

STATEMENT OF THE
PUERTO RICO CHAMBER OF COMMERCE
BEFORE THE SUB COMMITTEE ON INSULAR AFFAIRS
OF THE COMMITTEE OF NATURAL RESOURCES
U.S. HOUSE OF REPRESENTATIVES

Manuel A. Mejía, Chairman of the Board
Washington, D.C. - March 22, 2007

Madam Chairman and Members of Congress, my name is Manuel Mejía; I am the Chairman of the Board of the Puerto Rico Chamber of Commerce. We want to thank you for the opportunity to express the views and positions of our Institution on this most important issue; Puerto Rico's Political Status.

The issue of the political status has been an open and unresolved question in the history of Puerto Rico. It creates serious divisions among our society, forcing us to devote valuable human and economic resources in its debate, without reaching yet a definite solution. The Puerto Rico Chamber of Commerce certainly appreciates the present Congressional efforts to find a democratic solution to this issue.

Before I enter into the discussion, of the principal issues, allow me to say that today we stand before this distinguished committee as representative for over 2,500 businesses and professionals of all sector and university students as well as a federation of over 60 private sector organizations in the Island jointly employing two thirds of the workforce.

The Puerto Rico Chamber of Commerce does not favor any particular form of political status. Its membership includes individuals from all political perspectives. In this diversity, chamber members have reached a consensus on the need to resolve the status issue and bring emotional and economic stability to our society. Without an organized congressionally sanctioned process, locally celebrated plebiscites on the status issue will continue to create much uncertainty among present and potential investors. Such situation hinders economic prosperity; therefore, this should be resolved as quickly as possible. Neither Congress nor the Puerto Rican people should wait another decade to decide this issue. Once the status question is resolved, efforts could be efficiently channeled to deal with the various social and economic problems of our society.

The Puerto Rico Chamber of Commerce will not address the provisions of H.R. 1230 regarding the process to exercise the right to self-determination thru a Plebiscite versus a Constitutional Convention. Further, we will not address the provisions of H.R. 900 on the two federally sanctioned plebiscite processes.

For this reason our comments will be limited to the issues which have to be considered in the transition to any given status formula selected by the people of Puerto Rico. The central focus in our analysis is the economic and social circumstances of our members and, what is more important, those of the people of Puerto Rico. Before entering into the discussion of the process here are some pointers regarding Puerto Rico present economic structure.

Puerto Rico's economic model dates back to the early 1980s. During such years, most developing country governments, with a few exceptions, as well as many international organizations, had in mind a similar model of the development process as they went about their work. That model of how development goals should be attained greatly influenced government policies and institutions. It also profoundly affected national legal systems and the way government officials, lawyers, and legal scholars thought about law and its role in development. Since the late 1980s, most developing countries, in varying degrees, have abandoned that first model of development (Development Model I) and have evolved to a new model (Development Model II) that supersedes it. That has not been the case of Puerto Rico. This fundamental change in development models was in many ways as significant a transformation for developing countries as was the movement in the 1950s and 1960s from dependent to independent political status. This transformation is partially reflected in the change of name used to describe the "Third World: the "developing countries" of the 1960s have become the "emerging markets" of the 1990s. (The International Lawyer Winter 1999; Volume 33; Number 4 page 876).

Probably all Third World countries entered the decade of the 1960s with a fundamental belief that their governments had the primary responsibility for bringing about economic development. In the minds of most officials, lawyers, and scholars, the belief in government's dominant role evolved into a definite model about the nature of the development process. This model had four elements: (1) public ordering and state planning of the economy and society; (2) reliance on state enterprises as economic actors; (3) restriction and regulation of private enterprise; and (4) limitation and control of the country's economic relations with the outside world. Puerto Rico's model still has these elements present to certain extent. (The International Lawyer Winter 1999; Volume 33; Number 4 page 877)

The position of our institution revolves around two main concerns. One is that the process ought to be fair and well informed, for the people to make an enlightened decision. The other is that, should the people of Puerto Rico decide to change the present status, an orderly and well-defined transition has to be clearly stated. This is of outmost relevance, because the people should know, not only the final outcome of their decision, but the road to reach it, if they are going to issue a responsible vote.

