

The Economic Implications of Puerto Rican Statehood



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April 29, 2005**

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Table of Contents

I. Introduction.....	1
II. Related Work.....	6
III. Data Sources.....	11
IV. Assessing Impact of Key Economic Factors	
A. Federal Taxation.....	11
B. Earned Income Tax Credit.....	14
C. Tax Incentives for U.S. Companies.....	20
D. Tariffs.....	25
E. Welfare Benefits.....	28
F. Tourism.....	34
G. U.S. Military in Puerto Rico.....	40
V. Concluding Remarks.....	43
VI. Reference List.....	49

Acknowledgments

I really wish I could mention of all those that in some form or other have helped throughout this process called thesis. Yet, I will mention those who have been crucial:

First of all, I want to thank my advisor Professor Saleha Jilani for believing in this idea ever since I told her I wanted to write my thesis on this topic. Thanks for the patience, valuable input and words of encouragement.

Secondly, I want to thank Norm Medeiros for always being so willing to help me find the necessary literature required to explore my thesis topic. Thanks for the endless articles, emails, meetings and moral support.

Thirdly, I want to thank my awesome boss Aaron Smith in the Academic Computing Center who was very supportive and understanding all throughout this process. Thanks for not firing me after I would skip work at weeks at a time to work on my thesis.

Finally, I want to thank my family and friends because without them I would not be here at the end of my college career writing a thesis about a topic that I have always been passionate about. I love you all.

I. Introduction: Commonwealth vs. Statehood

Ever since Puerto Rico became a colony of the United States in 1898 following the Spanish-American War, there has been major debate on both the island and mainland, regarding the relationship between the two and the cultural, political and economic implications that it entails. Currently, Puerto Rico is a commonwealth of the United States; it has been since 1952, even though the actual term in Spanish is “Estado Libre Asociado”, which means Free Associated State. Many critics on the island and mainland argue that this arrangement is vague since, “In reality Puerto Rico’s status is neither that of an associated free state nor that of a state of the Union, but rather that of a territory”.¹ Moreover, the relationship has caused serious debates in the international community because the United Nations and many Latin American and Caribbean countries have accused the U.S. of colonizing the island and not allowing the people of Puerto Rico their deserved right to self-determination that goes against the United Nations General Assembly Resolution 1514, which states that,

Immediate steps shall be taken, in Trust and Non-Self-Governing Territories or all other territories which have not yet attained independence, to transfer all powers to the peoples of those territories, without any conditions or reservations, in accordance with their freely expressed will and desire, without any distinction as to race, creed or colour, in order to enable them to enjoy complete independence and freedom.²

When it comes to debates of Puerto Rico in the international arena, the U.S. claims that the island’s status quo does not violate the right of self-determination of the people of Puerto Rico and quotes the U.N. General Assembly Resolution 1541, which contradicts 1514 for it states that,

¹ Lawrence A. Hunter (2003)

² United Nations General Assembly Resolution 1514 of 1960, paragraph 5

...a non-self-governing territory can be said to have attained a full measure of self-government by emerging as a sovereign state, by freely associating with an independent state, or by integrating itself with an independent state.³

Thus, the U.S. keeps insisting, though, that Puerto Rico is an internal matter, and that the people of the island have employed their legit right of self-determination when they democratically chose to become an “Associated Free State” of the United States in 1952. For the purposes of international law, the status quo of Puerto Rico then can argued as one that started decolonization, but that has not been completely satisfied—kind of a “candy-coated” colonialism. In reality, the status of Puerto Rico cannot change unless approved by the U.S. Congress so is not entirely left to the people Puerto Rico to decide. Moreover, the majority of Puerto Ricans does want some kind of tie with the United States and have rejected the idea of independence in every referendum that has ever been conducted regarding the political status since the island became a commonwealth.

When established in 1952, the Commonwealth status was supposed to be a temporary status till the people of Puerto Rico decided whether they wanted to become an independent nation or a state. It seems highly unlikely that Puerto Rico will ever become an independent nation. The debate regarding status becomes narrower for there are only two choices for the status of Puerto Rico that seem plausible: either remain a commonwealth or join the Union as the fifty-first state. However, the current arrangement seems to be more attractive. The current Governor Aníbal Acevedo Vilá has declared,

We appreciate our relationship with the United States. We are Puerto Ricans. We have our own language and identity. But we are U.S. citizens. We are proud of that. The only way we can harmonize both things is by commonwealth.⁴

³ Robert Pastor (1984)

⁴ Kenneth Jost (1998)

Because of this, Puerto Rico finds itself in the same place fifty-five years later; the people of Puerto Rico have failed to take either stance since becoming a state or an independent nation entails changes in plenty of political, cultural, language and economic factors.

Whereas all of these factors should be taken into account when evaluating such a critical debate that will affect the lives of Puerto Ricans in so many different aspects, this thesis attempts to analyze only the major economic impacts that statehood would bring about if Puerto Rico ever joined the Union as the fifty-first state.

Pro-status quo advocates argue that Puerto Rico is too culturally different from the U.S. to ever become a state, but they want to improve upon the commonwealth status by being able to vote on laws that apply to Puerto Rico in Congress. Under the current status Puerto Rico has a resident commissioner in the U.S. Congress that although can make the voice of Puerto Ricans be heard, cannot vote on any matters not even those that affect the island. On the other hand, statehood supporters argue that Puerto Ricans, as U.S. citizens are underrepresented in Congress and should be able to vote in all matters like any other state. They argue that as U.S. citizens, Puerto Ricans should be able to vote in the U.S. presidential elections—something that at present they cannot do under the current status quo. Puerto Ricans have been U.S. citizens ever since the passage of the Jones Act in 1917 by Congress and thus are able to move freely from the island to the mainland and vice versa as they wish. Although there is clearly a strong preference for Spanish, the official languages of the island are Spanish and English.

The language issue is constantly brought up in the status debate since Puerto Ricans perceive the Spanish language as part of their cultural identity and refuse to forgo its usage. Nonetheless, the language of business in the island is practically English. Most

agencies and companies conduct their business in English and the language is taught in most private and public schools. Although some Puerto Ricans speak broken English especially in rural areas, the educated population has been well prepared and is fully bilingual. Furthermore, because of tourism in the metropolitan area, San Juan—the capital city and metropolitan cities such as Guaynabo, Bayamón and Carolina, English is commonly spoken and used. Nevertheless, popular belief seems to be among pro-status and independency advocates that the usage of Spanish language would have to be terminated in the case of statehood, and thus the Puerto Rican identity would be submerged. Also, Puerto Rico maintains a common currency with the U.S. utilizing the U.S. dollar as its only currency and in addition, the Puerto Rican government has modeled after the U.S. many laws and documents such as the Constitution of the Commonwealth of Puerto Rico.

Although advocates of the independent and statehood movement in the island argue that in fact the status quo is candy-coated colonialism, the reality is that the majority of the people in Puerto Rico want to be connected to the United States in some form, and the population is very much divided between the current status and statehood. Although not approved by the U.S. Congress, there have been three major local plebiscites in Puerto Rico regarding the status quo dilemma. As the following table shows, the commonwealth option obtained an absolute majority of the votes cast in the electoral events in 1967 and 1993. The 1998 plebiscite was an unusual referendum where the “none of the above” option cast the majority of votes since the advocates of the commonwealth status protested about the terminology used in the ballots, and exhorted those in favor of the status quo to vote for none of the options. The definitions of the

1998 plebiscite were quoted directly from the House of Representatives 856 “Young” Bill of 1998 of the U.S. Congress. Although the majority of islanders support the commonwealth status, it should be noted that the percentage of population that supports statehood has been growing, while independence has been constantly rejected by the majority and is supported by less than five percent of the population.

Plebiscite	1967	1993	1998
Commonwealth	60.40%	48.60%	-----
Statehood	39%	46.30%	46.50%
Independence	0.60%	4.40%	2.50%
Blank/Void	-----	0.70%	0.30%
"Territorial" Commonwealth	-----	-----	0.10%
Free Association	-----	-----	0.30%
None of the Above	-----	-----	50.30%

Source: The Commonwealth Elections Commission of Puerto Rico

It should be noted that since none of these referendums were approved by the U.S. Congress, voters were aware that regardless of the results the Congress was not to follow through with the decision of Puerto Ricans. This could have been a major disincentive for voters of all political beliefs to not participate in the referendums.

Although this thesis is explicitly concerned with the economics involved in the statehood debate, there are evidently many other aspects to be considered as the economic aspect is only a segment of what should be extensively scrutinized. The status issue is certainly about economics, but also about democracy and human rights as the international community has brought to attention. Furthermore, although it seems equally interesting to explore the impacts that Puerto Rican statehood would have on the U.S. since it is often very argued that the island would be more of a liability than it currently is, this thesis is concerned with the Puerto Rican position, and how statehood would impact the island’s economy. It is worth mentioning that many arguments from the U.S.

point of view are concerned with the fact that Puerto Rico, if it ever became a state, is likely to be a democratic state, which represents a threat for the Republicans in Congress. Although similar concerns were brought up when Alaska and Hawaii were joining the Unions and those predictions were wrong in both instances.

II. Related Work

At present, there are three main sources that have proven extremely helpful on this subject:

A) *Pay to the Order of Puerto Rico* by Alexander Odishelidze and Arthur Laffer, 2004.

