

17209 114496

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES



LM114496

Puerto Rico's Political Future: A Divisive Issue With Many Dimensions

What is Puerto Rico's political destiny? The island's over 3 million U.S. citizens continue to debate whether to retain the current Commonwealth arrangement or petition the Congress for statehood, independence, or an amended form of the present status. Any decision rests with the Puerto Rican people and the U.S. Government and holds significant repercussions, because the longstanding Puerto Rico-Federal relationship has fostered a web of legal, fiscal, and human ties.



114496

Consequently, deciding what the island's status should be and planning for any change will involve assessing an intricate array of concerns. Compounding ideological and political divisions, the status debate also presents numerous financial and other considerations and encompasses added dimensions, such as cultural convictions and international issues.

To enhance evolving deliberations over alternative future statuses, this report analyzes the U.S.-Puerto Rico relationship and highlights the broad range of issues likely to be addressed by island residents as well as Puerto Rico and Federal decisionmakers.



GGD-81-48
MARCH 2, 1981

015-792/114496

Request for copies of GAO reports should be sent to:

**U.S. General Accounting Office
Document Handling and Information
Services Facility
P.O. Box 6015
Gaithersburg, Md. 20760**

Telephone (202) 275-6241

The first five copies of individual reports are free of charge. Additional copies of bound audit reports are \$3.25 each. Additional copies of unbound report (i.e., letter reports) and most other publications are \$1.00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis. Check should be made out to the "Superintendent of Documents".



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-193013

To the President of the Senate and the
Speaker of the House of Representatives

The debate on alternatives to Puerto Rico's political relationship with the Federal Government continues. To assist Puerto Rico and the Congress in any future status deliberations, Senator Johnston and Resident Commissioner Corrada requested information on what a status change would involve.

This report analyzes the current Commonwealth arrangement and examines the broad range of issues inherent in each status alternative. A complementary report issued March 7, 1980, "Experiences of Past Territories Can Assist Puerto Rico Status Deliberations" GGD-80-26, analyzed the procedures and terms established by the Congress in admitting States and granting independence.

We are sending copies of this latest report to various officials in the Executive Branch, the Governor of Puerto Rico, and leaders of the island's major political parties.

A handwritten signature in black ink, appearing to read "Thomas R. Stearns".

Comptroller General
of the United States

C o n t e n t s

	<u>Page</u>
DIGEST	i
CHAPTER	
1	
PERSPECTIVES ON APPROACHING PUERTO RICO'S MULTIFACETED STATUS QUESTION	1
Diverse aspirations for greater political rights, equality, and socioeconomic progress fuel debate over alternative futures	1
Initial decisionmaking framework emanates from experiences of past territories	3
The objective of this report is to assist, not resolve, status deliberations	5
Scope and methodology	6
2	
PUERTO RICO'S EVOLUTION TOWARD GREATER SELF-GOVERNMENT ESTABLISHES FOUNDATION FOR STATUS ANALYSIS	8
Historic pursuit of political rights led to current relationship with the Federal Government	8
Puerto Rico's quest began under Spanish rule	9
Spanish-American War brought U.S. sovereignty	9
U.S. Supreme Court decided Puerto Rico was not an incorporated territory	11
1917 Organic Act included U.S. citizenship and locally elected legislature	11
An elected governor--another step toward greater self-government	12
Greater home rule--Constitution established and Commonwealth formed	12
Puerto Rican Federal Relations Act contains present basic arrangements	13
Varying concepts of Commonwealth	13
Puerto Rico's government responsibilities and structure are similar to States	14
Commonwealth Constitution modeled after U.S. and State constitutions	14
Executive power vested with an elected governor	15

CHAPTER

2

Popularly elected bicameral assembly executes legislative functions	16
Unified judicial system mandated	17
Municipalities are the only level of local government	18
Puerto Rico law is a blend of civil and common law traditions	18
Political process in Puerto Rico is democratic and stable	20
Constitution assures citizens' rights in collective decisions	20
Electoral law governs political process	21
National political and legislative participation has grown but remains limited	21
Residents have no vote for President but help choose candidates	22
Residents have some representation in the Congress	23
Conclusions	23

3

SUBSTANTIAL ECONOMIC GROWTH AND IMPROVED SOCIAL CONDITIONS ACHIEVED, BUT PERSISTENT PROBLEMS COMPLICATE STATUS DEBATE	25
Once reliant on agriculture, Puerto Rico's economy was transformed through industrialization	25
Major economic indicators up sharply since 1950	26
Manufacturing remains the driving economic force but its structure has changed	26
Other economic sectors also grew substantially	29
Importance of government has increased significantly	30
Gains in social conditions realized, but problems remain	30
Chronic unemployment and poverty persist as population growth exceeds job opportunities	31
Programs to diversify and strengthen economy and reduce unemployment are being pursued	33
Conclusions	34

CHAPTER

Page

4	PUERTO RICO'S STATUS DILEMMA: CHOOSING FROM DIVERGENT ALTERNATIVES	36
	Longstanding status controversy has intensified, but electorate's views are unknown	36
	The status options: similar concerns voiced, but ideological differences underscore splintered nature of debate	39
	Statehood advocates desire equality within the American system	40
	Commonwealth proponents want to keep ties but seek more autonomy	43
	Independence supporters advocate complete autonomy	45
	Conclusions	49
5	EACH STATUS WOULD ALTER FINANCIAL AND INTER- GOVERNMENTAL ARRANGEMENTS BETWEEN PUERTO RICO AND THE FEDERAL GOVERNMENT	51
	Present treatment similar to States, but key differences exist	51
	Current relationship prompted integral fiscal role of the Federal Government	52
	Statehood would bring equal treatment under Federal laws and programs	53
	Increased aid would benefit island governments and low-income residents	54
	Immediate equal treatment would greatly increase tax liabilities and likely prompt major realign- ments in Puerto Rico's revenue structure	56
	Proponents have advocated gradual application of full Federal taxa- tion and other transitional measures	60
	Most Federal and Puerto Rican responsi- bilities would not be affected, although some will need attention	60
	Independence would prompt far-reaching changes	61
	Eliminating the extensive Federal role: potential impacts and advocates' proposals	62
	Federal assistance would terminate, but questions surface regarding alternative funding and benefi- ciaries' vested rights	62

CHAPTER

Page

5	Independence would bring complete local control but end longstanding economic arrangements	63
	Federal services and regulation would cease, requiring numerous adjustments and additional financing	64
	Although maintaining special arrangements, the impact of amended commonwealth proposals hinges on future decisions	65
	Advocates seek discretion in using Federal funds and greater influence over Federal law	65
	Control sought over broad range of Federal activities	66
	Conclusions	67
6	A STATUS CHANGE WOULD PROMPT REASSESSMENT OF STRATEGIES FOR ATTRACTING BUSINESS INVESTMENT TO PUERTO RICO	69
	Exemptions from income and property taxes highlight Puerto Rico's tax environment	69
	Each status option to varying degrees would affect the liabilities of taxable firms	72
	Suddenly eliminating Federal corporate tax exemptions would entail risks to future business development in Puerto Rico	73
	Other factors important to business will also be affected by a status change	77
	U.S. wage laws would apply fully under statehood; amended commonwealth proposals and independence would bring increased local control	77
	Statehood should not change shipping costs, but the effect of an amended commonwealth or independence is speculative	80
	Effects on trade arrangements vary by status option	81
	The effects of a status change on capital cost and availability differ	82
	Energy costs will remain high regardless of a status change	84
	Conclusions	85

	<u>Page</u>
CHAPTER	
7	
U.S. Constitution provides basis for State representation	103
Increases occurred frequently in the House size until 1912	103
Sporadic politically motivated violence presents an uncertain factor in resolving status controversy	103
Dissatisfaction with political status has caused isolated incidents of violence	104
possibility of increased violence discussed	105
Conclusions	105

APPENDIX

I	Synopsis of the history of Puerto Rico's status in United States courts	108
II	Organization chart of the government of the Commonwealth of Puerto Rico	119
III	Methods for estimating the amount of additional Federal aid Puerto Rico would have received if it had been a State in 1979	120
IV	Methods for estimating taxation in Puerto Rico if it had been a State in 1979	127
V	Highlights of financial operations of Puerto Rico government	136

ABBREVIATIONS

AABD	Aid to the Aged, Blind, and Disabled
AFDC	Aid to Families with Dependent Children
EDA	Puerto Rico Economic Development Administration
ESEA	Elementary and Secondary Education Act
FBI	Federal Bureau of Investigation
FLSA	Fair Labor Standards Act
GAO	General Accounting Office

CHAPTER

Page

7	STATUS DEBATE HAS MANY ADDED DIMENSIONS	88
	Cultural convictions are important and emotional concerns	88
	Puerto Rico's culture is distinct, and the Spanish language dominates	89
	Language policy historically has fluctuated, but efforts to improve English proficiency continue	89
	Option for conducting Federal court proceedings in Spanish is advocated	90
	Four States admitted between 1812 and 1912 had language requirements imposed	91
	Recent legislation designed to protect rights of linguistic minorities	92
	Various measures used by other coun- tries to accommodate different lan- guage groups	92
	Widely divergent methods proposed to preserve Puerto Rico's language and culture	93
	International considerations augment status debate	94
	Puerto Rico's status under continuing consideration by U.N. committee, despite U.S. opposition	94
	Status positions include hypotheses of international acceptance	96
	Status proposals offer Puerto Rico varying positions in the interna- tional community	97
	Status debate may include strategic defense concerns	98
	Independence would raise complicated issue of citizenship	99
	U.S. courts have seldom addressed sovereignty changes, but general principles exist	100
	International treaty provisions have resolved nationality problems	101
	Some citizenship questions addressed by independence party proposal	101
	A change in citizenship could affect unrestricted migration	102
	Statehood would present congressional apportionment decision	102

ABBREVIATIONS

GRS	General Revenue Sharing
IRS	Internal Revenue Service
NPP	New Progressive Party
ORS	Office of Revenue Sharing
PDP	Popular Democratic Party
PIP	Puerto Rican Independence Party
PSP	Puerto Rican Socialist Party
SSI	Supplemental Security Income
UN	United Nations
WIN	Work Incentive Program

D I G E S T

Puerto Rico's leaders and populace long have focused on one enduring dilemma--political status. Ardent debates have persisted for decades, but island residents remain divided sharply on whether to retain the present Commonwealth arrangement or petition the Congress for statehood, independence, or an amended form of the current status.