The Process

The self determination process should be dealt on its own merits. It should not be mixed with the normal electoral process. Voters have to be able to focus upon the status issue, apart from any distractions and confusions with other issues. All political parties in the Island have different positions with regard to their desired solutions to the status question. Indeed, each one of them uses the status as the principal issue in their political platforms and as their main identifier. As a result, the issues of governance and administrative policies are mingled in the electoral process with those related to the status and the type and form of future political relations between Puerto Rico and the United States. This situation creates confusion among voters, obscuring their ability to focus on the real issues to be decided at each electoral process. The status question is an ideological and emotional issue, becoming one of the most divisive issues in Puerto Rico. Too many human and economic resources have been spent in debating this issue. It is clear that a final solution is of foremost relevance for the future of our people. By solving the status issue, we will be deciding not only our future, but also the one for the generations to come.

The long-term process to address the status issue in Puerto Rico requires that voters be well-informed on the consequences of their decisions throughout the entire process. Before Puerto Ricans are asked to stamp their status preference on a plebiscite ballot, it is necessary to clearly spell-out the cultural, political and socioeconomic consequences of each political status alternative to be presented.

The information transmitted to the people should be based upon accurate and unbiased data. The data that the Federal Agencies provide with respect to the costs and benefits of each status alternative must be consistent in terms of objectivity and basis. Some examples where consistency and objectivity are of utmost importance are statements about the nature of our American citizenship. Statements on the implications of federal corporate and personal taxation under statehood must be based on scientific estimates. We hereby offer the resources of our institution to help in obtaining additional information about the socioeconomic impact of each status alternative to supplement what has already been obtained, and what needs to be gathered in order to allow the people to make an informed decision.

The only viable alternative to solve Puerto Rico's status issue is a federally sanctioned process. This process must outline very specific steps to accomplish its objectives, the participating institutions for each step in the process, and, very importantly, the responsibility and role of each participant at each step. Our institution believes that the private sector must have a role and a consequent responsibility in this important undertaking. Political parties should welcome the

private sector's contributions to this process. On this issue we would like to congratulate Madam Chairman and the distinguished members of this commission for allowing us to testify this morning. We feel that this is an initial step, to encourage a broader participation of private sector institutions in Puerto Rico to complement the views and recommendations of our local government and political parties.

The Outcome and Its Transition

1. The transition



Source: Puerto Rico Planning Board

Puerto Rico's economy has been directed and structured on the basis of its present status. Our economy has achieved a high degree of integration to the U.S. economy. Our total exports in the year 2005 were \$56.5 billion. It should be noted that, on the average, 82.6% percent of

our exports of merchandise go to the U.S. market. Most of our imports come from the continental U.S., and our financial markets are totally integrated to the national market. The capital stock of Puerto Rico, and the investments made considering the reduction of political risk due to the stability of our relationship with the U.S and the application of federal laws in interstate cannot be changed overnight. To do otherwise risks grave dislocations and suffering for the people of Puerto Rico if the change is not accompanied with countervailing measures.

Our local tax system is based upon the present flexibility granted to the states and is administered considering local economic conditions as any tax system ought to be. Any change in political status will require a major restructuring of the tax system in Puerto Rico. A drastic and fast change in the local tax system could affect the whole economy.

2. U.S. Citizenship

We are U.S. citizens since 1917, accepting with honor the rights and responsibilities of such citizenship. Our great participation in U.S. military conflicts from World War I to the most recent interventions in Iraq is a clear evidence of this point.

Contradictory statements have confused our people on the nature of our citizenship and its future under different status options should be avoided. We feel

that Congress has the duty to state without ambiguity what will happen to our present U.S. citizenship under each status alternative. A clear expression from Congress is necessary to spell out the confusion created by federal and local officials, so that Puerto Ricans can make the appropriate decision.

3. The Federal Tax Treatment of U.S. Corporations

Our industrialization program was developed on the basis of preferential federal tax treatment of U.S. corporations doing business in Puerto Rico. Drastic modifications were made in 1993 and 1996 to Section 936 until its eventual phase out in 2005. These modifications have severely eroded industrialization initiative, not only because tax benefits were diminished, but also because they created uncertainty about the stability of federal policies toward Puerto Rico. Since uncertainty is a formidable enemy of productive investment and economic growth, we now face more difficult conditions to promote the prosperity for our people.