This book argues explicitly from the U.S. point of view, that Puerto Rico and its present status as a commonwealth is a costly liability to the average U.S. taxpayer. The exact figure that the authors mention is \$400 a year per American taxpayer, totaling to \$22 billion a year subsidy that American taxpayers have to pay for the Commonwealth of Puerto Rico and thus the U.S. citizens that do not pay federal income taxes. They go through the economic history of the island and criticize the development strategies chosen by government officials on the island, and mainland U.S.A., which have caused a big dependency of Puerto Rico's economy on the U.S. economy.

Although it seems that every fact and/or figure stated here must be taken with a grain of salt due to the fact that the authors are clearly biased against the current status quo, the authors go through the key economic implications of the current status and the economic changes that statehood would bring, to convince the reader that Puerto Rico and the U.S. are both losing because of the current commonwealth-status relationship: free tax incentives for U.S. companies that do not benefit Puerto Rico anymore, partial

welfare benefits without paying federal income tax, tariffs on goods, hindrance to investment and/or tourism, etc. In the following sections this thesis will address these economic variables that are so crucial in the status debate and compare what there authors have said with other data and evidence in competing sources.

Although Odishelidze and Laffer do mention statehood and independence as two possible resolutions to this detrimental dependency of Puerto Rico on the U.S., almost every argument they present suggest that Puerto Rico should join the Union as the fifty-first state. The only instance in where they refer to benefits for Puerto Rico if the island were to become an independent nation is when they talk about the disadvantages that Puerto Rico faces against other countries in terms of foreign investment because the island is under federal minimum wage legislation—Puerto Rico’s federal minimum wage is that same one as in the United States. Thus as an independent nation, Puerto Rico could attract investors by offering cheaper labor that currently is not valued at the minimum wage. Nevertheless, their main focus is statehood as they harshly criticize all of the welfare benefits that Puerto Ricans receive partially without paying federal taxes and go into detail about how these grants would change in the statehood scenario.

However, it has been difficult to obtain the exact data on which they have based their conclusions. They depict the change in welfare benefits as highly beneficial for Puerto Ricans counteracting these major expenses for the U.S. with the money collected from corporate and individual income taxes that would be in the range of \$2.12 billion to \$2.72 billons that neither U.S companies currently pay at the corporate level, nor Puerto Ricans currently pay at the individual level. They briefly mention the Earned Income Tax Credit which is one of the crucial federal programs not available for Puerto Ricans

because they do not pay federal income tax. However, they do not present any arguments as to how this program would affect the calculus of Puerto Rico being a liability to the U.S. One of the sections of this thesis specifically will argue how paying federal income tax would not negatively affect Puerto Ricans collectively if the federal program of the Earned Income Tax Credit was implemented.

B) The Institute for Policy Innovation (IPI): **“Leave No State or Territory Behind: Formulating a Pro-Growth Economic Strategy for Puerto Rico”** Released by Lawrence A. Hunter, July 2003.

This report argues that, while the author refuses to advocate any particular permanent status, the uncertainty caused by the current status quo is detrimental to Puerto Rico’s economy, since “Without a definitive resolution of the relationship between the Island and the U.S., neither government officials nor companies can chart their fiscal and economic courses”. Although the report criticizes the individual tax scheme for individuals satisfying Puerto Rican residency (Internal Revenue Code, Section 933), the authors focus more heavily on the economic development strategies enacted to turn Puerto Rico’s economy from an agriculturally-based one to one that is industrially-based.

The primary focus of the report is, as stated below:

...on the extent to which current economic and fiscal policies (tax, spending and regulatory policies) of both the Puerto Rican government and the federal government of the United States create impediments to economic growth and prosperity on the Island.

The tax breaks implemented in 1976 (Internal Revenue Code, Section 936) brought in even more U.S. firms that were already investing in Puerto Rico since the tax incentive scheme in the island dates back to the 1920s. This U.S. firms that invested in

the island were successful at creating employment, and hence improving the economy up to a certain point. However, capital-intensive companies, rather than labor-intensive companies, also began exploiting the tax breaks offered by the section. Section 936, or versions of it such as Section 956 or 30A, is still a very much debated topic and a key factor in the status quo dilemma, since some critics argue that becoming a state and thus removing these tax breaks will be a detrimental move for the Puerto Rican economy. This article attempts to demonstrate how these tax breaks are no longer benefiting the island's economy in terms of employment generation, or infrastructure development, but are only benefiting giant manufacturing companies based in the U.S. The article argues that the phasing out of Section 936, which started in 1996 and is supposed to end in 2006, has not negatively affected growth in Puerto Rico when compared to the poorer states of the Union such as Mississippi and West Virginia.

It should be noted that the IPI is not promoting statehood. In fact, the article explicitly states that even though full integration with the mainland might seem like the answer to improve the economy and achieve convergence with the U.S. economy, there is a lot more to be done. Puerto Rico's economy is in fact already very much integrated with the U.S. economy in view of the facts that the inhabitants of the island are U.S. citizens, the island is inside the U.S. tariff wall, it is under the military protection of the U.S., the currency used is the U.S. dollar, and residents of the island partially enjoy the benefits of Social Security, Medicare and others. Even if Puerto Rico were to become fully integrated to the U.S., which would imply other economic benefits besides the ones available, the IPI clarifies that this would not necessarily mean full convergence with the U.S. economy.

C) The United States General Accounting Office's (GAO) Report to Congressional Requesters: **"Tax Policy: Analysis of Certain Potential Effects of Extending Federal Income Taxation to Puerto Rico"**, August 1996.

This report simulates a scenario whereby Puerto Ricans would have had to pay Federal Income Tax in fiscal year 1992. The GAO estimated the amount that would have been paid in federal income tax and how the Earned Income Tax Credit would come into play; the percentage of the taxpayers who would have positive taxes liabilities in spite of this credit, and the percentage that would be eligible for the credit. It argues that while it seems that Puerto Ricans on net, taken collectively, would be financially worse after a federal tax was implemented or levied, the Earned Income Tax Credit, not currently available for residents of Puerto Rico, would offset at least some of the negative impacts that islanders would face if they had to pay federal taxes. This implies of course some significant income redistribution from rich to poor in Puerto Rico. This report claims that the local income tax system of the Commonwealth of Puerto Rico collects higher taxes than any other state at the local level and they estimate by how much the island's government would have to reduce its own income tax to keep the new combined amount of federal and local taxes the same as it was before the federal income tax imposition. They also compare the average taxpayer in the island with the average taxpayer of the 50 states, and go briefly over the amount of money that the U.S. Treasury could save by eliminating the tax credits earned by U.S. corporations operating in the island.

III. Data Sources

There is not a simple particular data set that has been utilized, rather the data found regarding the island's economy and the different tables that are included come from the various following sources:

The Puerto Rico Planning Board

U.S. Census Bureau

The Puerto Rico Development Company (PRIDCO)

The United States General Accounting Office

Departamento de Hacienda de Puerto Rico—Puerto Rican Treasury Department

The Puerto Rico Tourism Company

The World Travel & Tourism Council

Internal Revenue Service—Department of Treasury

IV. Assessing Impact of Key Economic Factors

A. Federal Income Tax for Individuals

Puerto Ricans were declared U.S. citizens with the passage of the Jones Act in 1917. They are U.S. citizens under a provision of the U.S. immigration and nationality clause—a statutory citizenship that can be revoked by Congress for future generations. They are not constitutional citizens under the 14th amendment like Americans born in any of the 50 states of the Union. However, since they are indeed U.S. citizens they are thus subject to the U.S. Internal Revenue Code. Under Section 933 of the Code, any U.S. citizen satisfying Puerto Rican resident requirements is exempt from being taxed at the

federal level. Individuals that have income from sources within the United States, pay federal income tax. Since 1918, Puerto Rico has been allowed to exercise its own taxing authority by passing laws generally similar to the U.S.

Another important fact to mention is that the current local income tax system is the most significant source of revenue for the Puerto Rican government, which in the turn is the most significant source of employment in the island, as the government is oversized. This variable is crucial in the debate regarding Puerto Rico's status, since the effect is twofold. On the pro statehood side, it is argued that the local taxing system of Puerto Rico imposes more taxes at higher rates than states, and it layers taxes one on top of other. The pro status quo advocates use this variable to argue that statehood would be economically detrimental for individuals, since federal taxation combined with the local taxation would imply higher rates than just the local system. Moreover, if local tax rates would have to decrease in the statehood scenario, the government could be negatively affected as these local taxes are its main source of revenue. Certainly, federal income taxation would hurt wealthy Puerto Ricans who would have to pay more in taxes, but given the income distribution of the island most of the population would benefit from some kind of tax refund as their incomes are very low.

In the study conducted by the U.S. General Accounting Office for fiscal year 1992, they found that although the amount of per capita individual income tax is lower in Puerto Rico than in most states, the percentage of total personal income that these local taxes amounts represent were higher in the island than in any other state. However, when considering taxation at the federal and local level, Puerto Rico had the lowest rate of combined taxes since only Puerto Ricans that receive income from sources within the

U.S. have to pay federal taxes. Most sources compare Puerto Rico to Mississippi since the island would replace Mississippi as the poorest state if it ever joined the Union, and the GAO is no exception. Incidentally, in 1992 the state of Mississippi had the lowest percentage of personal income when local and federal taxes were combined in the U.S, approximately 8.2 percent. Without the implementation of federal taxes in Puerto Rico, the per capita combined tax, as a percentage of personal income was 5.3. The GAO calculated a minor increase to 5.5 percent if federal taxation was implemented. This slight increase is due to the fact that with federal income taxation, tax credits that are available to low-income families across the fifty states would have also been available to low-income families on the island.