The eventual outcome holds significant consequences for the island and the remainder of the United States because strong legal, human, and economic ties have been forged over the years. Moreover, any status decision involves assessing a perplexing array of concerns. This report identifies and examines the broad range of issues likely to confront Puerto Rico and the Congress in deliberating the island's future status.

DIVERSE FORMULAS FOR FULFILLING
POLITICAL AND SOCIOECONOMIC
ASPIRATIONS FUEL DEBATE OVER
ALTERNATIVE FUTURES

Historically, Puerto Rico steadfastly has pursued greater political powers, and the island has attained gradually more extensive self-governing measures. Since 1952 the Commonwealth of Puerto Rico has exercised local executive, legislative, and judicial authority similar to States. The island's Constitution, patterned after the Federal and State models, provides for three branches of government and guarantees a democratic political system. Regular elections are held, and voter participation is high. (See ch. 2.)

In addition to its political evolution, Puerto Rico's economy, led by manufacturing, has achieved dramatic growth. Once based primarily on agriculture, the economy has been transformed to a modern, industrial one. The island's per capita income is one of the highest in the Caribbean. Further, considerable improvements in housing, health care, education, transportation, and communication services highlight Puerto Rico's social development.

Although substantial progress has been achieved, serious problems remain. Unemployment on the island well exceeds the national average and remains a chronic difficulty for Puerto Rico--one of the most densely populated locations in the world. In 1979 Puerto Rico's per capita income was less than half that of the lowest State, and more than half of island families had incomes below the U.S. poverty level. In addition to finding employment for a predominantly urban, young, and expanding populace, the island faces certain social and health problems as well as difficulties in operating its educational system. (See ch. 3.)

Puerto Rico's socioeconomic problems are intertwined inextricably with the political status question. Criticism of the current status because of its limitations in resolving the island's problems has accentuated status debates. Although recognizing that a status change will not automatically solve all the island's difficulties, participants assert that an alternative framework is required to guide Puerto Rico's development. (See ch. 4.)

Presently, Puerto Rico exercises local self-governing authority and operates within the broader Federal political system. Consequently, the island does not exercise responsibilities within the Federal Government's purview, such as levying tariffs on imports or exports, entering into treaties with foreign governments, coining money, and establishing rules for naturalization. Puerto Ricans domiciled on the island are U.S. citizens, but residents cannot vote in national elections or elect Senators and Representatives to the U.S. Congress. Puerto Ricans, however, help choose presidential candidates and elect a Resident Commissioner to the United States, who in many respects is like a member of the House of Representatives.

All of the island's political parties are dissatisfied with this relationship and have expressed some similar basic concerns. Each argues that aspects of the arrangement do not provide full political and personal dignity and hinder Puerto Rico's ability to meet its socioeconomic needs. Moreover, all status participants, intensely proud of their Puerto Rican heritage, are adamant about preserving and enhancing the island's culture and Spanish language.

Although the desire for greater political rights and equality universally remains the nucleus of the status debate, the island's political parties differ markedly on the preferred alternative. An amended commonwealth is favored by the Popular Democratic Party; the New Progressive Party advocates statehood; and the Puerto Rican Independence and Socialist parties support independence.

Commonwealth proponents maintain that Puerto Rico's present fundamental relationship with the Federal Government has served the island well and should be continued, but changes are necessary. Supporters believe that Puerto Rico needs more flexible treatment in U.S. laws and programs as well as greater authority over several areas controlled by the Federal Government. They assert that greater autonomy is needed to resolve socioeconomic problems, assure the commonwealth principle's viability, and preserve the island's identity. (See pp. 43 to 45.)

Statehood advocates maintain that admission is the inevitable culmination of Puerto Rico's political development and would fulfill the implied promise inherent in Puerto Ricans' U.S. citizenship. They believe that only statehood can bring political equality and dignity as well as assure social justice and economic security. Proponents assert that Puerto Rico's admission is entirely consistent with America's multicultural composition and that statehood would greatly enhance the island's development while increasing its national role. (See pp. 40 to 43.)

Independence supporters believe that association with the United States has been extremely detrimental to the island's development. They maintain that complete autonomy is required to correct Puerto Rico's pressing problems and to extricate the island from U.S. domination. Only through independence, advocates assert, can Puerto Rico attain self-reliance, achieve more equitable socioeconomic development, and protect and enhance the island's cultural and national identity. (See pp. 45 to 49.)

Each status option would bring an alternative political framework and entail important financial, economic, and other considerations. Moreover, each would alter the island's intricate and longstanding relationship with the Federal Government which has influenced greatly

Puerto Rico's development. Although any status' outcome depends on future events, the range of issues and potential impacts to be deliberated vary by status option.

PROPOSALS TO MODIFY COMMONWEALTH
STATUS INCLUDE REQUESTS FOR INCREASED
AUTHORITY, BUT AMENDMENTS HINGE ON
FUTURE DECISIONS

Broad proposals to clarify Commonwealth status and expand island political powers have been advocated in every decade since the Commonwealth was established in 1952. Presently, commonwealth proponents have identified areas where they believe changes are necessary, but they note that more definitive proposals and methods for implementing amendments need to be studied thoroughly and worked out in greater detail.

Consequently, the exact nature of modifications to Commonwealth status are contingent upon future deliberations by Puerto Rico and approval by the Congress. The latest suggested revisions, however, provide some insight into what an amended Commonwealth could entail. (See chs. 5, 6, and 7.)

Although certain amendments are advocated, fundamental elements of the present relationship, such as common citizenship, currency, defense, and duty-free access to U.S. markets, most likely would be maintained. Additionally, the island's exemption from certain Federal internal revenue laws likely would continue along with the Commonwealth government's receipt of U.S. customs duties and certain Federal excise tax collections.

Certain arrangements, however, have been labeled candidates for revision. One notable area involves changing the manner in which Federal funds are provided to Puerto Rico's government. Presently, like States, Federal disbursements are targeted for use in specified programs and projects. The proposed alternative, however, suggests that all grants-in-aid be consolidated into a block grant to permit the island government greater discretion in using these funds.

Other suggested amendments would provide a greater voice in Federal legislation and activities affecting the island. One proposal involves granting the island representation in the U.S. Senate as well as the House of Representatives.

Additionally, in the future, Puerto Rico would not be subject to Federal laws unless specifically mentioned. If included, the island would be authorized to object to new Federal legislation and regulation and have such objections acted upon by the Congress.

Another proposal involves establishing a U.S.-Puerto Rico commission to study whether to retain, modify, or eliminate Federal legislation and regulations already applicable to the island. The commission also would consider the possibility of transferring various Federal functions to the island. It would further examine the desirability of Puerto Rico making gradual contributory payments to the Federal Treasury at a time when the island's economy would not be adversely affected. (See pp. 65 and 66.)

These amended commonwealth proposals would provide greater influence over future Federal actions, and other suggested modifications would increase Puerto Rico's control over areas currently within the Federal purview. Such modifications entail permitting Puerto Rico to establish minimum wage rates and environmental regulations and to participate in establishing immigration quotas. Others include granting Puerto Rico the authority to participate in international organizations, make treaties with foreign countries, and set tariffs on goods imported into the island. Any action in these areas, however, would be consistent with U.S. laws, policies, and international obligations. (See pp. 66 and 67.)

STATEHOOD WOULD BRING NATIONAL
POLITICAL EQUALITY AND PROMPT
MAJOR ADJUSTMENTS

Statehood would ensure Puerto Rico equality in the American political system. The island already is exercising local self-governing authority and its residents are U.S. citizens, but admission would bring equal participation in national matters. As a result, island residents would be entitled to vote in national elections and be represented fully in the Congress, assuring a much stronger voice in Federal activities and legislation. Moreover, as a State the U.S. Constitution would be fully applicable to Puerto Rico as would Federal laws and assistance programs.

Because Puerto Rico presently is treated like a State in most Federal activities, and the

island already provides services similar to those of State and local governments, statehood would not change most elements of the present relationship. Admission, however, would end limitations on any Federal programs where Puerto Rico is treated differently from States. For example, if Puerto Rico had been accorded equal treatment in 1979, island governments and certain residents would have received substantial additional amounts of Federal aid. (See pp. 54 to 56.)

Along with extending added Federal funds, immediate equal treatment under statehood would engender fundamental changes to taxation in Puerto Rico. The island historically has been exempted from most Federal internal revenue provisions and has received rebates of U.S. customs duties and certain Federal excise tax collections. Additionally, in the absence of full Federal taxation, the island government developed a tax system similar to that of the Federal Government rather than those of States. Immediate equal treatment would bring full Federal tax liabilities, eliminate Federal rebates, and likely necessitate adjustments to make Puerto Rico's revenue system compatible with the Federal one while obtaining sufficient funds to maintain public services. (See pp. 56 to 60.)