No matter if Puerto Rico chooses to maintain the present commonwealth status, or to become a state or a republic, there is a common interest in promoting the economic development of the Island. We obviously want to prosper. It is not in the best interest of the United States to have a territory, state or an independent neighbor plagued with poverty. Over the past half century Puerto Rico has made, with the assistance of the federal government, big efforts to promote its economic growth. We have worked hard, and achieved great improvements in economic conditions. But more efforts are needed to improve our economic development under our competitive global economy. Even the status quo should be regarded as a transition from poverty to progress, and our economic development strategies are designed from this perspective. Any change in status has to provide instruments to achieve our common goal of economic development.

It is important for Congress to realize that any successful transition requires an efficient instrument. For that reason, we actively support the efforts of private organizations and of the Government of Puerto Rico to develop new and efficient and effective economic development model, to transform our Island into a developed and prosperous economy. At the very least, Congress ought to clearly state what will be the federal tax treatment to U.S. corporations under each status formula, as well as under the corresponding transition periods, including the period of time for which the corresponding tax treatment is guaranteed.

4. Federal Tax Treatment to Residents and Local Business

People know that the local tax system will have to be adjusted if there is a change in status. We all realize that the present tax structure is consistent with existing conditions, and that any transformation in conditions, as it will be the case if the political status is changed, will result in deep modifications in taxation. The problem is that no reliable information has been produced about what those changes might be.

The role, functions and activities of government differ under each status formula. In a state, the U.S. federal government is in charge of many activities that are the responsibility of local authorities, and federal taxes will be levied on local residents. In a republic, all or most of the activities actually performed by the federal government in Puerto Rico will be transferred to the local government, and it won't be subject to federal laws and regulations. Both scenarios drastically change the needs and tax system for government financing. Transformations of that nature cannot be done overnight without a great risk of serious economic dislocation.

We know of no serious study to document and analyze this most important aspect. It is unfair to ask people to choose between status options and not tell them the consequences of their decisions. At the very least, Congress ought to clearly establish which will be the federal tax treatment to residents under each status, as well as during the different stages of each transition period.

5. Access to U.S. Commercial and Financial Markets

Over the past century, Puerto Rico integrated its economy to the U.S., with obvious mutual benefits. It has been already shown that 82.6% percent of our exports of merchandise are sold in the U.S., and that we depend upon external trade to achieve a reasonable rate of economic growth. Our monetary and financial systems are also totally integrated to the U.S. Most of our productive and infrastructural investments are financed with funds lent from U.S. individuals and institutions, while Puerto Rican savers hold over \$20 billion in assets issued by the federal government and private U.S. institutions.

Any modification in the status quo will have consequences in our financial institutions and in the asset values of all citizens. These effects ought to be clearly identified, and measures designed to take advantage from favorable opportunities and to minimize any adverse effect. Again, limited information has been produced in this respect. Here it is necessary to clarify what will be the terms and conditions for Puerto Rico's access to the United States commercial and financial markets under each status formula, including what will be its position with respect to present and future trade agreements that the U.S. engages with foreign countries.

6. Access to Foreign Commercial and Financial Markets

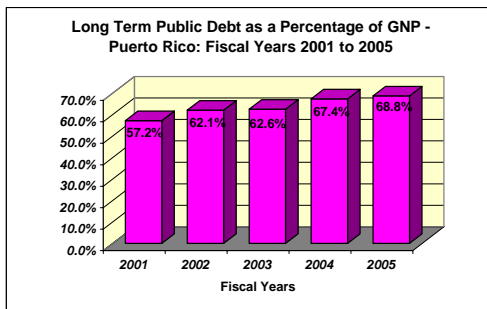
Puerto Rico's economic model is predicated upon the diversification of our economy. It calls for promoting growth in all industrial sectors, and diversifying manufacturing by strengthening the Life Sciences and Biotechnology Sectors. It also seeks to diversify export markets and sources of investment funds. Such policy is consistent with U.S. interests in reducing its trade deficit.

A change in status would modify conditions for the implementation of this economic model. In order to know what modifications we will have to make in our

economic development strategies, it is necessary to know which will be the conditions and restrictions to Puerto Rico's access to foreign commercial and financial markets under each status formula, as well as the market penetration of foreign goods in our economy.