While paying federal income tax in Puerto Rico could represent an economic relief for the people who are at the bottom of the income distribution in the island, the wealthy or relatively well-off would be hurt by this change. For a single person in 2004, the tax rates schedules are as follow:

Taxable income is over	But not over	The tax is	Plus	Of the amount over
\$0	\$7,150	-----	+10%	\$0
7,150	29,050	715	+15%	7,150
29,050	70,350	4,000.00	+25%	29,050
70,350	146,750	14,325.00	+28%	70,350
146,750	319,100	35,717.00	+33%	146,750
319,100	-----	92,592.50	+35%	319,100

Source: Internal Revenue Service

Given the most recent data on the income distribution of the island that could be found for fiscal year 1999, most individuals who file taxes individually would fall in the first bracket—62.5% to be specific (see section on the Earned Income Tax Credit). Meaning

that 37.5 percent of these filers would have some kind of tax liability—27 percent of which would fall within the \$7,150-\$29,050 income bracket. For married couples or qualifying widows/widowers, the tax rate schedules in 2004 are as follow:

Taxable income is over	But not over	The tax is	Plus	Of the amount over
\$0	\$14,300	\$0.00	+10%	\$0
14,300	58,100	1,430.00	+15%	14,300
58,100	117,250	8,000.00	+25%	58,100
117,250	178,650	22,787.50	+28%	117,250
178,650	319,100	39,979.50	+33%	178,650
319,100	-----	86,328.00	+35%	319,100

Source: Internal Revenue Service

Again, given the income distribution of married families in the island, 38.7 percent of families would fall within the first bracket having no federal tax liability whatsoever. 51.2 percent of the families in the income distribution would fall on the second income bracket having some kind of federal income tax liability. As both of these tables show whether single or married, the tax rate schedules hurt the wealthy the most.

Understandably, the wealthy in Puerto Rico would be opposed to statehood just for this policy change. However, the aggregate picture suggests that paying federal income tax would work as a method for redistribution given the Earned Income Tax Credit.

B. Earned Income Tax Credit

The Earned Income Tax Credit (EITC) is a crucial variable that should be taken into account if Puerto Rico were to become a state since it is a wage subsidy that reduces the tax on decisions to work. The Internal Revenue Service defines this credit as "...a federal income tax credit for low-income workers who are eligible for and claim the

credit. The credit reduces the amount of tax an individual owes, and may be returned in the form of a refund”.⁵ Under its current status, Puerto Ricans are not eligible for this tax credit. This credit is key to analyzing the impact that the implementation of taxes at the federal level would have on the island if it were to become a state. There have been proposals to initiate a local EITC program by supporters of the current status quo and statehood as parts of their political campaigns for the 2004 elections. Both parties claim that Puerto Rico’s persistent poverty should be combated with a local version of the credit since the federal EITC, “...has been hailed as the best anti-poverty program ever invented. It puts cash into the hands of poor, working families, and does not punish them for earning more”⁶. Moreover, the democrat Senator Bob Graham of Florida introduced a bill in Congress that would grant the federal EITC benefits to the people of the Commonwealth of Puerto Rico.

As previously mentioned, in 1996, the U.S. General Accounting Office (GAO) conducted a study to examine the potential effects of extending federal income taxation to the island. The study estimated that for fiscal year 1992, 59 percent of the Puerto Rican population that filed local taxes would have been eligible to earn some EITC. The GAO also argues that it is likely that individuals and families with very low incomes that were not required to file Commonwealth taxes would file taxes in order to take advantage of the EITC. When they combine the amount of EITC that people who did file would have earned with the amount of EITC that people who did not file would have earned, they estimate that a federal income tax liability for Puerto Rico as a whole would not exist, and thus federal income taxation on the one hand is not the hindrance that pro-status quo

⁵ Internal Revenue Service

⁶ John Marino (2003)

advocates depict it to be for in aggregate analysis. On the other hand however, federal taxation represents a hindrance for the rich who cannot claim EITC and would see overall tax rates increasing.

To be more specific, the GAO estimated that for fiscal year 1992, Puerto Rico's federal tax liability would have been approximately \$623 million without taking into account the EITC for the 651,201 individual income tax returns filed in that year. The implementation of EITC would have covered approximately \$574 million of the tax liability since approximately 384,107 filers would have received some amount of EITC. They assume that the remaining \$49 million would have been covered by the amount of EITC that families who did not file local taxes because they were exempt due to their low incomes, would get, if they had an incentive to file such as being eligible for an EITC refund.

Estimated Potential U.S. Tax Liabilities and EITC for Residents of Puerto Rico⁷				
(Dollars in millions)				
U.S. adjusted gross income classes	Number of Puerto Rican Returns	US tax liability before EITC	US EITC	US tax liability after EITC
Less than \$0	922	\$0	\$0	\$0
\$0 to \$2,999	34,906	0	7	-7
\$3,000 to \$5,999	50,719	0	40	-40
\$6,000 to \$9,999	133,266	8	200	-192
\$10,000 to \$14,999	152,916	33	226	-193
\$15,000 to \$24,999	151,122	118	101	17
\$25,000 to \$49,999	103,758	261	0	261
\$50,000 to \$99,999	20,493	128	0	128
\$100,000 and over	3,099	75	0	75
Total	651,201	\$623	\$574	\$49

⁷ The United States General Accounting Office's (1996)

Unfortunately, the necessary information required to update this study could not be provided by the Puerto Rico Treasury Department. So it is impossible to know for certain what would be the amount of Federal Income Tax that Puerto Ricans would have to pay. Furthermore, it cannot be determined if the Earned Income Tax Credit would have had the same effect as this study shows for 1992. Nevertheless, the most recent information on the income distribution of Puerto Rico was found from the U.S. Census Bureau for year 1999, in which it is clear that many Puerto Ricans households would have received some kind of Earned Income Tax Credit.

Puerto Rico’s Income Distribution—1999

Subject	Households	Families			Nonfamily households
		Total	Married-Couple Families	Female Householder	
Total	1,261,816	1,008,555	693,509	262,232	253,261
Less than \$10,000	468,223	316,675	166,070	130,705	158,242
\$10,000 to \$14,999	180,320	150,199	102,878	38,585	30,702
\$15,000 to \$19,999	128,899	110,950	78,617	26,077	17,295
\$20,000 to \$24,999	105,928	91,874	67,668	19,788	13,339
\$25,000 to \$29,999	76,106	67,898	51,726	13,172	7,144
\$30,000 to \$34,999	62,212	55,912	44,235	9,002	5,418
\$35,000 to \$39,999	47,978	43,056	34,841	6,609	4,225
\$40,000 to \$44,999	37,453	33,228	27,662	4,327	3,485
\$45,000 to \$49,999	27,407	24,763	20,677	3,245	2,261
\$50,000 to \$59,999	38,187	34,324	29,290	3,807	3,283
\$60,000 to \$74,999	33,898	30,515	26,443	2,867	2,791
\$75,000 to \$99,999	25,504	22,892	20,169	1,916	2,115
\$100,000 to \$124,999	12,379	10,992	9,690	826	1,156
\$125,000 to \$149,999	5,062	4,554	4,039	399	444
\$150,000 to \$199,999	4,525	4,027	3,711	207	399
\$200,000 or more	7,735	6,696	5,793	700	962

Source: U.S. Census Bureau

When comparing this table to the one provided by the GAO, it can be seen that the threshold whereby many individuals would have received some amount of EITC in 1992 was around \$25,000. In 2005 however, the threshold is around \$30,000 for parents of a

child and \$35,000 for parents of more than one child as data from The Center on Budget and Policy suggests:

Earned Income Tax Credit in 2004			
	Income Threshold (if single)	Income Threshold (if married)	Potential EITC
no children	\$11,490	\$12,490	\$390
1 child	\$30,338	\$31,338	\$2,064
more than 1 children	\$34,458	\$35,458	\$4,300

Source: Center of Budget and Policy Priorities

It is clear that most of these households would indeed be eligible for this credit as more than fifty percent of every column has an income of less than \$30,000 (unfortunately, the data does not specify the number of children per household):

Percent Distribution—1999

Subject	Households	Families			Non-family households
		Total	Married-Couple Families	Female Householder	
Total	100	100	100	100	100
Less than \$10,000	37.1	31.4	23.9	49.8	62.5
\$10,000 to \$14,999	14.3	14.9	14.8	14.7	12.1
\$15,000 to \$19,999	10.2	11	11.3	9.9	6.8
\$20,000 to \$24,999	8.4	9.1	9.8	7.5	5.3
\$25,000 to \$29,999	6	6.7	7.5	5	2.8
\$30,000 to \$34,999	4.9	5.5	6.4	3.4	2.1
\$35,000 to \$39,999	3.8	4.3	5	2.5	1.7
\$40,000 to \$44,999	3	3.3	4	1.7	1.4
\$45,000 to \$49,999	2.2	2.5	3	1.2	0.9
\$50,000 to \$59,999	3	3.4	4.2	1.5	1.3
\$60,000 to \$74,999	2.7	3	3.8	1.1	1.1
\$75,000 to \$99,999	2	2.3	2.9	0.7	0.8
\$100,000 to \$124,999	1	1.1	1.4	0.3	0.5
\$125,000 to \$149,999	0.4	0.5	0.6	0.2	0.2
\$150,000 to \$199,999	0.4	0.4	0.5	0.1	0.2
\$200,000 or more	0.6	0.7	0.8	0.3	0.4

Source: U.S. Census Bureau

John Marino, a columnist for the *Puerto Rico Herald* quotes a study conducted by the Center for the New Economy—a Puerto Rican government agency, which estimated that the EITC would benefit 160,000 families, 289,000 children and would create 20,000 employment opportunities in the economy. Unfortunately, the actual study, its methodology and results cannot be accessed.

