reducing the unemployment rate which is estimated at 20%-25%. Kingston is expected to use part of the new tax receipts to finance labor-intensive development projects. Some of the new revenues may also be used to buy equity/<sup>participation</sup> in domestic bauxite operations and to finance Jamaica's share of a proposed joint-venture aluminum smelter with Guyana and Trinidad.

Implications for the World Bauxite Market

10. Coming at a time when many bauxite exporting countries are suffering balance-of-payments strains caused by high oil prices, Jamaica's tax moves threaten to spur other bauxite exporters to take similar action. Thus far, four other Caribbean exporters, accounting for an additional 30% of US supplies, have initiated or threaten action to increase revenues (see Table 3):

- Guyana initiated contract renegotiations with a Reynolds' subsidiary in July but apparently will legislate a tax increase along the lines of the Jamaican formula.
- The Dominican Republic opened contract renegotiation talks with an Alcoa subsidiary in July. It has rejected a company offer to double tax and royalty payments and introduced legislation to unilaterally



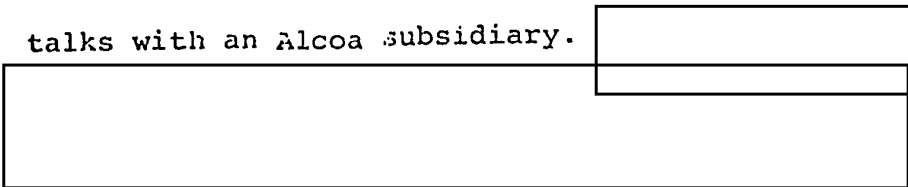
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implement the Jamaican tax formula.

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- Surinam soon plans contract renegotiation talks with an Alcoa subsidiary.

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- Haiti has informed Reynolds officials that it intends to open contract renegotiation talks no later than this December.

11. Australia, the world's largest bauxite producer and supplier of about 20% of US bauxite and alumina needs, may also follow Jamaica's lead. Canberra will be under increasing domestic political pressure to narrow the bauxite revenue gap between Australia and Jamaica. The Whitlam government recently expressed dissatisfaction with its present share of bauxite revenues, and the Queensland provincial government has already opened contract renegotiations with a Kaiser subsidiary to raise royalties.

12. Other bauxite exporters also probably will raise taxes and royalties. Three countries -- Guinea, Sierra Leone, and Yugoslavia -- recently joined Jamaica, Australia, Guyana and Surinam in establishing the International Bauxite Association (IBA). Its main goal is increasing earnings from bauxite through cooperative action. The IBA's charter



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apparently prohibits restrictions on production to achieve this goal but the countries probably have enough economic leverage if they stick together to boost world bauxite prices to the Jamaican level. These seven countries account for 75% of Free World bauxite production and 68% of commercially exploitable reserves (see Figure 1 and Table 4). Including the Dominican Republic, which has applied for membership in the IBA, the share of world production rises to 77%.

13. There are few alternative bauxite sources to which the aluminum companies can turn. Only the United States, France, Greece, and India are important non-IBA producers. Greece is the only country that has reserves large enough to warrant capital outlays of approximately \$15 per ton for each new unit of production capacity. Athens, which insists that exports be at or close to world prices, would probably institute the Jamaican formula and at present no North American companies have plans to enter into bauxite production there.

14. Aluminum companies are very interested in Brazil and Indonesia for future bauxite needs. These two countries have large reserves and are not major producers at present.

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The bauxite boom beginning in the Amazon region could make Brazil a major producer within ten years. A dozen projects are in the early stages of discussion and one project already underway -- Mineracao Rio De Norte -- is scheduled to come on stream in 1977 with an initial production of 3.4 million tons of bauxite annually. Production from this project is reportedly committed for the next 20 years. A US-owned company has a 5% equity interest in the project and will receive 10% of annual output. Exploiting Brazil's extensive reserves has several drawbacks, however. Production costs are high because most of the deposits are inaccessible and require extensive development of infrastructure. Moreover, there are indications that Brazil contemplates action similar to Jamaica's once it becomes an exporter.

15. The international aluminum companies confront much the same situation in Indonesia. The state mining enterprise -- Aneka Tambang -- is likely to retain majority control of new bauxite mining ventures and negotiate stiff financial terms. Although Indonesia apparently prefers not to join the IBA at this time, it probably will exploit any success the association may have in raising prices.



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Role of Bauxite Substitutes

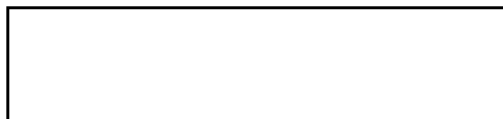
16. The availability of bauxite substitutes sets a long-term ceiling on bauxite prices. As the Jamaican tax formula becomes standard, world prices will reach \$20-\$25 per ton. The higher cost to consumers will accelerate research aimed at breaking the bauxite-alumina chain. Four small pilot plants in the United States currently are testing methods of producing alumina from non-bauxite materials. One of these -- a joint venture of Earth Sciences Inc., National Steel Corporation and Southwire Company -- is testing a process to recover alumina from alunite. The participants hope the pilot plant will provide necessary data to begin construction of a commercial plant with a capacity of 500,000 tons per year by mid-1975 that would come on stream in 1978.