In addition to prompting changes to island government financing, statehood likely would require major adjustments to Puerto Rico's strategies for attracting business development. The island's industrial growth has resulted largely from extensive investment by U.S. manufacturing firms attracted by Federal and local tax exemptions and other competitive advantages such as common market and currency as well as the availability and relatively low cost of labor. Statehood would not change many factors important to business location decisions, but elimination of Federal tax advantages could entail risks to Puerto Rico's future economic development, particularly if such provisions are rescinded suddenly. (See ch. 6.)

Proponents believe that statehood's intrinsic benefits, such as political stability, increased awareness of Puerto Rico, and greater influence over Federal legislation, would enhance future development, but they recognize that adjustments would be required. Noting that the

Congress has used various measures to assist new States, they maintain that Puerto Rico's unprecedented situation warrants the designing of a unique approach to facilitate a statehood transition. As a result, proponents have identified examples of the type of transitional measures which they believe should be considered in negotiating the terms of any statehood legislation.

Most notably, they have asserted that gradual implementation of full Federal taxation over a 20-year period would be logical and necessary. Other examples of transitional measures which have been suggested to help the new State finance public services and reorient economic strategies include: the Federal Government assuming Puerto Rico's public debt, gradually eliminating Federal tax rebates, temporarily extending exemption from Federal taxes to certain businesses, providing special monetary assistance, and setting aside Federal contracts for manufacturing firms in Puerto Rico. (See pp. 42 and 60.)

In addition to political, financial, and economic issues, other considerations likely could surface during statehood deliberations. For example, questions have been raised regarding the continued official use of Spanish under statehood, but advocates assert that no obstacle exists to admitting a Spanish-speaking State. Clarification of this issue would be contingent upon future decisions by Puerto Rico and the U.S. Government and could entail assessing many varied considerations including Puerto Rico's unique circumstances and past U.S. history. (See ch. 7.)

Additionally, Puerto Rico's military importance to U.S. defenses and its strategic location in the Caribbean--a region vitally important to the United States--could be a factor because statehood would guarantee the current defense arrangements. Further, should Puerto Rico be admitted, the Congress would have to decide whether to reapportion the number of seats in the House of Representatives or increase its size.

INDEPENDENCE WOULD BRING AUTONOMY AND ENGENDER FAR-REACHING CHANGES

Independence would end the current U.S.-Puerto Rico relationship and extend complete autonomy to the island. As a sovereign nation Puerto Rico would possess authority over all governmental

matters. The island no longer would operate within the broader Federal system nor be subject to U.S. laws or regulations.

Because independence would completely revamp the intricate Federal-Puerto Rico relationship, major adjustments would be required. One crucial challenge to the new nation would be compensating for the loss of Federal domestic assistance programs. These integral and longstanding funding sources have become increasingly important to Puerto Rico's income and government revenue. The new nation, however, would be eligible for foreign aid from the United States, other countries, and international organizations. (See pp. 62 to 63.)

Along with its financial role, the Federal Government also has been responsible for regulating many key areas, such as immigration and communications; and providing basic government services including defense, postal, and various safety certifications. An independent Puerto Rico would be confronted with decisions regarding which Federally administered activities to assume and how such new responsibilities would be managed and funded.

In addition to realigning government finances and responsibilities, the new nation would have to reorient its economic structure. Independence would bring Puerto Rico the authority to implement its own monetary, trade, wage, and immigration policies. Additionally, an independent Puerto Rico would be responsible for concluding treaties with the United States and other countries concerning trade, defense, and other important areas.

Independence, however, also would end features of Puerto Rico's relationship with the Federal Government which have influenced greatly the island's economic growth and integrated its economy with that of the United States. Losing common market and currency with the United States and Federal tax advantages that draw U.S. investment would entail risks and require fundamental changes, such as developing alternate export markets and capital sources.

Advocates believe that the political rights and authority inherent in independence would foster the island's development, but they recognize that time and transitional arrangements would be

required to establish a new institutional framework and economic order. Emphasizing that the island's past development has been directed primarily by its association with the United States, the Puerto Rican Independence Party (PIP) has stated that autonomy can be adequately achieved only through an orderly and rational transition to self-reliance. Accordingly, the PIP has identified several transitional measures which are indicative of those which it believes should be considered in negotiating any independence transition. (See pp. 47 and 62.)

To offset the sudden loss of Federal assistance, the PIP has proposed that the Federal Government contribute to a special Development and Economic Reconstruction Fund over a 10-year period. This U.S. foreign aid, which would decrease each year, would help finance essential government activities until the economy is re-oriented, consumption patterns reduced, and other revenue sources developed. (See p. 63.)

The PIP also has suggested that U.S. property and postal facilities be given to the new nation and that certain communications and transportation arrangements be maintained temporarily. Additional postindependence arrangements suggested by the PIP concern the vested rights of beneficiaries in Federal trust funds such as social security, the property rights of American businesses and U.S. citizens, and the immigration of Puerto Rico residents to the United States. (See pp. 63, 64, and 102.)

Other measures have been proposed to enhance the island's ability to reorient its economic development. Most notably, the PIP has advocated proposals for introducing U.S. tariffs gradually, negotiating the change in currency, and extending credit terms and tax arrangements. (See ch. 6.)

Along with financial and economic issues, other considerations would require negotiations during independence deliberations. The most notable areas include how independence would alter the current U.S.-Puerto Rico defense arrangements, including U.S. military facilities and operations, and how the complicated issue of Puerto Ricans' future citizenship would be approached. The PIP has made proposals for eliminating the U.S. military presence and establishing Puerto Rican citizenship. (See pp. 64, 101, and 102.)

CONCLUSIONS

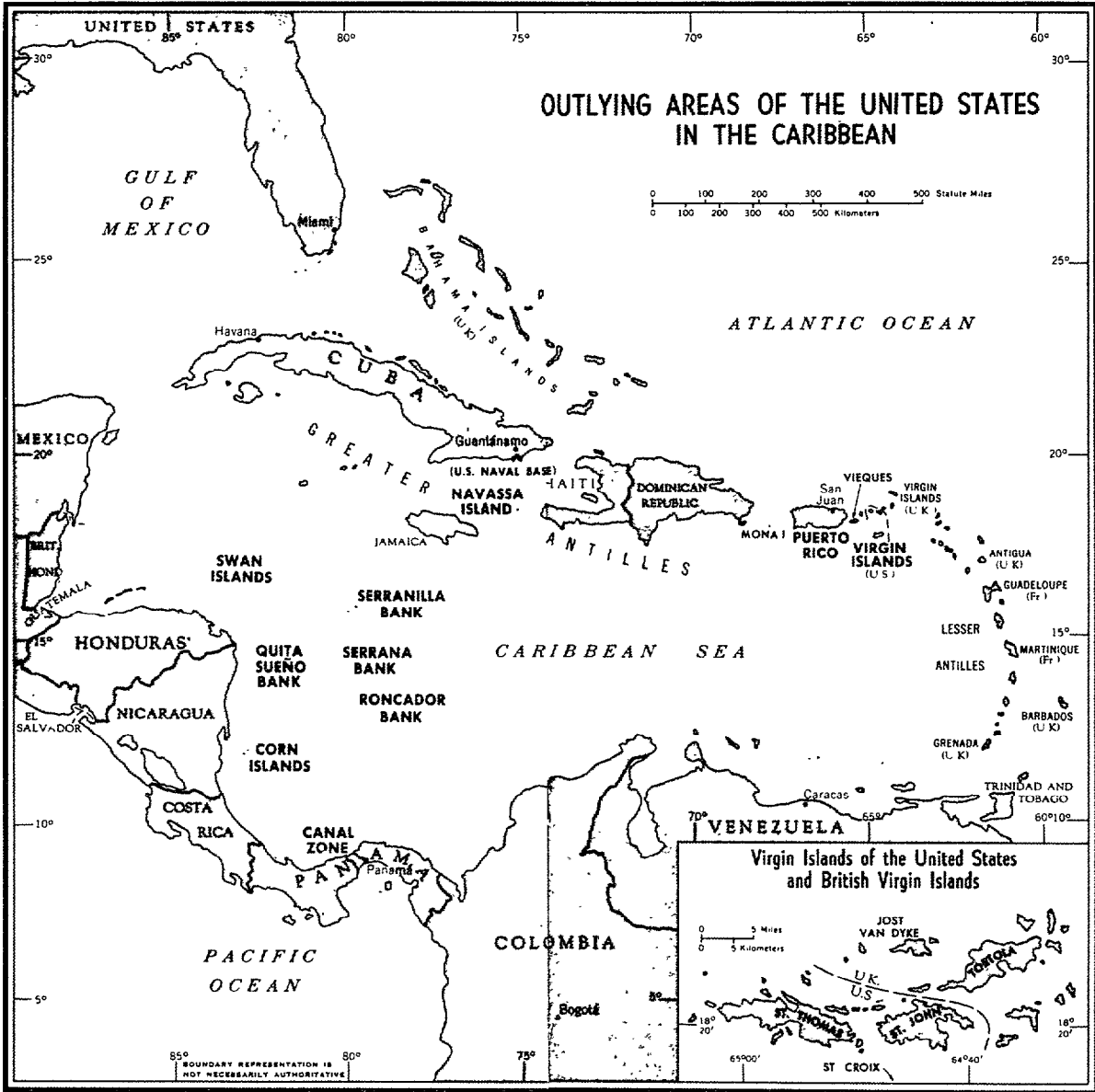
Puerto Rico has made great progress, but fervent debates over conflicting proposals for attaining greater political rights and socio-economic advancement have eluded resolution and perpetuate the island's bitter division over its political destiny. Advocates of amended commonwealth, statehood, and independence remain steadfast in pursuing their status preference.