In July 2004, a few months before the U.S. presidential elections, *The Puerto Rico Herald*—a well respected newspaper on the island, published in its weekly column called “The Washington Update” an article that dealt with the different stances that President George Bush and Senator John Kerry had in respect to this tax credit for Puerto Rican families. The payroll tax refund program has included Puerto Rican workers with three or more children ever since 1997 when former President Clinton was working on expanding the EITC and the Child Credit. Whereas the EITC lowers taxes for low-income workers, the Child Credit provides lower middle-income workers a tax relief given the number of children in their families. Puerto Rican families of low-income workers receive no Child Credit federal assistance if they only have one or two children and, “This is because the Earned Income Credit, which provides the refund in the case of one and two child families in the States, does not apply in the Commonwealth”.⁸

While President Bush wanted to completely disqualify Puerto Rican families for the credit, Senator John Kerry wanted to expand the Child Credits so that these low-income families with only one or two children receive some kind of assistance regardless of Puerto Rico’s political status. The article however does not specify if John Kerry

⁸The Puerto Rico Herald-Washington Update (2004)

wanted to expand these benefits partially or completely since currently Puerto Rican families with one or two children do not receive any assistance. The article states that,

As it is, an estimated 100,000 Puerto Rican low and middle-income workers with three or more children are eligible for the refunds. Extending the assistance to low-income workers with one child or two children would greatly expand the potential reach of the program”.

If Puerto Rico were to become a state, both credits would be given to low-income Puerto Rican families as they are given to these families in the other fifty states. Nevertheless, the Earned Income Tax Credit and the Child Credit are yet another paradigm in the current political situation of the island; Puerto Rican families with one or two children do not receive any type of credit while families with more than two obtain the same credits that Americans would receive.

C. Corporate Taxation

In order to encourage U.S. firms to invest in Puerto Rico when its economy was primarily an agricultural one, the US government decided to give generous tax incentives to firms in order to stimulate infrastructure investment and employment generation in Puerto Rico—to shift the economy from agricultural toward industrial. Section 936, established in 1976, basically provided U.S. firms operating in the island un-taxed income. It succeeded other tax breaks that date back to 1921 to Operation Bootstrap—an economic development strategy undertaken by the Puerto Rican government. These tax breaks were successful strategies in terms of stimulating the economy of the island especially in the 1950s and 1960s, where U.S. companies were attracted by the tax incentives and a lower minimum wage rate relative to the one in the U.S. at the time. This strategy worked well up to a certain point as indicated by the fact that the growth in GDP

was twelve percent a year in Puerto Rico during the 1950s and early 1960s—the “golden-years” of economic growth in the island. Since the late 1970s, critics argue that companies looking to invest in Puerto Rico, were increasingly capital intensive oriented rather than labor oriented, partly due to the fact that several principally capital intensive industries had already set up shop there.

Tax incentives stimulated industrialization, infrastructure development, and employment generation in the 1950s and 1960s on the island. However, critics argue that by the 1970s capital-intensive companies begun to exploit the tax benefits without actually significantly improving the island’s economy. Moreover, because of the high costs that these firms represented to the U.S. Treasury in terms of foregone taxes, in August 1996 the U.S. Congress repealed Section 936 of the U.S. Internal Revenue Code, and substituted it with Section 30A that retains the 936 benefit for ten years to existing corporations. Under Section 30A, wages paid by these companies are untaxed. Firms that cannot claim Section 30A benefits can declare themselves as “Controlled Foreign Corporations” (CFC’s) and receive tax benefits under Section 901 of the U.S. Internal Revenue Code. By declaring themselves as CFC’s, U.S. companies can claim tax incentives when investing in countries like Mexico, Singapore, Ireland and Puerto Rico among others. According to a case study conducted by a tax advisor in Puerto Rico, “...over 50 Section 936 corporations have reorganized their Puerto Rican operations into Controlled Foreign Corporations under Section 957 and 7701 (a)(5)”.⁹ If Puerto Rico were to become a state, the island could potentially provide tax benefits to corporations at the state level as it already does to attract investment—in 2000, approximately \$17 billion of income earned by U.S. corporations was exempted from paying taxes at the local level,

⁹ Frank Rivera.

but the tax incentives provided by the U.S. in Section 30A and 901 of the Internal Revenue Code would not be available, as the island would be treated uniformly like any other state by the U.S. government.

There is a lot of debate and disagreement regarding the effect that these tax incentives have had on the island's economy. The Institute for Policy Innovation (IPI) presents their case on why these tax breaks are mainly benefiting giant capital intensive companies now and are not benefiting the island's economy, specifically biotechnology companies like Merck, Abbott Labs, Eli Lilly and Ortho and pharmaceutical companies like Pharmacia, Schering-Plough, J&J, Abbott Labs, Cardinal Health and Pfizer—(16 of the top 20 pharmaceutical drugs in the U.S. are manufactured in Puerto Rico). On the other hand, the Puerto Rico Industrial Development Company (PRIDCO), heavily targets the pharma manufacturing market with local incentives. PRIDCO believes that this market will further stimulate the island's economy since the pharmaceutical sector employs more than 11 percent of the local labor force and generates 40 percent of the GDP of \$72 billion of the island.¹⁰

Advocates of the commonwealth status argue that these tax incentives have helped the economy prosper in Puerto Rico since the island's economy has grown at a faster rate than any other economy in the Caribbean. Nevertheless, the gap between the two economies of the island and mainland suggests that Puerto Rico's economy although it has prospered indeed, still lags behind its potential. Because of the difference in sizes of the two economies, perhaps comparing Puerto Rico's economy to the U.S. economy might not seem accurate. But as it has been stated before, Puerto Rico's economy is behind to the point that even when compared to the poorest state of the Union,

¹⁰ Leslie Valmont (2004)

Mississippi, it is evident that Puerto Rico is poor even for the lowest levels of standards for the mainland.

Evidently the initial tax incentive strategy alone has not been working in closing that gap for more than fifty years and therefore this policy, which could not exist if statehood was implemented, is not crucial for the enhancement of the economy since most of the benefits of early tax incentives have been realized. To attract more investment, other developments are necessary either to replace these tax breaks or to work in conjunction with them

The PRIDCO however believes that these tax incentives are crucial for industries such as pharmaceutical and bio-technology companies to be lured to the island. These industries are believed to be important for growth. They see the phasing out and elimination of Section 936 as a major problem, which they must deal with at the local level by compensating these companies with other incentives so that they continue to invest on the island: “And contrary to earlier concerns over the effect of the lifting of Section 936 on the Puerto Rican economy, pharma employment and pharma exports are both up”.¹¹ The fact that companies that can invest in Puerto Rico can declare themselves as CFC’s places the island among a list of competitors that do not only offer the tax incentives for CFC’s, but that also offer cheap labor. Puerto Rico’s grand disadvantage when it comes to competing with these other countries is that the island is under federal minimum wage legislation. PRIDCO has decided to launch an advertisement campaign that attracts U.S. companies by putting emphasis on the academic and industrial infrastructure of the island. Investing in Puerto Rico seems like a good decision for these CFC’s companies since they are protected under U.S. law and the island offers a well

¹¹ Lisa Jarvis (2003)

educated bilingual population. Evidently, PRIDCO is a pro-tax incentives company and claims that the pharmaceutical companies generate employment and fuel the economy in spite of them being capital intensive.

If Puerto Rico was a state, companies that invested on the island could not declare themselves as CFC's. Nevertheless, it is not correct to assume that these companies have only decided to invest in Puerto Rico because of the tax incentives. PRIDCO's advertisement campaign is proof that the island has a lot to offer to investors regardless of whether tax incentives are available or not. As an article in the *World Trade Magazine* claims, "The reality of the situation in Puerto Rico reveals how the returns reaped from investments in the manufacturing sector rest on solid fundamentals rather than solely on tax incentives".¹² Among the solid fundamentals, investors should take into account that Puerto Rico does not only offer the workforce and the infrastructure suitable for business, but is also within the U.S. political sphere, law, customs regulations and utilizes the same currency—no currency exchange risk.