17. Pechiney -- A French-owned aluminum company -- claims to have a non-bauxite alumina process that is commercially competitive with bauxite. The process is now only entering the pilot-plant test stage, however. Even if it proves successful the process will not be ready for commercial application before 1980.

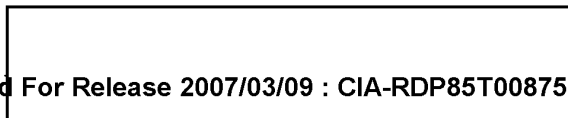
18. Cost estimates for producing alumina from non-bauxite clays by the most promising method indicate that these clays would be competitive if bauxite costs reach



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\$25-\$30 per ton. At this price, the United States would be able to cover all domestic aluminum requirements from indigenous clays and other aluminum-bearing materials such as anorthosite and alunite. Erecting facilities to process non-bauxite materials would be very expensive. An alumina plant handling non-bauxite clay costs approximately \$110,000 per ton of daily capacity compared with \$66,000 for a plant using bauxite (see Table 5). At least \$1 billion would be needed just to construct plants to handle current alumina consumption in the United States.



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Table 1

Bauxite Holdings of the Six Aluminum Companies  
Operating in Jamaica

Company	Total bauxite production capacity (Thousand Long Tons)	Location of Capacity	
		Country	Percent of bauxite capacity
Alcan Aluminum Ltd.	5,500	Jamaica	55
		Guinea	14
		Malaysia	11
		Other	20
			100
Aluminum Company of America	12,050	Surinam	38
		Australia	23
		Dominican Republic	12
		Jamaica	11
		Other	16
	100		
Reynolds Metals Company	7,850	Jamaica	56
		Guyana	17
		United States	15
		Haiti	10
		Other	2
	100		
Kaiser Aluminum and Chemical Corp.	11,650	Jamaica	58
		Australia	40
		Other	2
	100		

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Table 1

(Cont.)

Bauxite Holdings of the Six Aluminum Companies  
Operating in Jamaica

<u>Company</u>	<u>Total bauxite production capacity (Thousand Long Tons)</u>	<u>Location of Capacity</u>	
		<u>Country</u>	<u>Percent of bauxite capacity</u>
Anaconda Company	900	Jamaica	100
Revere Copper and Brass Inc.	500	Jamaica	100





Table 2

## Jamaica: Balance of Payments

	Million US\$			
	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>
Exports (fob)	342.1	343.3	377.6	396.1
of which: bauxite and alumina	225.1	232.7	220.2	207.2
Imports (fob)	449.0	474.1	528.6	574.8
Trade Balance	-106.9	-130.8	-151.0	-178.7
Tourism (net)	80.0	92.7	114.1	108.3
Other current transactions	-126.0	-133.6	-159.7	-177.0
CURRENT ACCOUNT BALANCE	-152.9	-171.7	-196.6	-247.4
Direct Investment (net)	161.4	175.5	97.9	75.5
Other capital and errors and omissions	12.7	44.3	43.3	149.1
CAPITAL ACCOUNT BALANCE	174.1	219.8	141.2	224.6
PAYMENTS BALANCE	21.2	48.1	-55.4	-22.8



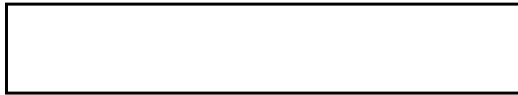


Table 3

Source of United States Bauxite  
and Alumina Supplies\*  
(metal content)

<u>Origin</u>	<u>Percent</u>
Domestic	8.7
Jamaica	39.2
Australia	20.6
Surinam	16.7
Guyana	6.7
Dominican Republic	4.5
Haiti	1.4
Other	2.2
Total	<u>100.0</u>

\* Includes imports of US Virgin Islands

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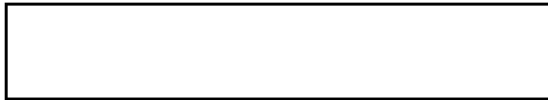

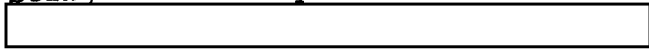


Table 4

Free World Bauxite Reserves  
(Million Long Tons)

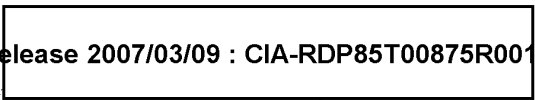
<u>Country</u>	<u>Reserves</u>
International Bauxite Association	<u>10,180</u>
Australia	4,700
Guinea	3,500
Jamaica	1,000
Surinam	500
Yugoslavia	250
Guyana	200
Sierra Leone	30
Brazil	2,000
Indonesia	80*
Greece	700
France	60
United States	40
Other	<u>1,820</u>
Total	14,880

\* Does not include a large bauxite deposit recently discovered by Alcoa. Information on the deposit's size is being withheld by Indonesia and Alcoa 