Compounding ideological and political divisions, each status alternative presents numerous intricate financial, economic, legal, and other concerns. Moreover, the status debate encompasses added dimensions, such as cultural convictions, sporadic incidents of politically motivated violence, and international considerations.

Consequently, resolving the status debate will require much deliberation and hinges on a series of future decisions and events. Among the most important will be decisions regarding the exact terms of any status change as well as policies and strategies concerning economic development, the scope of government services, and revenue sources to finance such activities. Other determinants, perhaps the most crucial, defy quantification because they are based upon personal and political preferences for a future type of society and Puerto Rican identity.

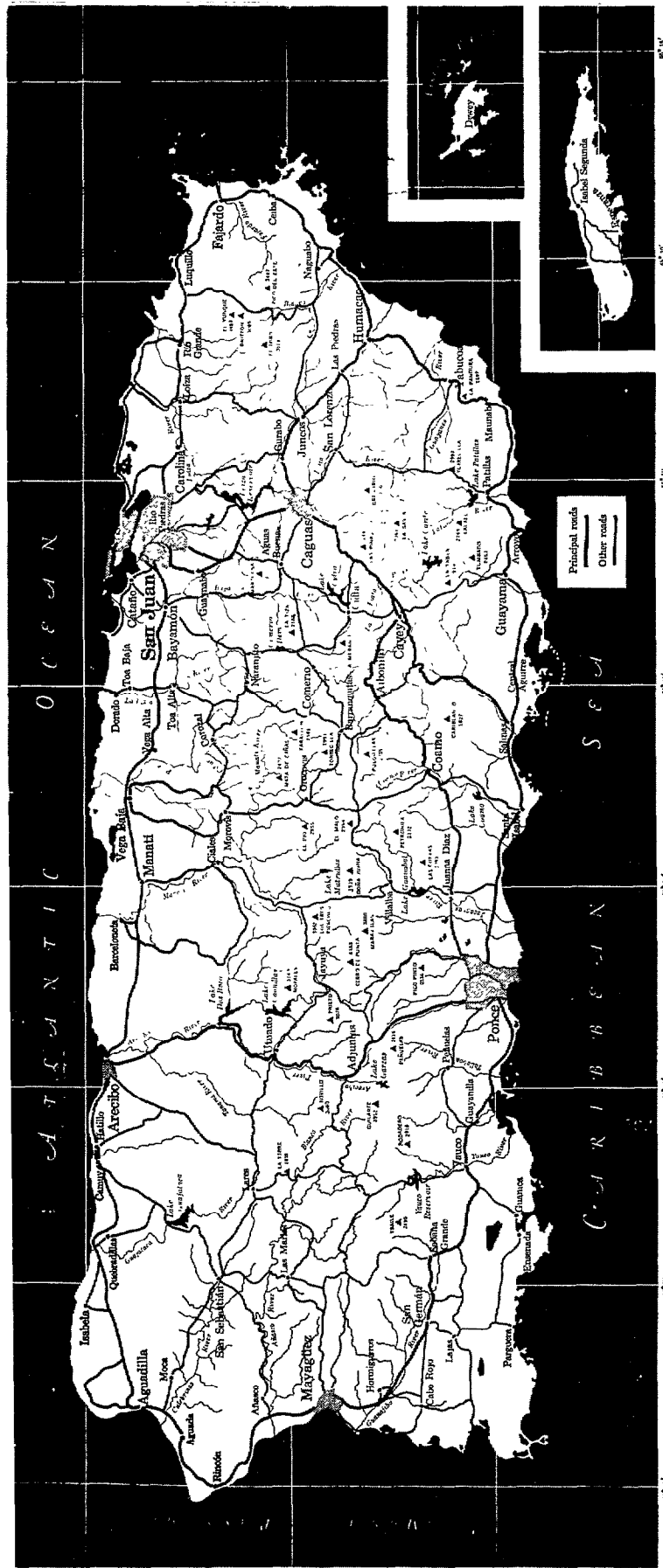
Weighing the status debate's multifaceted issues and selecting the island's preferred future status rests primarily with the Puerto Rican people. The Federal Government also must concur with the selected status and any arrangements designed to facilitate its implementation.

To assist any future status deliberations, this report describes Puerto Rico's development and intricate relationship with the Federal Government and explores issues and potential impacts likely to be addressed by the Congress and Puerto Rico. It highlights areas that warrant further consideration and clarification to enhance deliberations concerning the merits and ramifications of each status alternative.



Source: U.S. Department of The Interior

Map of Puerto Rico



Source: Puerto Rico Office of Federal Affairs, Washington, D.C.

CHAPTER 1

PERSPECTIVES ON APPROACHING PUERTO RICO'S

MULTIFACETED STATUS QUESTION

Puerto Rico is attracting greater attention as its prolonged status debate intensifies. The island's over 3 million residents are divided sharply on whether to retain the present Commonwealth arrangement, or petition the Congress for statehood, independence, or an amended form of the current status. Whatever selection is made, the question of Puerto Rico's political status has emerged as a complex and sensitive national and international issue.

Deciding the island's future status rests with its residents and the Congress. Historically, when approving status changes for U.S. territories, the Congress has adhered to the territories' wishes, as they coincided with U.S. interests. The Congress has been guided by tradition, but it also has been adaptable in considering and legislating status conversions.

In deliberating Puerto Rico's future status, island residents and the Congress will confront a complicated array of political, economic, cultural, legal, and other issues. Puerto Rico has made great strides in self-government and socio-economic development; however, aspirations for equality and greater political rights remain fervent and divisive, and serious social and economic problems persist. The island shares many strong bonds with the States, but it also possesses many unique characteristics. Additionally, Puerto Rico's development has been greatly influenced by several special and complex arrangements with the Federal Government which could be affected by a status change.

Consequently, resolving Puerto Rico's future status entails many difficult decisions and the potential need for various adjustment measures. The eventual outcome holds significant consequences for the island and the remainder of the United States. This report should enhance understanding of Puerto Rico's unique development and assist the Puerto Rican people and the Congress by helping to clarify issues to be addressed during status deliberations.

DIVERSE ASPIRATIONS FOR GREATER POLITICAL RIGHTS, EQUALITY, AND SOCIOECONOMIC PROGRESS FUEL DEBATE OVER ALTERNATIVE FUTURES

Once under Spanish, then U.S. sovereignty, Puerto Rico has steadfastly pursued greater local self-governing authority and political powers. The island has attained and exercised self-governing rights and responsibilities similar to States and has remained a stable democratic community for many years.

In addition to its political development, Puerto Rico has made impressive social and economic progress through innovative efforts, diligence, and effective leadership. These factors, coupled with Federal cooperation and assistance, fostered Puerto Rico's rapid evolution to a modern industrial society with one of the highest per capita incomes in the Caribbean and a life expectancy greater than the U.S. standard.

During Puerto Rico's political and socioeconomic development, strong legal, human, and economic ties have been forged between the island and the remainder of the United States. The most prominent include common citizenship, defense, currency, and market; substantial and continual migration of Puerto Ricans between the island and the States; "statelike" treatment in most Federal programs and activities; and considerable investments in Puerto Rico by U.S. corporations.

While fostering these bonds, the development of Puerto Rico's legal relationship with the Federal Government also produced several unique features. For example, most island residents, businesses, and many U.S. corporations operating in Puerto Rico are in effect exempt from paying Federal income taxes. Additionally, island residents cannot vote in presidential elections, do not have full voting representation in the Congress, and cannot participate fully in all Federal programs.

Such differences are among many factors which spur discussions over Puerto Rico's political destiny. Growing criticisms that the current Commonwealth status has political and economic limitations in solving the island's difficulties also accentuate these debates. Although substantial progress has been achieved, many serious social and economic problems remain. Chronic unemployment, an extremely high population density, a shortage of educational facilities, and a per capita income which is about half that of the lowest State are among the most often cited.

Puerto Rico's social and economic problems are intertwined inextricably with the political status question. All major political parties in Puerto Rico believe that their status option is a prerequisite to resolving the island's continuing ills. Although not viewed as a panacea, each status alternative involves establishing a new framework to guide the island's future social and economic evolution.

Each option, however, is based on a divergent political ideology and belief about the type of society and identity that is best for Puerto Rico. While one party believes the answer lies with statehood, another contends that Puerto Rico could best be served through an amended form of Commonwealth status, while two others support independence.

Although widely different alternatives have been debated with fervor and emotion, the underlying desire for greater political rights, social and economic advancement, and dignity universally

remains the nucleus and driving force behind the status debate. Many participants contend that the continuing status question has protracted Puerto Rico's search for a solidified identity and perpetuated feelings of inequality, dependency, isolation, and lack of adequate control over the island's future. Some believe that the current relationship contains many aspects of colonialism and maintain that the present arrangement has deterred the island's general development and increased its dependency on the Federal Government. Another assertion is that the divisive status debate hampers unified efforts to resolve social and economic difficulties and continues the island's fragmentation into distinct groups.

Dissatisfaction with the current status has intensified. Amended commonwealth, statehood, and independence proposals have been made, but no direct vote on the status issue has been held since 1967. Although a proposed 1981 status plebiscite has been postponed, the status debate will continue unabated because all political parties remain committed to pursuing an alternative relationship with the Federal Government.