The IPI in its report exhorts the Puerto Rican government to acknowledge the fact that the tax incentive policy has mainly benefited the giant capital intensive corporations and not the Puerto Rican economy per se since these tax incentives "...skew the distribution of the benefits of the economic growth that does occur toward non-Island inhabitants". However, the skewing of benefits is indeed towards the U.S. corporations, but also to the Puerto Rican economy. The corporations are perhaps benefiting the most, but Puerto Rico is still better off by gaining some kind of investing, rather than none whatsoever. Another path should be taken whereby the Puerto Rican government sponsors what can be called a local economy, where indigenous Puerto Rican businesses

¹² Brian E. Andreoli and David M. Press (2004)

have the opportunities to succeed in addition to benefiting from the presence of foreign direct investment on the island. The economy of Puerto Rico however should not strictly be dependant on the U.S. companies that invest on the island.

Tax incentives for U.S. companies are one, if not the most used economic arguments against statehood. Nevertheless, as it has been discussed above the Puerto Rican economy has plenty to offer to investors in spite a potential removal of these incentives. Also, although statehood on one side would get rid of them, on the other side could potentially increase investment since it would give a sense of stability to investors that is not currently offered under the current status for, "...instability and uncertainty caused by the unsettled political situation limits the interest and desire to commit capital to the island".¹³ In *Pay to the Order of Puerto Rico*, Odishelidze and Laffer state that external investment in Hawaii soared after statehood was declared—the authors do not specify whether external investment entails only U.S. investment or overall foreign investment. Since the political turmoil and uncertainty was no longer a hindrance for investors in Hawaii (Hawaii became a state in 1959), "the number of companies doing business in Hawaii grew six fold between 1955 and 1971". Thus, the status issue clearly would have significant consequences for the economy, partly because neither government officials nor companies can plan a course they would like to pursue. In order for the economy to flourish more, Puerto Rico should choose between statehood and independence; something it has been unable to do for more than fifty years.

¹³ Lawrence A. Hunter (2003)

D. Tariffs

Another major economic change that statehood would bring about is in the form of tariffs. At present, Puerto Rico is inside the U.S. tariff wall, thus policy applied to foreign source goods applies to the island as it would to any other state. Puerto Rico trades with the U.S. freely. Nevertheless, Puerto Rico has an excise tax that is imposed on most goods consumed in the island, and which varies according to whether the good comes from the island or outside the island. The U.S. counts as outside the island in local taxing law and thus, an excise tax is imposed on goods from the mainland that enter Puerto Rico. The local tax is currently set at 3.6 percent compared to the overseas excise tax that is 6.6 percent. It is argued that this excise tax imposition works as a protective tariff system that is not efficient since it impedes free trade, leads to multiple taxation and distortion, reducing imports from the U.S. and possibly diverting consumption towards high-cost domestic P.R. producers.

The Puerto Rico Convention Bureau under the Excise Tax Act of Puerto Rico has convened that an excise tax must be paid for all shipments to Puerto Rico. All articles arriving from the U.S. with the purpose of being sold, consumed and retained on the island are subject to a 6.6 percent excise tax of the commercial invoice value. Equipment or materials entering the island for the purpose of exhibitions or displays are exempted from paying the excise tax if the good is returned to its point of origin within sixty days. The excise tax is a great revenue source for the government of Puerto Rico and under statehood, the 6.6 percent excise tax from goods coming from the mainland would no longer exist. Trade with the mainland would increase since regular taxes would apply to all consumers across the island and mainland and this 3 percent difference in the excise

tax would no longer be valid for goods coming from the U.S. This would be a move toward free trade that could increase imports from the U.S. As of 2002, roughly 87 percent of gains from exporting goods came from the U.S., whereas only 51 percent of imports came from the U.S.

Puerto Rico--Merchandise Imports and Exports 1980 to 2002 (in millions)

Item	1980	1985	1990	1995	1997	1999	2000	2001	2002
Imports	9,018	10,162	16,200	18,969	21,928	26,697	27,198	27,642	30,511
From U.S.	5,345	6,130	10,792	12,213	13,904	15,949	15,171	14,718	15,675
From other	3,673	4,032	5,408	6,756	8,024	10,748	12,027	12,924	14,836
Exports	6,576	11,087	20,402	23,573	26,653	37,779	43,191	46,806	50,641
To U.S.	5,643	9,873	17,915	20,986	25,045	33,173	38,335	40,981	44,907
To other	933	1,214	2,487	2,587	1,608	4,606	4,856	5,825	5,734

Source: U.S. Census Bureau

When Sila María Calderón was governor of the island (2001-2004), she increased excise taxes on products such as beer, tobacco and automobiles. This caused a lot of commotion in the U.S. Congress especially because in 2002 the Puerto Rican government increased the excise tax on beer by 78 percent, but exempted the local brewery Medalla. Senator Ben Nighthorse Campbell from Colorado—where the Coors brewery is located, protested about the unique relationship between the mainland and island, and the special rebates on rum that the Congress allows Puerto Rico to enjoy because of their special politic-economic relationship. An article in the Puerto Rico Herald quotes him:

This excise tax has placed an undue and unfair burden on the Island’s consumers and on U.S. beer producers. It is costing jobs on the mainland in factories and in supplier industries, including agriculture.¹⁴

Specifically, Senator Nighthorse Campbell was referring to the unfairness of this increase in the excise tax, when Puerto Rico receives a rum tax “rebate” which the IPI states that in 2003 returned roughly \$360 million to the Puerto Rican Treasury Department. The

¹⁴ The *Puerto Rico Herald* (2004)

commonwealth status does not guarantee that Puerto Rico can always count on this type of subsidy since, “Tax rebates to the Puerto Rican government can be changed at any time Congress decides to change it”.¹⁵ As it has been shown, the U.S. Congress is already questioning these special benefits and exemptions, such as the rum rebate, in retaliation to the increase in the beer excise tax in Puerto Rico for imported beer. The Puerto Rican government should reconsider in a cost-benefit analysis if it is better to keep increasing the excise tax—a great source of revenue for the government and putting at risks the rebates it receives under the status quo or if they would like to implement freer trade with the U.S. and reduce taxing consumption of U.S. produced goods, as under statehood.

E. Welfare Benefits

Under current policy, Puerto Rico receives partial welfare benefits from the U.S. federal government. For most federal programs, Puerto Rico receives some percentages of the amount it would be granted if it were an official state, and in some cases receives the full amount. In 2001, the Republican Senator Jim Hansen from Utah claimed that Puerto Rico was a “welfare state” since it paid no federal income tax, but still received \$12 billion in federal expenditures.¹⁶ Puerto Ricans started receiving welfare benefits in 1974 the U.S. Congress passed legislation to make the people in the island eligible for food stamps. By 1982, these benefits, in addition to the low minimum wage, served as work disincentives that perpetuated welfare dependency. At present, there are some U.S. welfare programs that PR is not eligible for at all as a commonwealth. If the island were to become a state, it would be the poorest state of the Union with a per capita income of

¹⁵ Lawrence Hunter (2003)

¹⁶ The *Puerto Rico Herald* (2001)

only \$9000. That is less than half of Mississippi's per capita income, the current poorest state of the Union.

In *Pay to the Order of Puerto Rico*, a study conducted by Hexner and Jenkins shows that statehood would be beneficial for both, the mainland and the island. The authors claim that in terms of federal spending, Puerto Rico would see increases in programs not currently available such as Supplemental Security Income, an adjunct to Social Security, and that Medicaid would have a fourfold increase. Hexner and Jenkins calculated an increase of approximately 14 percent in overall federal spending on PR. This does not seem to translate into gains for the mainland. Nevertheless, the authors argue that this increase in federal spending would be counteracted by the income generated from the removal of tax incentives for corporations in the island.

The implementation of complete welfare benefits would also affect the working poor, as they would have more incentives to work under statehood since Puerto Rico would have to adopt the Earned Income Tax Credit discussed previously in this paper. In *Pay to the Order of Puerto Rico*, Odishelidze and Laffer present a table taken from a study called "The Costs of Puerto Rico's Status to American Taxpayers" in which they delineate the federal expenditures of the U.S. government from years 1981 to 2001. The following table includes some of the key federal grants that Puerto Rico has received over this period of time and total spending. Note that the original table includes six different sections in which total spending for federal grants amount to \$62.01 billion, federal salaries amount to \$8.77 billion, federal payments amount to individuals amount to \$21.04 billion, federal procurement contracts amount to \$3.61 billion, other federal assistance amount to \$32.61 billion and section 936 tax credits amount to \$63.21 billion.

Federal Expenditures and Tax Credits for Puerto Rico 1981-2001¹⁷	
Federal Spending	Spending
Nutritional Assistance (Food Stamps)	\$19.25 billion
Customs and ATF Rebates	\$7.34 billion
Educationally Deprived Children Program	\$3.59 billion
Medicaid	\$2.10 billion
WIC Program (food for younger mothers)	\$1.98 billion
Community Development	\$1.79 billion
Section 8 Housing	\$1.59 billion
Child Nutrition Program	\$1.96 billion
Family Support Payments (AFDC/TANF)	\$1.48 billion
Public Housing	\$0.93 billion
Low-Rent Housing Operating Assistance	\$0.79 billion
Community Development Block Grants	\$0.57 billion
Public and Indian Housing	\$0.48 billion
School Lunch Program	\$0.47 billion

The source for this table is the original study conducted by Robert J. Shapiro. The table provides a good idea of the grants that the Commonwealth of Puerto Rico receives from the U.S. government. The welfare benefits issue, while used constantly by advocates of statehood on the island, seems problematic to address since many sources provide different amounts for the funding that the island receives and different estimates if any, for how these amounts would change if the island were to become a state.