7. Long Term Public Debt

The topic of the long term public debt under each status formula is important by itself, as well as in relation to the design of modifications in our tax structure. Our long term public debt has been issued to finance investments in infrastructure. Many of these investments are the responsibility of the federal government in the states of the Union. A sovereign nation in order to benefit from the international trade agreements will have to establish a level playing field through the rule of law, but harmonized and unified with a free market economy and free market system which in itself will require that investments be made. On the other hand, some of these investments were made to comply with federal laws and regulations. Also, the design of local projects would have to meet or exceed federal regulations, thus constructions costs would be higher, increasing the needed for debt financing.

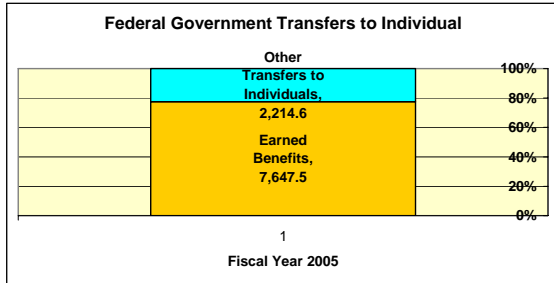


Source: Puerto Rico Planning Board

Long term public debt represents 68.8 percent of Puerto Rico's GNP. Given the tax structure presently available, the Island has no problem in paying for the service of that debt. But with a change in status, the government's ability to raise revenues will also change, and adjustments have to be made to recognize that fact.

Also, Puerto Rico needs to continue its present aggressive program to enhance its infrastructure. That is essential for the competitiveness of our economy. It is, therefore, necessary to know if there will be any constraints for issuing new public debt under the transition periods of the different status formulas.

8. U.S. Transfers



The issue of federal transfers is another that should be properly addressed before the Puerto Rican people are asked to make a decision about the status. Federal transfers to individuals totaled \$9,862.1 million in fiscal year 2005, accounting for 20.2 percent of personal income in the Island. Of these transfers, 79.0 percent were earned benefits, such as Social Security pensions and Veterans benefits.

It is essential for the people to know what will be the amount and terms of U.S. transfers to Puerto Rico under each status option. That information is vital for the persons to make an informed decision. Particular attention has to be paid to what is going to happen to the contributions that Puerto Rico makes to earmarked funds, such as Social Security, Medicare, and Unemployment Insurance, among others.

9. Travel and Migration

Almost all families have close relatives living in the continental United States. For family ties to be maintained, it is necessary to keep unrestricted travel between the U.S. and Puerto Rico.

Migrations of Puerto Ricans to the continent happened as a derived effect of U.S. citizenship, a significant demand for employment in the United States coupled to high unemployment and low income levels in the Island. In consequence, the issue of migration is related to the previously mentioned U.S. citizenship and economic development, but has a humanitarian dimension by itself. Hence, voters must know conditions for travel and migration between Puerto Rico and the United States under each status alternative.

Final Remark

In finalizing this presentation it is important to conclude that no law should be approved and consequently the proposed process should not be held if these basic concerns are not properly addressed. Not covering these basic concerns will not have afforded the Puerto Rican voters an opportunity to make an informed decision in selecting among the status options at the time.

The Puerto Rico Chamber of Commerce realizes that some of the key factors that have contributed to our economic development are subject to changes as circumstances vary over time, but we are also aware that drastic changes over a short period of time could prove to be disastrous if the changes occur at a rate faster than the ability of our economy to adjust to them.

Whatever alternative is democratically chosen by the people of Puerto Rico will probably result in economic adjustments and could entail sacrifices on our part. Private enterprise is ready to shoulder its responsibility; however, even in times of budgetary restraint, Congress should be sensitive to our needs and economic realities. Self-sustained economic development can only be achieved through a long term process. With your help, and a great deal of work on our part, we are confident that we can achieve our mutual goal of human progress for the people of Puerto Rico. But an adequate transition period is necessary. It ought to be designed in all relevant details and informed to the people before they are asked to choose.

Once again we would like to express our most sincere gratitude to Madam Chairwoman and the distinguished members of this Committee. The status issue needs to be solved if Puerto Rico is to offer a secure long term investment environment to interested individuals and organizations. Congress needs to act now. Our immediate goal at the Puerto Rico Chamber of Commerce is to focus on the preparation of a strategic plan for Puerto Rico's future economic development. A plan which is capable to adapt and transition into any status alternative and that will guaranty our fellow Puerto Ricans future economic prosperity and a better quality of life.

Thank you.