Interest in Puerto Rico's status controversy has not been confined to the island. In 1978 President Carter pledged to support whatever status the Puerto Rican people selected. In August 1979 the Congress reaffirmed Puerto Rico's right to self-determination. Both the national Democratic and Republican party 1980 platforms contained commitments to support a status change request. Moreover, the United Nations Decolonization Committee has had the status question under continuing consideration since 1972.

INITIAL DECISIONMAKING FRAMEWORK
EMANATES FROM EXPERIENCES OF PAST
TERRITORIES

The fundamental principles to be applied during any status deliberation are well-rooted in American history. The U.S. Constitution grants the Congress broad authority over territories and permits it great flexibility in admitting States or granting independence. Historically, in deliberating and legislating status changes, the Congress has emphasized the traditional principles of democracy, population, and economic capability and adhered to the territories' choices of self-government, while also considering U.S. interests and each applicant's distinct characteristics.

Following the Revolutionary War, the Congress conceived a framework to guide the first U.S. territory 1/ from an embryonic

1/For this report, a territory is defined as a part of the United States that is not a State. The District of Columbia is not included in this definition.

institution through self-governing stages until its final status was achieved. The process has grown in complexity over the years and has been applied flexibly. Since the 13 original States were formed, 37 additional States have been admitted to the Union, and one territory has opted for independence.

Although not necessarily establishing promissory or restrictive precedents, experiences of past territories can provide insight into issues likely to be deliberated by Puerto Rico and the Congress. Like Puerto Rico's debate, past status discussions centered on quests for greater political rights and equality and involved various other considerations.

After the initiative came from the territory, the Congress typically deliberated certain fundamental areas, such as the applicant's progress in self-government; social and economic development; population size and composition; geography; government organization, functions, and finances; and any unique circumstances. During such deliberations, the specific terms of the new status were worked out between the territory and the Congress. In some cases residents also were required to approve provisions of the status change legislation before the new relationship could become effective.

When evaluating statehood applications, the Congress has used its broad authority and has been guided by three admission principles. The Senate Committee Report accompanying the most recent admission act sets forth these standards as follows:

"(1) That the inhabitants of the proposed new State are imbued with and sympathetic toward the principles of democracy as exemplified in the American form of government;

(2) That a majority of the electorate desire statehood; and

(3) That the proposed new State has sufficient population and resources to support a State government and to provide its share of the cost of the Federal Government."

The Congress has been guided by tradition, but it also has been adaptable and used discretion in applying these principles. In assessing political and financial information during statehood deliberations, the Congress has usually required or prohibited certain practices as admission conditions and provided land grants and other transitional assistance to foster economic development and support public services.

Although statehood deliberations have resulted in some trends, the Congress' broad authority--combined with each State's unique characteristics and the increased complexity of government responsibilities--has led to many variations in admission procedures, time elapsed before attaining statehood, prerequisite conditions, and assistance provided.

Many elements considered during statehood deliberations also were analyzed when the Congress accepted the only decision by a U.S. territory to become independent. Throughout the Philippines' efforts to gain autonomy, the Congress closely monitored the territory's progress in self-government and social, fiscal, and economic development. Also, the Congress required that certain conditions be met and enacted special trade preferences and other measures to assist the Philippines' transition to independence.

The various procedures and terms established in admitting States and granting independence were analyzed in detail in our March 7, 1980, report entitled "Experiences of Past Territories Can Assist Puerto Rico Status Deliberations," GGD-80-26.

THE OBJECTIVE OF THIS REPORT IS TO ASSIST,
NOT RESOLVE, STATUS DELIBERATIONS

Whatever status is attained depends primarily on the expressed desire and sustained determination of the Puerto Rican people. The Federal Government also would decide whether to approve the selected status and any arrangements designed to facilitate its implementation. This will be a difficult and confusing process because it involves deliberating a perplexing array of political, legal, social, economic, and cultural issues.

Anticipating a status decision and citing a lack of comprehensive information, Senator Johnston of Louisiana and Resident Commissioner Corrada of Puerto Rico requested that we examine what a status change would entail, so that the Congress and Puerto Rico would have data prior to making a status determination. Discussions with the requesters and congressional committee offices, Puerto Rican officials and leaders, and others confirmed the need to identify and clarify the potential impacts and issues of a status change.

Each alternative presents diverse considerations because of Puerto Rico's political, social, and economic characteristics and the island's unique development. Although several factors can be gauged, many remain unknown because they depend on future arrangements regarding the exact terms of any new status. Others, perhaps the most crucial determinants, defy quantification because they are based on political ideology and preferences for a future type of society and identity for the Puerto Rican people.

The relative importance and dimensions of political, social, cultural, and economic considerations have to be assessed by each Puerto Rican on the basis of his or her personal values and beliefs. Because any status decision rests primarily with island residents, the purpose of this report is not to identify an "appropriate or best status alternative" nor to prioritize considerations in resolving the status debate. Rather, its objective is to help identify and clarify subjects to be addressed during status deliberations.

SCOPE AND METHODOLOGY

Before Puerto Rico's status can be changed, in all likelihood, several events would transpire. Most notably, the Puerto Rican people would select the desired status, the Congress would decide whether to approve this choice, and the exact terms would be negotiated between Puerto Rico and the Congress (these are not necessarily in any particular order).

Because these factors hinge on numerous future determinations, so does the outcome of any status alternative. The initial framework for making these determinations, however, can be developed; thereby providing insight into issues to be deliberated during Puerto Rico's evolving discussions over alternative status options.

This report provides an analytical foundation to enhance deliberations by the Puerto Rican people and the Congress. It describes Puerto Rico's unique evolution and explores status change issues and potential impacts that may require detailed consideration, further study, and new or transitional arrangements. Specifically, this report:

- Profiles Puerto Rico's political, economic, and social development.
- Summarizes each status proposal and its underlying ideology.
- Provides a detailed description of Puerto Rico's present legal, financial, and intergovernmental arrangements with the Federal Government, and analyzes how they would be affected by statehood, independence, and an amended form of the current status. It identifies what components would change and examines the magnitude of consequences that could occur.
- Describes the potential financial and other repercussions of a status change on the Puerto Rican people and government; Puerto Rico's strategies for attracting and retaining business investment; and the Federal Government.
- Identifies legal, social, and other issues of a status change, such as language and cultural concerns and international considerations.

Factors inherent in Puerto Rico's unique relationship with the Federal Government might prompt measures to minimize disruptions caused by a status change. Because the specific terms of any status change are presently unknown, our analysis concentrated on what changes would occur if Puerto Rico's present arrangement with the Federal Government was replaced immediately with the basic Federal-State model or U.S.-Sovereign nation relationship.

Similarly, our analysis of an amended commonwealth relationship was based on general proposals to amend the present status.

This report does not predict the necessary policy decisions by Puerto Rico and the Congress, nor develop and assess specific terms. However, it does describe arrangements under consideration by the island's political parties. The parties believe that transitional plans need to be considered when deliberating and implementing their status options.

In conducting this study, we analyzed Federal and Commonwealth government documents, reports, and other materials; studied pertinent Federal and Commonwealth legislation; held numerous meetings with officials in Federal and Commonwealth government agencies and with academic experts, business organizations, and others; examined prior studies, reports, or publications by the Commonwealth government, the Congressional Research Service, the U.S. Department of Commerce, and many others; reviewed political party platforms and various other published documents explaining the status alternatives; and invited each of the island's major political parties to provide us with information concerning their status ideology and proposals.

Each status option advocates granting Puerto Rico greater political rights and entails many social, economic, and legal considerations. The next two chapters describe the island's past development--politically and socioeconomically. Building upon this prerequisite foundation, subsequent chapters analyze the numerous issues and potential impacts of Puerto Rico's status alternatives--statehood, commonwealth, or independence.

CHAPTER 2

PUERTO RICO'S EVOLUTION TOWARD GREATER SELF-GOVERNMENT

ESTABLISHES FOUNDATION FOR STATUS ANALYSIS

Puerto Rico gradually has attained local self-governing powers like States and has exercised these responsibilities for many years. The island's Constitution, patterned after the Federal and State models, provides for three branches of government and guarantees a democratic political system. Regular elections are held for municipal assemblymen up through governor, and voter participation is high.

The island consistently has sought greater self-government and political rights but is divided on how to continue its political evolution--as a state, an independent nation, or a commonwealth with greater political powers. While Puerto Rico's ultimate status remains open, the development of its unique relationship with the Federal Government provides the foundation for assessing what change each status option entails.

HISTORIC PURSUIT OF POLITICAL RIGHTS LED TO CURRENT RELATIONSHIP WITH THE FEDERAL GOVERNMENT

Puerto Rico steadfastly has pursued increased control over internal matters and political equality since the latter stages of Spanish dominion. Such efforts persisted after the island was ceded to the United States. Since that cession Puerto Rico has been foremost among all present U.S. territories in gaining self-governing rights which today are similar to States.

During this development, close ties between Puerto Rico and the remainder of the United States have been fostered through such factors as common citizenship and market. Conversely, unlike States, Puerto Ricans and others domiciled on the island cannot vote in national elections or elect Senators and Representatives to the Congress. Further, the island is exempt from most Federal internal revenue laws and is treated differently from States under some Federal programs and is not subject to the full application of the U.S. Constitution.

The fiscal and other effects of these features are discussed in subsequent chapters, and they are an outgrowth of the framework developed as Puerto Rico's legal relationship with the Federal Government evolved. This unique development has produced several special arrangements and controversies through legislative and judicial determinations.

Puerto Rico's quest began under Spanish rule

Originally discovered by Columbus in 1493, Puerto Rico remained under Spanish control from the early 1500s until the 1898 Spanish-American War. During the 16th through 18th centuries, governing powers rested with a Governor-General, appointed by Spain, who also exercised great control over social matters. Opportunities for political expression and a voice in government were extremely limited.