According to the U.S Census Bureau federal spending in 2003 for the Commonwealth of Puerto Rico was \$14,661,000. Figures on federal government expenditures for direct payments to retired or disabled individuals for year 2003 are the following:

Social Security Payments	
Retirement Insurance Payments	2,237,235
Survivors Insurance Payments	988,982
Disability Insurance Payments	1,498,242
Supplemental Security Payments	n/a

Source: U.S. Census Bureau

¹⁷ Alexander Odishedlize and Arthur Laffer (2004)

As Odishedlize and Laffer claimed, under the current status quo Puerto Rico does not receive any Supplemental Security Payments which all of the other fifty states and the District of Columbia receive. Unfortunately because of time constraints it is impossible to assess how each grant would change in the case of statehood, or to find a list of all the grants that the island would be eligible for that are not available now. One program which the Commonwealth of Puerto Rico is not eligible for that would drastically change under statehood is the Earned Income Tax Credit. From the many programs and grants that the US government funds for its states and territories, the Nutritional Assistance Program, the Educationally Deprived Children Program and the WIC program will be addressed here.

The Nutritional Assistance Program (NAP)—the equivalent of food stamps in the island, is a block grant which is a cash alternative to the Food Stamp Program, to improve diets of needy persons residing in the Commonwealth of Puerto Rico.¹⁸ This program has been widely appraised and criticized at the same time because since it is a cash grant, there is no way to identify who is a recipient. Thus there is no stigma associated with it, which implies that there is no incentive to get out of it. In fiscal years 2002 and 2003, Puerto Rico received \$1,350,518,000 and \$1,377,000,000 respectively in Nutritional Assistance Program funds. The Commonwealth of Puerto Rico alone is eligible for this particular program, meant to serve the same purposes of the Food Stamps Program in the U.S. Odishelidze and Laffer state that,

The Puerto Rican food stamp program has gone plastic, as beneficiaries are outfitted with debit cards to allow them to make their food purchases up to their benefit limit without having to handle coupons that other customers can see.

If Puerto Rico were to become a state it would be treated uniformly as other states and the current NAP program that is only available to the Commonwealth of Puerto Rico

¹⁸ Catalog of Federal Domestic Assistance.

would be eliminated. Since this program is unique to the island, it is hard to assess how the actual food stamp program for which the fifty states are eligible would work in Puerto Rico since only data regarding the funding for NAP from the U.S to Puerto Rico is available and not participation rates among the population. This is due to the fact that the grant is not only used to provide cash or coupons to participants, but can also be used for administrative expenses for production and distribution of the food.

Puerto Rico is partially eligible for the Educationally Deprived Children Program—a program designed to improve the education of poor children throughout the U.S. The House of Representatives Bill 950 of the U.S. Congress has set a special formula for territories, including Puerto Rico. The National Center for Education Statistics has published statistics on Student, School/District Characteristics for Public Schools that gives a sense of the funding per pupil in public schools:

State/Territory	Number of Students Enrolled in Public Schools	% in Title I Schools	% eligible for free/reduced lunch	Per-pupil Expenditures
Hawaii	183,829	44.60%	12.40%	\$7,306
Kentucky	660,782	74.60%	69.00%	\$6,523
Mississippi	492,645	68.80%	65.30%	\$5,354
New York	2,888,233	60.10%	16.80%	\$11,218
Puerto Rico	596,902	99.30%	81.20%	\$3,563

Source: National Center for Education Statistics

As this table shows, spending per pupil in Puerto Rico is lower than in any of the other states, while the island has the highest percentages of students that are enrolled in Title I schools and that are eligible for a free/reduced lunch—another federal grant program. Under statehood Puerto Rico would be able to get rid of the special formula that Congress has set forth for territories and would be able to get the funding that states are

entitled to and thus improve overall education for needy students in high-poverty public schools.

The WIC Program, short for the WIC Farmers' Market Nutrition Program (FMNP) provides supplemental foods, health care referrals and nutrition education at no cost to low-income pregnant, breastfeeding postpartum women, and to infants and children up to five years of age, who are found to be at nutritional risk.¹⁹ The Food and Nutrition Service granted the Commonwealth of Puerto Rico \$1,534,641, \$2,333,613 and \$1,932,986 for fiscal years 2003, 2004 and 2005 respectively, under this program. In 2002, 2.63 percent of all U.S. WIC participants were from Puerto Rico.²⁰ For the WIC Program purposes, the Commonwealth of Puerto Rico and other territories such as America Samoa, Guam and the Virgin Islands receive funding at the state level. Puerto Rican statehood would not affect how the WIC program is funded in the island.

It has been quite the task to assess how Puerto Rican statehood would change funding for some of these federal programs. The fact of the matter is that it has been difficult to determine for which programs the island receives partial benefits as opposed to the benefits it should receive as another state. While every source encountered in the literature agrees on the fact that federal spending would increase, the only actual program that has been carefully studied has been the Earned Income Tax Credit Program. Many sources, including Odishedlize and Laffer, refer to special formulas that are applied to territories for federal spending in certain programs like Medicaid, Medicare, Section 8 Housing and the Educationally Deprived Children Program. Most government agencies like the U.S. Census Bureau or the Puerto Rican Planning Board provide figures for

¹⁹ United States Department of Agriculture (2004)

²⁰ United States Department of Agriculture (2003)

federal spending by state. However, this cannot be used for comparison in terms of spending since plenty of factors and demographics affect eligibility by program by state.

If Puerto Rico were to become a state, federal aid for welfare benefits is definitely bound to increase. The current status quo has caused plenty of commotion in the U.S. Congress since Puerto Ricans receive these benefits on one hand like U.S. citizens in the fifty states, but do not pay federal taxes on the other hand unlike U.S. citizens. Moreover, many Congress men and Senators have expressed their concerns about what the special political relationship between the island and mainland is costing the U.S. Certainly, from the U.S. point of view federal tax implementation would not represent a net gain; the removal of tax incentives for corporations investing in the island seems more promising. Nevertheless, all the federal programs that are available for the U.S. citizens of the Commonwealth of Puerto Rico would no longer be funded through special formulas and Puerto Ricans would receive the same welfare benefits as recipients in any of the other fifty states. Statehood advocates argue that through the implementation of statehood and thus the complete eligibility for all federal programs, Puerto Rico would finally have the feasible means to fight its high poverty levels that exceed those of any of the other fifty states of the Union.

F. Tourism

Tourism is already a promising sector of growth in the Puerto Rican economy, which could further improve under statehood. Although it is supposed to be a major economic industry in a tropical island with such beautiful natural resources (i.e. gorgeous beaches, and the only tropical rain forest in the Caribbean—El Yunque), tourism only

accounts for approximately five percent of GDP in Puerto Rico. Tourism however, as a percentage of GDP in Puerto Rico is an economic indicator that might not give an accurate depiction of what the role of the tourism industry actually is in the island's economy. Odishelidze and Laffer claim that this is the case since the manufacturing industry occupies such a great share of the Puerto Rican GDP (42.1 percent)²¹ because of all the income generated by the U.S. biotechnology and pharmaceutical companies. Nevertheless, five percent of GDP is still too low of a figure for the tourism industry in an island where anyone who has visited it can testify to the extent of this industry. Certainly tourism depends on many variables that make it difficult to estimate how this industry would be affected by the implementation of statehood on the island. When comparing the percentage of GDP that tourism accounts for in Puerto Rico to other Caribbean countries/islands, it is quite noticeable how the Puerto Rican tourism sector lags behind.

Tourism Economy of the Wider Caribbean

Country/Territory	Contribution of Tourism Economy to GDP in 2002	Projected Travel and Tourism Growth Rate (2002-2014)
	Percent of GDP	Percent Growth per annum
Aruba	72	4
Bahamas	46	6
Barbados	37	5
Costa Rica	12	6
Cuba	11	6
Dominican Republic	18	5
Jamaica	27	6
Panama	15	4
Puerto Rico	5	4
Trinidad and Tobago	9	5

Source: World Resources Institute

²¹ Magaly Rivera.

In “The Future Growth of Hawaiian Tourism And Its Impact on the State and on the Neighbor Islands”, a report conducted by Paul G. Craig in 1963, the importance of age, disposable income, travel time and travel rates, among other variables is discussed. Although this report was written more than forty years ago, it is the most relevant piece of literature that one can come across to study the effects of statehood on tourism, especially since Hawaii given its history and geographic location, is the most similar state to the Commonwealth of Puerto Rico. Today, in Hawaii the tourism industry accounts for nearly one-fourth of GDP, whereas in Puerto Rico it only accounts for approximately five percent. The World Travel & Tourism Council’s statistics for the Puerto Rican tourism industry are the following:

Puerto Rico’s Tourism Industry—the Current Picture

Direct Impact		
Employment	23,303	1.6% of total employment
GDP	\$1.239.4 million	1.4% of total GDP
Direct and Indirect Impact		
Employment	83,186	5.8% of total employment
GDP	\$4.881.6 million	5.3% of total GDP
Exports, Services and Merchandise	\$4.677.9 million	6.7% of total exports

This table shows the current role of tourism in the Puerto Rican economy. Furthermore, the predictions that the World Travel & Tourism Company have made for year 2014 are optimistic and suggest that this sector will keep growing, but the question is to assess how statehood would affect tourism. In the study mentioned above on tourism in Hawaii, Craig mentions the publicity inherently associated with Hawaii becoming a state, for “Hawaii probably received, free of charge, more promotion in all U.S. news media during 1958-1960 than all paid advertising by all overseas tourist areas combined”.²² Since U.S.

