GAO
Accountability · Integrity · Reliability

Highlights

Highlights of GAO-06-541, a report to Committee on Finance, U.S. Senate

Why GAO Did This Study

The federal possessions tax credit, which was designed to encourage U.S. corporate investment in Puerto Rico and other insular areas, expires this year.

Proponents of continued federal economic assistance to Puerto Rico have presented a variety of proposals for congressional consideration.

In response to a request from the U.S. Senate Committee on Finance, this study compares trends in Puerto Rico's principal economic indicators with those for the United States; reports on changes in the activities and tax status of the corporations that have claimed the possessions tax credit; explains how fiscal relations between the federal government and Puerto Rico differs from the federal government's relations with the states and other insular areas; and compares the taxes paid to all levels of government by residents of Puerto Rico, the states, and other insular areas.

GAO used the latest data available from multiple federal and Puerto Rican government agencies. Data limitations are noted where relevant. Key findings are based on multiple measures from different sources. GAO is not making any recommendations in this report.

In comments on this report the Governor of Puerto Rico said the report will be useful for evaluating policy options.

www.gao.gov/cgi-bin/getrpt?GAO-06-541.

To view the full product, including the scope and methodology, click on the link above. For more information, contact James White at (202) 512-9110 or whitej@gao.gov.

May 2006

PUERTO RICO

Fiscal Relations with the Federal Government and Economic Trends during the Phaseout of the Possessions Tax Credit

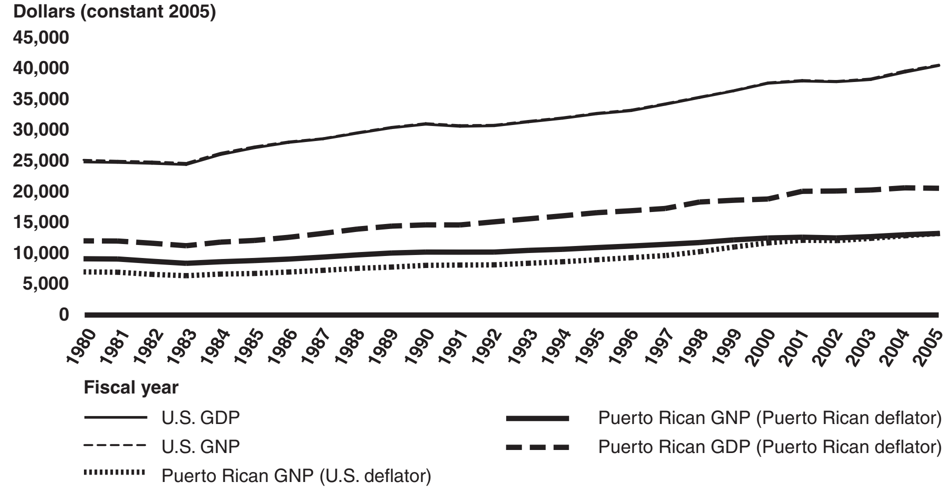
What GAO Found

Puerto Rico's per capita gross domestic product (GDP, a broad measure of income earned within the Commonwealth) in 2005 was a little over half of that for the United States (see figure below). Puerto Rico's per capita gross national product (GNP, which covers income earned only by residents of the Commonwealth) was even lower relative to the United States. Concerns about Puerto Rico's official price indexes make it difficult to say whether the per capita GNP of Puerto Rican residents has grown more rapidly than that of U.S. residents; however, the absolute gap between the two has increased.

U.S. corporations claiming the possessions tax credit dominated Puerto Rico's manufacturing sector into the late 1990s. After the tax credit was repealed in 1996 beginning a 10-year phaseout period, the activity of these corporations decreased significantly. Between 1997 and 2002 (the latest data available) valued added in these corporations decreased by about two-thirds. A variety of data indicates that much of this decline was offset by growth in other corporations, so that some measures of aggregate activity remained close to their 1997 levels. For example, value added in manufacturing remained fairly constant between 1997 and 2002. Most of the offsetting growth was in the pharmaceutical industry.

Residents of Puerto Rico pay considerably less total tax per capita than U.S. residents. However, because of lower incomes they pay about the same percentage of their personal income in taxes. The composition of taxes differed between Puerto Rico and the states with federal taxes being a larger share of the total in the states. This difference reflects the facts that (1) residents of Puerto Rico generally do not pay federal income tax on income they earn in the Commonwealth and (2) the Commonwealth government has a wider range of responsibilities than do U.S. state and local governments.

U.S. and Puerto Rican Real Per Capita GDP and GNP, 1980–2005



Source: GAO analysis of U.S. Bureau of Economic Analysis and Puerto Rican Planning Board data.