In the 1800s, however, an attitude of revolution and reform prevalent throughout the Spanish empire, a rapid rise in Puerto Rico's population, and an increased awareness of Native culture and identity fostered movements for increased political autonomy. Although granted some limited political rights, such as Spanish citizenship and representation in the Spanish Parliament, Puerto Rico continued a prolonged struggle to gain greater self-governing measures.

Eventually, the island obtained increased participation in managing its own affairs through the Charter of 1897, which established two local governing bodies--the Chamber of Representatives and the Council of Administration. Puerto Rico elected all Chamber members and 8 of the 15 Council members. These coequal houses, known as the insular parliament, had powers over local matters not specifically reserved by Spain. Cabinet secretaries were chosen from the Council or the Chamber by the Governor-General and were responsible to the insular parliament. Although his powers were reduced, the appointed Governor-General kept control of the military. He was also empowered to name seven Council members, suspend certain civil rights, and refer legislation to Spain if he saw it as detrimental or unconstitutional. In addition, Islanders could elect delegates with full voting rights to the Spanish Parliament. The Charter could not be amended except by law and upon petition of the insular parliament.

Because it was short lived, the Charter's practical application was never tested. The Spanish-American War began before the island legislature's first meeting on July 17, 1898. Eight days after the meeting American troops arrived, beginning a 2-year military occupation.

Spanish-American War brought U.S. sovereignty

Following the War's conclusion, Puerto Rico was ceded to the United States through the December 1898 Treaty of Peace. Initially, U.S. military governors attempted to improve social conditions and provided a temporary government for the approximately 1 million Islanders. Economic development was hampered because tariffs on Puerto Rican goods continued. Two commissions, appointed to formulate U.S. policy, concluded that

most Islanders were willing to be associated with the United States and that a civil government should be instituted. According to the treaty, however, decisions on the Islanders' civil rights and political status rested with the Congress.

The Congress passed Puerto Rico's first Organic Act on April 12, 1900, terminating the military administration and establishing a civil government with executive, legislative, and judicial branches, effective May 1, 1900. Known as the Foraker Act, this legislation vested executive authority primarily in a presidentially appointed Governor and 11-member Executive Council, with 6 members holding high administrative positions. Although all Council positions were appointed by the President, at least five Council members were required to be Puerto Ricans.

This Council and the House of Delegates, a 35-member locally elected body, constituted the island's Legislative Assembly, which could pass laws on "all matters of a legislative character not locally inapplicable." Like in other territories, however, the Congress could annul any local law--a right held but never exercised for Puerto Rico.

The judicial system consisted of a presidentially appointed Supreme Court and a district court selected by the Governor. This system had jurisdiction over local matters and was the same as the one established by the military already in operation. A U.S. District Court also was established to hear Federal cases.

The Organic Act established certain political and financial ties with the Federal Government. All U.S. laws not specified as locally inapplicable were to apply equally to Puerto Rico. For example, Federal internal revenue laws were not extended to the island. Island residents were deemed citizens of Puerto Rico and under U.S. protection. Also, U.S. currency was to be official legal tender, and a Resident Commissioner was to serve as an official representative to the United States.

To provide government revenue, the Organic Act specified that most goods imported into Puerto Rico were subject to full U.S. tariffs and the proceeds remitted to the island. Also, temporary duties and taxes on goods shipped between Puerto Rico and the United States would be returned to the Puerto Rican treasury. These temporary levies were to be discontinued no later than March 1, 1902. By then, the Puerto Rican legislature was to have enacted a complete taxation system, and merchandise shipped between Puerto Rico and the States would be free from U.S. tariffs.

Because these temporary levies were different from the free trade arrangements between the States, the issue prompted much controversy. The measure of self-government to be given, the Islanders' legal status, and the extension of the U.S. Constitution were also highly debated topics. Discussion over

these issues did not cease after the Organic Act was enacted because the debates were taken up in the courts.

U.S. Supreme Court decided Puerto Rico was not an incorporated territory

In the beginning of the 20th century the United States Supreme Court decided the Insular cases. In the principal case involving Puerto Rico, the Court had to determine if the Organic Act provision imposing temporary duties on Puerto Rican exports conflicted with the U.S. Constitution's Uniformity Clause, which required that "* * * all Duties, Imposts and Excises shall be uniform throughout the United States."

In sustaining the Organic Act provision, the doctrine of territorial incorporation was formulated. The doctrine provided that if a territory were incorporated, all parts of the U.S. Constitution would be applicable; but if unincorporated, only the fundamental parts applied. Because the Treaty of Peace, unlike all previous territorial acts, did not contain provisions for incorporation, Puerto Rico was not incorporated and thus the Congress was not bound by the Uniformity Clause.

Because of subsequent court decisions, it is questionable whether the rationale behind the Insular cases would be currently applicable. Further discussion of the distinction between incorporated and unincorporated status and the applicable constitutional provisions is contained in appendix I, "Synopsis of the History of Puerto Rico's Status in United States Courts."

1917 Organic Act included U.S. citizenship and locally elected legislature

Many Puerto Ricans voiced disapproval of the first Organic Act because they believed it did not provide as much autonomy as the 1897 Spanish Charter. Consequently, they pressed for greater self-government, such as a totally elected legislature. After sustained attempts (delayed by World War I), revisions were granted in March 1917.

This new Organic Act, known as the Jones Act, marked a major step toward home rule. It included a bill of rights and authorized a popularly elected 19-member Senate as a coequal companion to the 39-member House. The Executive Council was divested of its legislative role, and most of its members were to be appointed by the Governor, rather than presidentially appointed. Puerto Rican Supreme Court Justices, the Governor, and several council members, however, continued to be appointed by the President. Although granting more self-governing powers, the Congress retained the right to nullify any local law. Also, the Governor could refer legislation to the President for final disposition

if the Governor's veto was overridden. This procedure was exercised only three times, all in the 1940s.

The Jones Act also extended U.S. citizenship to Puerto Ricans who desired it. Like the original act, however, the Jones Act did not solve the island's ultimate status. In 1922 the U.S. Supreme Court reaffirmed that these revisions did not incorporate Puerto Rico into the Union. Although recognizing that citizenship was an important factor, the Court stated that incorporation depended upon a clear and deliberate action by the Congress.

An elected governor--another step toward greater self-government

Although the new Organic Act provided a fully elective legislature, questions concerning the island's ultimate status remained, and requests for increased autonomy continued. For example, Puerto Ricans argued that although they were U.S. citizens subject to the military draft, their participation in national affairs was limited.

Legislation passed in 1947 authorized Puerto Rico to select its own governor and enabled the governor to appoint executive officials. However, like all its predecessors, the act did not determine the island's final status, and the Congress still retained the power to annul legislation.

Greater home rule--Constitution established and Commonwealth formed

Dissatisfaction with this remaining Federal jurisdiction propelled movements for increased local control. In 1950, the Congress authorized Puerto Rico to organize a constitutional government. This legislation specified that the constitution was to be republican in nature and include a bill of rights. After the populace approved the law, a constitutional convention was held.

Three of the island's four major political parties had delegates elected to the constitutional convention. One party refused to nominate candidates because the convention "did not have the constituent authority necessary to make Puerto Rico a free and independent republic." The constitutional convention met initially on September 17, 1951, and completed its work in February 1952. On February 6, the convention delegates approved a Constitution by 88 to 3.

Following congressional and local approval the Constitution of the Commonwealth of Puerto Rico became effective on July 25, 1952, and certain sections of the Organic Act were repealed. Thus, Federal responsibility in purely local matters terminated, and, like States, local executive, legislative, and

judicial authority rested with Puerto Rico. The remaining sections of the Organic Act became the Puerto Rican Federal Relations Act.

Puerto Rican Federal Relations Act
contains present basic arrangements

Current fundamental arrangements between the island and the Federal Government are described in the Puerto Rican Federal Relations Act, as amended. Among other provisions this act continues Puerto Rico's exemption from certain U.S. internal revenue laws. Excise taxes on certain Puerto Rican goods domestically produced and transported to the United States are returned to the island treasury, as are U.S. tariffs on foreign goods imported into the island.

Provisions for U.S. citizenship and free trade between Puerto Rico and the States are also continued. Puerto Rico has control of all public lands and buildings, highways, harbor areas, streams, and submerged lands not reserved for Federal Government purposes. A Resident Commissioner continues to represent island residents in the United States. The act also provides that U.S. laws not locally inapplicable shall apply equally to Puerto Rico and describes the U.S. District Court's jurisdiction to hear Federal cases.

Varying concepts of Commonwealth

Although the Commonwealth was recognized as a further step toward self-government, different interpretations regarding the island's relationship with the Federal Government have arisen. Prior to the 1952 Commonwealth, Puerto Rico was considered an unincorporated territory. Since then, the question of whether Puerto Rico's status has changed has been the subject of much analysis and debate. Some believe that the Commonwealth is a new entity and no longer a territory within the meaning of the territorial clause of the U.S. Constitution. While some consider the Commonwealth another type of unincorporated territory short of statehood, still others contend that it did not change Puerto Rico's political and legal status.

Congressional committee reports disclosed that the Commonwealth status provided more self-government but would not "preclude a future determination by the Congress of Puerto Rico's ultimate political status [and] "* * * would not change Puerto Rico's fundamental political, social, and economic relationship to the United States." However, the precise legal definition of Commonwealth has not been determined. The 1966 report by the Commission on the Status of Puerto Rico noted that this unclear legal relationship is not a unique situation.