²² Paul G. Craig (1963)

visitors are the main customers of the tourism sector on Puerto Rico, it is fair to say that the advertisement that it would receive would have a positive impact in tourism because more tourists would not only become aware of its resources, but also because of a new sense of political stability and safety could impart to the island.

When comparing Hawaii to the island, Puerto Rico comes across as more accessible in terms of tickets fares and time travel, especially for east coast tourists. Cities such as New York, Chicago, Los Angeles and Corpus Christi are included in this table, which used results from an Orbitz.com search done in March 2005 for two weeks in May and November—peak months for vacation (this table only includes least expensive airline tickets fares):

Orbitz Results for Airfares—March 2005

Month	Airport	City	State	Destination	Connections	Fare
May	JFK	New York	New York	San Juan, PR	None	\$244
6th-13th	LAX	Los Angeles	California	San Juan, PR	1	\$468
	ORD	Illinois	Chicago	San Juan, PR	None	\$292
	CRP	Cospus Christi	Texas	San Juan, PR	2	\$471
	JFK	New York	New York	Honolulu, HI	1	\$627
	LAX	Los Angeles	California	Honolulu, HI	None	\$397
	ORD	Illinois	Chicago	Honolulu, HI	1	\$606
	CRP	Cospus Christi	Texas	Honolulu, HI	2	\$770
November	JFK	New York	New York	San Juan, PR	None	\$244
4th-11th	LAX	Los Angeles	California	San Juan, PR	1	\$496
	ORD	Illinois	Chicago	San Juan, PR	None	\$395
	CRP	Cospus Christi	Texas	San Juan, PR	2	\$562
	JFK	New York	New York	Honolulu, HI	1	\$661
	LAX	Los Angeles	California	Honolulu, HI	None	\$566
	ORD	Illinois	Chicago	Honolulu, HI	None	\$724
	CRP	Cospus Christi	Texas	Honolulu, HI	1	\$638

Based on these results, Puerto Rico does appear to be more accessible in terms of tickets prices and connections, to tourists from both coasts, not only the east coast as it might

seem because of geographical proximity. Nevertheless, Hawaii has managed to properly exploit its tourism industry whereas Puerto Rico has not. Odishelidze and Laffer argue that this industry is only a fraction of what it could be and that this fraction "... has the potential to be frozen as factors like crime rate, and other residues of dependency, continue to deflate what could be a reputation for inexpensive vacations in an exotic spot close to home". The truth is that this sector is growing in the island and that 2014 projections indicate that tourism as a percentage of GDP will grow to 5.5 percent and that employment will increase from 5.8 to 7.1 percent. However, these numbers still fall short, and could further increase as they did in Hawaii, if the island were to become a state. The Hawaii Tourism Authority issues a yearly report that depicts how the tourism industry is performing in the economy. In year 2003, travel and tourism accounted for 21.7 percent of GDP and accounted for approximately 183,600 jobs or 22.8 percent of total employment for that state. Comparing these figures to the figures of Puerto Rico demonstrates how the island's resources for tourism are not being fully utilized.

In the study that Paul G. Craig conducted in 1963, since the Hawaiian tourism industry infrastructure was not quite developed, he estimated how the private and public sectors had to grow in order to accommodate this new demand. The private sector had to invest in facilities for visitors, especially hotels, whereas the public sector was concerned with a new demand for employees that would provide services for visitors and the construction/maintenance of roads, parks and water works among others. Craig assessed how many additional hotel rooms were needed to accommodate the new number of visitors. When it comes to the case of Puerto Rico, with its quite developed tourism infrastructure—in 2001, the private sector invested an estimated \$250 million in 22 hotel

projects, it becomes quite the task to estimate how many hotel rooms are currently available. A report in 2002 by Ernst & Young states that an additional 5,000 rooms were constructed in the 2001 to 2004 period, which represented a 40 percent increase in the 12,754 rooms available on the island. However, the Puerto Rico Tourism Company statistics suggest that Puerto Rico is able to accommodate more visitors since the occupancy rates of hotel in the metropolitan areas, only vary from 70.3 to 80.1 percent in years 2001 to 2004 for the metropolitan areas and from 52.7 to 56 percent in the non-metropolitan area. Thus, the industry has the capacity to accommodate the new demand that would be associated with statehood.

Hotel Rooms Available 2001-2004

	2001-2002	2002-2003	2003-2004
Metropolitan area			
Total Registrations	987,323	1,068,664	1,666,203
Non-Residents	803,207	875,211	962,419
Residents	184,116	195,453	203,784
Occupancy Rate	70.30%	75.10%	80.10%
Rooms Rented	1,475,978	1,594,016	1,760,106
Rooms Available	2,100,626	2,122,946	2,196,444

Source: Puerto Rico Tourism Company

The Puerto Rican government has shown plenty of interest in sponsoring pro-tourism policies to further stimulate this sector of the economy. After the terrorist attacks of September 11, 2001, the Puerto Rican economy faced a sharp economic downturn which the government counteracted by creating economic packages to invigorate the tourism sector in the island. They provided temporary incentives such as 50 percent reduction in jet fuel tax paid by the airlines and a 20 percent discount on electricity bills for certified hotels.²³ Investments in the private sector are constantly being made to further improve the facilities and make the island one of the top destinations in the world.

²³ Ernst & Young LLP (2002)

Tourism thus has the potential of becoming a strong pillar of the Puerto Rican economy generating more profits and employment opportunities for an economy with a 13 percent unemployment rate, just as it did in the case of Hawaii. The transition from commonwealth to statehood would boost this sector since it entails the advertisement and commitment associated with such an important political change: the addition of the fifty first state to the Union.

G. United States Military in Puerto Rico

There has been a lot of rebellion against the U.S. military present on the island, and its role has become a major argument against statehood for the people of Puerto Rico, especially after many civilians protested against the abuses towards the people of the island of Vieques which the Navy used for bombing practices. A report released in 1999 concluded that although the Navy committed to promote economic growth in the island of Vieques since they controlled approximately 76 percent of the land, they failed to do so because at the time 73 percent of the population lived in poverty. The Navy also affected the environment—the island’s lagoons, forests, mountains and coastline were highly contaminated, thus breaching the 1983 understanding between the government of Puerto Rico and the U.S. Navy. The Navy left Vieques once and for all in May 2003 after a referendum was held whereby the people of the island rejected fifty million dollars in aid that the U.S. government offered if the Navy was allowed to remain on the island.

Although the U.S. Navy left Vieques, the U.S. Military still plays a significant role on the island with twenty-four bases and roughly 100,000 individuals that are employed in army related occupations. According to the U.S. Census Bureau, federal

expenditure for salaries and wages of Army, Navy and Air Force related occupations in the island amounted to \$132,654,000 in fiscal year 2003. The Army and Air Force ROTC programs are offered in most universities in the island while Junior ROTC programs are offered in several private Puerto Rican high schools. Moreover, the Latinos for Social Change Organization claims, "...the land occupied by the military is some of the most fertile on the island amounting to approximately 13 percent of the arable land in Puerto Rico".²⁴ These US military installations form part of the US Atlantic Command and Puerto Rico is a key place that supports this command's mission. Statehood would be in the interest of the U.S. in terms of the militia since currently it is constrained by the Puerto Rican government as the Vieques resolution demonstrates. As advocates of the Puerto Rican independent movement have asserted time and time again, if Puerto Rico had been a state, the U.S. Navy could have kept their practices in the island, which they described as "...the only place in the Atlantic suitable for practicing amphibious landings by Marines, backed by airpower".²⁵

From the Puerto Rico perspective, an article published by the *Puerto Rico Herald* in 2002 quoted U.S. Army sources that stated that Roosevelt Roads—the biggest military installation in the island, contributed an estimated \$250 million annually to the economy of Puerto Rico.²⁶ After the Navy resumed its practices in Vieques, political instability regarding the islanders' attitudes towards the U.S. army caused the U.S. Army Southern Command to depart from the island in 2002 causing a slump in the economy of at least \$300 million a year. The article quoted above from the *Puerto Rico Herald* states:

²⁴ Latinos y Latinas por el cambio social.

²⁵ [CNN.com](http://www.cnn.com) (2002)

²⁶ The *Puerto Rico Herald*. (2002)

Civilian employees, contractors of every sort, medium and small businesses around the installations and even the government of Puerto Rico (forgone revenue to public utilities and forgone tax revenue to Hacienda [the Puerto Rican Treasury Department]) will feel the pinch.

The U.S. military thus represents an important part of the Puerto Rican economy whether Puerto Ricans enjoy it or not, and although resentment is a valid sentiment against certain U.S. policies that many islanders share, the only way by which Puerto Ricans could detach themselves completely from the U.S. Armed Forces would be through independence. However, it seems that all sources regardless of their stance about the military agree on the fact that the economy would suffer drastically with independence, which is not a viable alternative. Detaching the island from the military might represent nationalistic desire of the people of Puerto Rico, but in reality the economy would highly suffer as the island has already an incredibly high unemployment rate that would further increase since many civilians are currently employed in army related occupations. Opponents to the U.S. army propose using the empty facilities for projects that stimulate the economy. However, facilities that have been unused for many years still remain empty.