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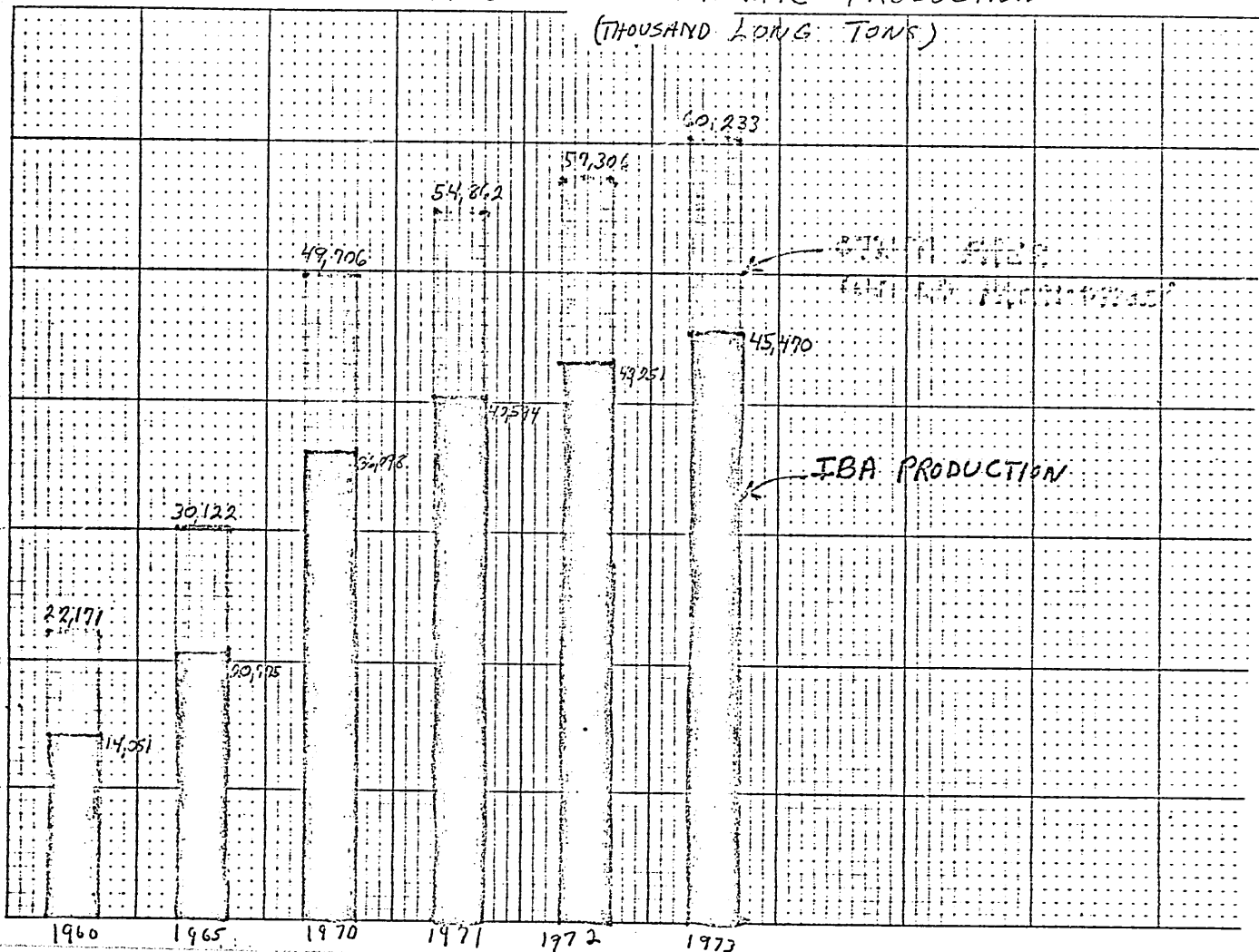
Table 5

## Summary of Alumina Process Cost Estimates\*

<u>Raw material and process</u>	<u>Operating cost (dollar/ton of alumina)</u>	<u>Fixed capital cost (dollar/ton of daily capacity)</u>
Clay Nitric acid-pressure leaching	\$93	\$110,100
Anorthosite Lime-soda sinter, wet grinding option	\$111	\$100,400
Bauxite Bayer	\$88	\$66,000

\* Costs are for a plant of 1,000 tons/day capacity.

Figure 1  
FREE WORLD BAUXITE PRODUCTION  
(THOUSAND LONG TONS)



[REDACTED]  
CENTRAL INTELLIGENCE AGENCY  
WASHINGTON, D.C. 20505

S-6512

CIA No. 8288  
30 September 1974

MEMORANDUM FOR: Mr. David Stebbing  
Office of Investment Affairs  
Department of State

SUBJECT : Jamaica: Implications of the Tax  
Increase on Bauxite

Attached is a copy of the paper on bauxite that  
[REDACTED] promised you. He originally prepared it  
for another purpose. We are also sending copies to  
several other interested persons around town.

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[REDACTED]  
Chief  
North America/Caribbean Branch  
Office of Economic Research

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Attachment:  
As stated

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