"In short, a Federal relationship--whether it be commonwealth or statehood--is never completely clear. Rather there is a necessary and

desirable obscure fringe area which permits many legal, political, and practical adjustments to take place. It is true that Commonwealth has many areas of uncertainty because it is novel. But it is also true that commonwealth like statehood has many areas of uncertainty because of the nature of a Federal relationship."

The U.S. Supreme Court has not directly considered Puerto Rico's status since 1922. The issue has been discussed in lower Federal courts and the Puerto Rico Supreme Court, but these rulings did not clarify the broad status issue. Further discussion of U.S. court cases dealing with Puerto Rico's status is contained in appendix I.

PUERTO RICO'S GOVERNMENT
RESPONSIBILITIES AND STRUCTURE
ARE SIMILAR TO STATES

Although the island's present relationship with the Federal Government has not been defined precisely, Puerto Rico exercises virtually the same control over its internal affairs as the States. Also, the island's Constitution provides for a government structure similar to that of the Federal Government and the States. In fact, Puerto Rico was the first of the present U.S. territories to have a congressionally approved constitution and locally elected Governor.

The island freely manages local affairs and also operates within the broader Federal political system. Presently, like States, Puerto Rico does not exercise responsibilities within the Federal Government's purview, such as levying duties or imposts on imports or exports, entering into treaties with foreign governments, coining money, and establishing rules for naturalization.

Commonwealth Constitution modeled
after U.S. and State constitutions

Most of the Commonwealth Constitution's provisions were adopted directly from the U.S. and State constitutions. Puerto Rico's Constitution provides for three separate independent branches of government--executive, legislative, and judicial--with appropriate checks and balances. An organization chart of Puerto Rico's government is included as appendix II. The Commonwealth Constitution also includes an extensive Bill of Rights essentially derived from the traditional protections contained in Federal and State constitutions.

Although there is much similarity, the Commonwealth Constitution contains provisions not in the U.S. Constitution. Examples include

- popular majority ratification of constitutional amendments;

- prohibition of sex discrimination, wire-tapping, and the death penalty;
- jury conviction in a felony case by three-fourths majority vote;
- minority party representation in the legislature equal to each party's elective strength; and
- employees' rights and protections for equal pay, the work environment, and collective bargaining.

Some of these provisions, however, are present in other Federal laws or in the constitutions or laws of one or more States.

Executive power vested
with an elected governor

The Commonwealth government's executive authority rests with its Governor. The Governor is responsible for executing Commonwealth laws and can make appointments, grant pardons and reprieves, and approve or disapprove joint resolutions and bills passed by the legislature. The Governor must also report annually on the Commonwealth Treasury's condition and the proposed expenditures for the ensuing fiscal year and present a message concerning the Commonwealth's affairs when each regular legislative session begins.

The Governor is Commander-in-Chief of the militia, which is the National Guard, and can order it to prevent or suppress rebellion, invasion, or any serious public disturbance. Although the Governor can proclaim martial law, the Legislative Assembly must convene immediately and either ratify or revoke the Governor's proclamation.

The Governor is popularly elected in general elections held every fourth November. A gubernatorial candidate must be at least 35 years old as well as a U.S. citizen and a citizen and bona fide resident of Puerto Rico for the preceding 5 years. No limit exists on the number of terms that the Governor can be reelected.

In addition to prescribing the Governor's powers, the Commonwealth Constitution establishes various executive departments, headed by Secretaries, appointed by the Governor with the advice and consent of the Senate. The Constitution also establishes the position of Secretary of State, whose appointment must be approved by both legislative houses. The Secretary of State succeeds the Governor in case of a permanent or temporary vacancy in that office.

Executive branch responsibilities are similar to those in States, but more extensive. For example, they include:

education, health, police and fire protection, telephone communications, electricity, water, and maritime transportation. The executive branch presently includes the Office of the Governor, 14 departments, 38 agencies, and 43 public corporations. The Commonwealth government's operations are discussed further in appendix V.

Popularly elected
bicameral assembly executes
legislative functions

The Commonwealth Constitution provides that "The legislative power shall be vested in a Legislative Assembly * * *." The Assembly is bicameral and convenes annually from the second Monday in January through April. Each house is led by an officer--the Senate by the President and the House of Representatives by the Speaker. Although special sessions may be called only by the Governor, regular sessions may be extended indefinitely by joint resolution.

A majority of both houses must approve bills before they are submitted to the Governor, who has 10 days to sign the bill into law or return it with objections. If the Governor does not act within 10 days the bill becomes law. Also, a returned bill can become law if two-thirds of each house approve it.

The Legislative Assembly also has the power to create, consolidate, or reorganize executive departments and define their functions. Further, it has broad authority over local municipalities. The Assembly is also responsible for approving the Commonwealth's budget and determining how the Commonwealth and the municipalities impose and collect taxes. Moreover, the Assembly may propose constitutional amendments by concurrent resolution, approved by at least two-thirds of each house.

Legislative Assembly members are popularly elected in general elections and serve 4-year terms concurrent with the Governor. Legislators must read and write Spanish or English and be citizens of the United States and Puerto Rico. Minimum age for Senators is 30 years old and Representatives 25 years. Also, all legislators must have resided on the island at least 2 years immediately prior to election.

The Legislative Assembly consists of 27 senators and 51 representatives. Two senators are elected from each of 8 senatorial districts, and 11 others compete for "at large" seats. Representatives are elected from 40 districts, 1 member from each, and 11 "at large."

Additionally, in certain situations if more than two-thirds of the members in either house are elected from a single party, such number of members may be increased so that the total number of minority members can be 9 in the Senate and 17 in the House. With more than one minority party, seats are apportioned

according to each group's electoral strength. This unique constitutional provision has been used to assure representation of minority parties in the legislature approximating their voting strength on an island-wide basis.

The Commonwealth Constitution also establishes an independent Controller who is principally responsible to the Legislature. The Controller, appointed by the Governor with consent of the Legislative Assembly to a 10-year term, is charged with auditing all revenues, accounts, and expenditures of the Commonwealth, its agencies and instrumentalities, as well as local municipalities.

Unified judicial system mandated

The Commonwealth Constitution provides for a unified judicial system for purposes of jurisdiction, operation, and administration. The Constitution vests judicial power in a Supreme Court and any courts as may be established by law. It also empowers the Legislative Assembly to create and abolish courts, except for the Supreme Court, in a manner not inconsistent with the Constitution, and to determine courts' venue and organization.

The Assembly exercised this authority by passing the Judiciary Act of 1952, which vested judicial power in a General Court of Justice--composed of the Supreme Court and the Court of First Instance. The Supreme Court is almost exclusively a court of appellate jurisdiction although it does have original jurisdiction to hear habeas corpus petitions and other causes and procedures conferred on it by law. The Court can hold laws unconstitutional, but only by majority of the Court's Justices. The Court is authorized to adopt rules for administering Puerto Rico courts and rules of evidence and civil and criminal procedure, subject to legislative approval. The Court's decisions may be appealed to the U.S. Supreme Court in the same kinds of cases that can be appealed from the highest State courts.

Currently, Puerto Rico law provides that the Supreme Court have seven Justices--a Chief Justice and six Associate Justices--appointed by the Governor upon the advice and consent of the Senate. Justices must be citizens of Puerto Rico and the United States, residents of Puerto Rico for at least 5 years prior to appointment, and admitted to practice law in Puerto Rico at least 10 years prior to appointment. Moreover, Justices serve indefinite terms, and the size of the Court can be changed "only by law upon request of the Supreme Court." Furthermore, Justices cannot participate in political campaigns, contribute to political parties, or hold elected office.

The Court of First Instance has original jurisdiction over civil and criminal proceedings and is comprised of two divisions--the Superior Court and the District Court. Although the

1952 act specifies cases to be heard in these courts, each division can hear a case if the concerned parties and the judge agree. The Superior Court also hears appeals from final judgments of the District Court. Court of First Instance judges are appointed by the Governor for specified terms with advice and consent of the Senate.

As mentioned earlier, the U.S. District Court for the District of Puerto Rico hears Federal cases. Appeals from this Court are treated essentially like those from other Federal District Courts. The island's official courtroom language is Spanish, except in the Federal District Court where English is required. Although attempts have been made to allow certain proceedings in Spanish, legislation has not been enacted. (See pp. 90 and 91.)

Municipalities are the only level of local government

The Commonwealth Constitution empowers the Legislative Assembly to create, abolish, consolidate, and reorganize municipal subdivisions. Municipalities cannot be abolished or created, however, unless a majority of their voters ratify the legislation. The Legislative Assembly also determines how municipalities can impose and collect taxes and authorizes them to develop programs and create agencies for the general welfare.

The island is divided into 78 municipalities ranging from small rural towns to metropolitan cities. Each municipality has a mayor and assembly, popularly elected to serve terms concurrent with the Governor and Commonwealth legislature. To qualify for municipal office, a candidate must be able to read and write Spanish or English and be a resident and qualified voter of that municipality.

Each municipality can levy certain sales taxes, but responsibilities vary. Major public services, however, are generally provided by the Commonwealth government. Municipalities' revenue sources and services are discussed further in appendix V.

PUERTO RICO LAW IS A BLEND OF CIVIL AND COMMON LAW TRADITIONS

Prior to becoming a U.S. territory, Puerto Rico law was based on Spanish civil law--Spain's version of the civil law system developed primarily in continental Europe under the influence of Roman Law. In England and subsequently in nearly all of the United States, common law prevailed.

Civil law and common law differ principally in the way law is created. In a civil law jurisdiction, the legislature establishes laws primarily by enacting codes with broad provisions. Civil law courts look to codes as primary sources of law. Court decisions usually are neither primary sources of law nor binding

on other courts, even though they are consulted as aids in the decisionmaking process.