As it has been argued above, the U.S. military is very much present on the island, and plays a major role in the economics and politics of Puerto Rico. It is reasonable to assume that this military presence will not change drastically if Puerto Rico were to become a state given the fact that there are so many military installations on the island already. In any case, the U.S. would probably decide to open more bases. The economic changes of statehood from a military perspective seem relatively unimportant, given the fact that the status quo regarding military presence will remain. What is worth

mentioning is that the military could serve as leverage to the people of Puerto Rico in the case that they decided to actively pursue statehood for the island.

Certainly, this thesis addresses the issue from the Puerto Rican perspective, but as it has been discussed, although statehood would be economically beneficial for the island, Puerto Rican statehood is not as economically straight forward a matter for the U.S. It is not clear whether federal individual and company taxes would counteract the implementation of many welfare programs, especially the Earned Income Tax Credit. If Puerto Rico wanted to push for statehood, they could put pressure on the U.S. government by rebelling against more of these military bases—as in the Vieques case. In view of the fact that Puerto Rico is a crucial military strategic venue for the U.S., this military presence argument represents one of the strongest reasons for the U.S. to admit the island into the Union.

V. Concluding Remarks

The findings of this thesis suggest that statehood would be economically advantageous for the commonwealth of Puerto Rico. When assessing the impact of statehood in the key economic factors what would be affected, it seems like the benefits of Puerto Rican statehood definitely outweigh the costs. From all the major policy changes discussed in this paper, the two that are recurrently brought up as major hindrances for statehood: the implementation of federal taxation and the removal of tax incentives for U.S. companies. However, it has been shown that there are two sides to the story. While paying federal income taxes is depicted as a major downturn for the Puerto Rican economy, the negative effects that this would have on the wealthy would definitely

be counterbalanced by the positive effects it would have for the poor. As shown previously, a great share of the population qualifies for some kind of refund under the EITC programs requirements and this is due to the high levels of poverty in the island. In this form, the implementation of taxation at the federal level would act as a much needed income redistribution strategy for the island. It would definitely hurt the rich, but would benefit the poor in various ways. The poor will not only have more feasible means to sustain themselves and their families, but many poor individuals that are probably living off welfare would have an incentive to seek employment and work as the EITC is only available for employed individuals.

The other policy change would be the removal of the tax incentives for U.S. corporations that are currently investing or planning to in the island. As discussed previously, the effect of the removal of these tax incentives is unclear for U.S. companies could decide to invest or reallocate to other countries in which they can declare themselves as Controlled Foreign Corporations on the one hand. But on the other hand since Puerto Rico has plenty to offer to U.S. investors, it seems hard to foreshadow the reaction of the U.S. companies that are currently investing in the island. After all, Puerto Rico does have to offer a highly educated bilingual labor force, U.S. law and no currency exchange risk, among others. If these federal tax incentives were completely removed, the government of Puerto Rico could offer more attractive tax incentives at the local level than the ones they currently offer. Thus the removal at the tax incentives at the federal level could be counteracted to some extent. Also, more U.S. companies could choose to invest in Puerto Rico since the political instability inherent in the current status quo would no longer be a hindrance to investors. For all of these reasons, it does not seem

that Puerto Rican statehood and thus the removal of federal tax incentives, necessarily mean a negative impact on foreign direct investment for the island of Puerto Rico.

All of the other impacts of key economic factors of Puerto Rican statehood entail benefits for the island's economy. The tourism industry would profit from statehood as the number of visitors and possibly days of stay would increase because of the valuable promotion associated with the statehood transition in the media and a new sense of inherent political stability and safety. Moreover, the employment opportunities for the local labor force in the tourism industry would increase with the new demand of tourists. Welfare benefits would also increase for the island as the United States would apply the same formulas for every federal grant program to the island as they currently do with any other of the fifty states—the Earned Income Tax Credit being one of them. The removal of tariffs would sponsor real free trade between the island and mainland and would increase the supply of goods while decreasing the prices for the Puerto Rican consumer that is currently forced to consume more expensive domestically produced goods. The U.S. military's role in Puerto Rico would not dramatically change since its presence is already crucial for the island's economy—in any case it would increase. Now, islanders might not be content with the U.S. military presence for nationalistic reasons. However, explicitly talking from an economics point of view, the military bases already located in the island are beneficial since they generate a crucial portion of employment for civilians.

The three referendums held in Puerto Rico reaffirmed the fact that the majority of islanders—or of the voters at least, are content with the current status quo. Nevertheless, given all of the reasons mentioned above it seems difficult to understand why this is the case. Why approximately half of the population rejects the notion of Puerto Rican

statehood? The answer to this entails a lot more than an economic analysis of the major changes that would occur. Certainly, Puerto Rico's right to self-determination as seen by the field of international law might be threatened by its current political situation with the mainland, but the status quo does have its appeal. Many Puerto Ricans believe that statehood menaces the notion that they have of their own cultural identity. Because of the current political relationship with the United States, Puerto Ricans can manage to enjoy certain privileges such as being entitled to the U.S. citizenship, while having none of the responsibilities that come along with being a citizen. The argument however is that with the status quo, Puerto Ricans can still be true to their cultural identity. Among the many arguments regarding culture that oppose statehood there is talk about Puerto Rico not being able to have it's own team in the Olympics or have a contestant representing the island in the Miss Universe pageant—which the island has won four times already almost making it the Latin country which has won the most except for Venezuela. These arguments might seem trivial, but these two events are regarded in the Puerto Rican community as events where Puerto Ricans can make themselves known to the rest of the world.

Statements such as the one presented in the introduction of this paper made by the current governor of the island about the political relationship of the island and mainland are very popular. In order for Puerto Rico to become a state, language and cultural identity issues would have to be addressed in a way that makes Puerto Ricans comfortable about joining the Union. It is very argued that the usage of Spanish in the island would remain the same as there are many other states of the Union with a high population of Spanish speakers like California (5.5 million), Texas (3.4 million), New

York (1.8 million), and Florida (1.5 million).²⁷ In terms of culture, and this is getting into the anthropological field, it seems unreasonable to think that the fifty states of the Union are homogenized into a single culture. Hawaii joined the Union in 1959 and that has not made Hawaiians less appreciative of their culture. Pro status quo and independence advocates seem to be confusing culture with nationalism. If the culture of Puerto Ricans would be submerged by joining the Union then the same thing can be said for 1952 when the island became a Commonwealth.

The other side of the coin seems more perplexing in any case: Why would the United States admit Puerto Rico as the fifty-first state of the Union? While this is a whole different thesis, it would be interesting to see why the United States would want this permanent and binding political union. As it has been previously discussed, Puerto Rican statehood can only happen if approved by the U.S. Congress. In terms of what it would imply economically for the United States, it seems that Puerto Rico would become even more of a liability for the U.S. The only economic factor that could redeem Puerto Rico bringing significant revenue to the U.S Treasury Department could be the fact that the U.S. companies that are located in the island would pay regular federal taxes. However, it is not certain if these companies would choose to reallocate after the implementation of statehood and thus the removal of tax incentives. They could potentially stay in the island since Puerto Rico definitely has other advantages to attract investors. None of this is certain though. In terms of the implementation of federal taxation for individuals since the levels of poverty are so high, the United States would end up giving more aid in programs such as the EITC than receiving revenue.

²⁷ American Demographics

It seems like that the economics inherent in a transition to Puerto Rican statehood would not be reason enough for the United States to admit the island as the fifty-first state. There are other dimensions to the debate however. Because of the pressure exerted to the United States by the international community and organizations such as the United Nations, it seems like it would be in the interest of the United States to end once and for all the so called “candy-coated” colonial relationship. Since in the scenario of statehood Puerto Ricans would have the same privileges and responsibilities of any other U.S. citizen, it would not longer be valid to argue that the United States treats Puerto Ricans as the second-class U.S. citizens. Furthermore their U.S. citizenship would be a constitutional citizenship as opposed to a statutory one, which means that it could never be revoked by U.S. Congress—although it seems like that is highly unlikely to happen. Another aspect of Puerto Rican statehood that seems would benefit the U.S. is the stability that it entail in terms of the U.S. military role in the island as discussed in the U.S. military section of this paper.

It has been fifty-three years since Puerto Rico became a commonwealth. The commonwealth status was supposed to be temporary until Puerto Ricans decided whether to become an impendent nation or a state of the Union. It seems very unlikely that it will ever become an independent nation. But, will it ever become a state? The population that favors statehood has been increasing as indicated by the results of the three referendums regarding the status issue in the island. However, at the rate things are going, it seems like the answer is NO. After all economics is not the only thing in the minds of Puerto Ricans. Culture and language will always come into play which is perfectly reasonable as they are very important components of a person’s identity. The pride of being Puerto

Rican should remain intact regardless of Puerto Rico's political status. Until culture and nationalism are separated as the two different things they are when it comes to the status debate in the island, the commonwealth will remain intact as it is: a gray area.

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