Civil law courts generally do not create the law but only apply it, and common law courts traditionally are a principal lawmaking body. Common law court decisions of a jurisdiction's highest court are binding on itself and the lower courts in the same jurisdiction. Although statutes and codes are primary sources of law as in civil law jurisdictions, common law legislation is usually more specific than civil law codes.

In practice, civil and common law systems often are not as dissimilar as they appear. Although civil law courts base their decisions principally on code provisions, they may rely on and follow consistent higher courts' decisions. Moreover, in instances where a code provision does not specifically address the matter in controversy, the distinction between applying the law and creating it may be insubstantial. At the same time, much of common law is legislatively rather than judicially created. This is particularly true of U.S. Federal law, since no U.S. Federal general common law exists.

Since becoming part of the United States, significant aspects of Anglo-American Common Law have been added to or replaced Puerto Rico's Spanish civil law. This synthesis to a mixed civil and common law jurisdiction began soon after Puerto Rico became a territory. Although the 1900 Foraker Act established a three-member commission to compile and revise Puerto Rico's laws, it

"was not appointed to sweep away the legal system of the island, but rather to preserve those native institutions which have given evidence of vigor and growth, and to adapt them to the fundamental principles of American Law."

Subsequently, the Puerto Rican legislature preserved two of the five principle Spanish civil law codes and replaced three others with codes based on common law. Although modified over the years, the Spanish Civil Code and to some extent the Code of Commerce are still in force. The Spanish Penal Code was replaced by one adopted from that of Montana. The Spanish Code of Civil Procedure and, in great measure, the Code of Criminal Procedure were replaced by ones adopted from those used by Idaho and California, respectively.

The blending of civil and common law is evident in Commonwealth Supreme Court decisions. For example, that Court has frequently held that the primary source of law is written law promulgated by the legislature--a fundamental civil law characteristic. However, as in common law jurisdictions, Puerto Rico's Supreme Court, almost since its establishment, has relied on its previous decisions as a basis for deciding

cases and has held itself and lower courts bound by those decisions.

Although the United States is essentially a common law country, civil law is not unknown. After the American Revolution there was considerable support for adopting French civil law. Although this did not occur, subsequent acquisitions of civil law and mixed jurisdictions, which later became States, led to a continued presence of civil law. For example, in such States as Texas, California, Arizona, and New Mexico the civil law doctrine of community property, giving spouses certain rights in marital property, still is in force.

Louisiana is the only State in which a civil code is still fully in force. Like Puerto Rico, civil law has been in use in Louisiana for several hundred years, but common law has also been a strong influence. For example, unlike pure civil law jurisdictions, consistent decisions of the Louisiana Supreme Court are consulted and followed by Louisiana State Courts.

POLITICAL PROCESS IN PUERTO RICO IS DEMOCRATIC AND STABLE

Puerto Ricans are constitutionally guaranteed free expression through an equal, direct, and secret vote. Regular general elections are held with electoral proceedings governed by law. Residents actively participate in the political process with usually about 80 percent of the registered voters participating.

Constitution assures citizens' rights in collective decisions

The Commonwealth Constitution establishes a democratic system of government and states that this system is fundamental to the Puerto Rican community. It emphasizes that the peoples' will is the source of public power and political order is subordinate to the rights of man, while assuring citizens' free participation in collective decisions. The Constitution provides for general elections every 4 years. At that time, the Governor, the Legislative Assembly, municipal officials, and any other officers the legislature may determine are elected.

Although matters concerning the electoral process are left to legislative determination, the Constitution provides that every person over 18 years old is entitled to vote, and the inability to read or write and nonownership of property cannot disqualify a voter. Although regulation of elections and the registration of political parties and voters are also left to legislative determination, this power is limited by constitutional provisions guaranteeing protections for citizens and political parties.

Electoral law governs
political process

The 1977 "Puerto Rico Electoral Act," as amended, which replaced prior electoral laws, presently governs the island's electoral process. The act (1) provides for a Commonwealth Election Commission and an Electoral Review Board; (2) details procedures for voting and voter registrations; (3) establishes regulations for political parties, candidates' eligibility, party funding, and political contributions; (4) sets penalties for violations; and (5) provides for citizens' protections and rights in the political process.

The Commonwealth Election Commission organizes and supervises the electoral process. The Commission is composed of a General Administrator, who acts as its chairman, and Electoral Commissioners from each political party. The Administrator is appointed by the Governor for a 10-year term with the consent of the Legislative Assembly. Commissioners are also appointed by the Governor following petitions from each party.

The Commonwealth Election Commission also regulates local election commissions. These permanent local commissions are composed of a chairman and regular members from each political party. Each polling place is staffed by a Poll Board comprised of one inspector from each political party and any other participating candidate or organization.

The Electoral Review Board investigates matters concerning the electoral process, candidate eligibility requirements, and election results. The Board has three members, appointed to 10-year staggered terms by the Governor, with consent of the Legislative Assembly. Although the Board's findings of fact are final, appeals on questions of law may be taken to the Commonwealth Supreme Court.

The electoral act altered Puerto Rico's voting system. Prior to 1980 all voters gathered in polling stations by a given hour, and the doors were closed until all ballots were cast. Beginning in 1980, however, all voters were to be permitted to cast ballots at any time between prescribed hours. Because a large number of registered voters did not obtain identification cards, this system could not be fully implemented for the 1980 election. According to a Commonwealth official, however, those without identification cards were allowed to vote at a prescribed hour under procedures applied in the past.

NATIONAL POLITICAL AND LEGISLATIVE
PARTICIPATION HAS GROWN
BUT REMAINS LIMITED

Puerto Ricans have been American citizens since 1917, but they cannot vote in presidential elections unless they are registered to vote in a State or the District of Columbia.

Residents, however, participate in choosing presidential candidates through the national conventions and presidential primaries. Additionally, Puerto Rico residents elect a Resident Commissioner to the United States but do send Senators or Representatives to the Congress.

In 1970, an advisory group appointed by the President and Puerto Rico's Governor studied extending Islanders the right to vote in presidential elections. It concluded that such enfranchisement was not incompatible with Commonwealth status because of common citizenship. Although the group recommended that the vote be granted if residents chose so in referendum, a direct vote by island residents has not been taken.

Residents have no vote
for President but help
choose candidates

Even though Puerto Ricans and other territorial domiciliaries cannot vote in national elections, they help choose presidential candidates. Puerto Ricans have traditionally participated in both the Republican and Democratic national conventions. Although the island's delegations have grown since the original two Republican delegates and six Democratic delegates in 1904, the number of island delegates has been determined differently from States.

The Republican party allocates three delegates for each Congressional District, but territories' delegations are determined arbitrarily. Puerto Rico's delegation varied until 1964 when it was allocated five members. In 1976 the island was allocated 8 seats, and in 1980 the delegation was further increased to 14 members.

Democratic convention delegations from the States and the District of Columbia are calculated on the basis of (1) votes cast for the Democratic presidential candidate in the last three elections and (2) the population as measured by the electoral vote. Between 1904 and 1960, Puerto Rico was allocated six delegates to each Democratic convention. In 1964 and 1968 Puerto Rico had an eight-member delegation, and in 1972 it decreased to seven. In 1976 the part of the formula measuring population by electoral votes was applied to Puerto Rico. Because the island was assumed to have 4 electoral votes its delegation increased to 22 members. Puerto Rico's delegation further increased in 1980 to 41 delegates, the 27th largest in attendance.

While Puerto Rico has traditionally participated in national conventions, early in 1980 the island held its first presidential preference primaries. Previously, island delegates were chosen by caucus without direct voter participation. The Republican primary was held in February and the Democratic

primary a month later. Combined turnout was substantial, with about 1 million eligible voters participating.

Residents have some representation in the Congress

Puerto Rico residents do not have voting representation in the Congress, because this right is constitutionally guaranteed only to State residents. They do, however, elect a Resident Commissioner to the United States, who in many respects serves as a member of the House of Representatives.

The first commissioner was elected in November 1900 but was not permitted on the House of Representatives' floor until June 1902. In February 1904, he was granted the same powers as delegates from other territories. The Resident Commissioner can introduce legislation and speak in committee or on the floor. Although allowed to vote in committee beginning in 1970, the Resident Commissioner cannot vote on the House floor.

CONCLUSIONS

Puerto Rico has made great progress in self-government. The island consistently has pursued greater political rights and has been exercising local self-governing responsibilities similar to States for many years.

Puerto Rico is a stable, democratic community. The island's constitution, patterned after the Federal and State models, provides for three independent government branches and assures protections of citizens' rights. Elections, governed by law, are regularly held and voter participation is high.

The island exercises virtually the same control over its internal affairs as the States and operates within the broader Federal political system. Like States, the island does not exercise responsibilities within the Federal Government's purview, such as levying duties or imposts on imports or exports, entering into treaties with foreign governments, coining money, and establishing rules for naturalization.

Puerto Ricans domiciled on the island are U.S. citizens, but they cannot vote in national elections or elect Senators and Representatives to the Congress. They do, however, help choose presidential candidates and elect a Resident Commissioner to the United States, who in many respects serves as a member of the House of Representatives.

In addition to these ties, other bonds have developed between Puerto Rico and the remainder of the United States, such as common market, defense, and currency. Additionally, the evolution of Puerto Rico's legal relationship with the Federal Government has produced several unique features, such as the island's exemption from most Federal internal revenue laws.

These common bonds and unique arrangements have greatly influenced Puerto Rico's economic and social evolution. The next chapter describes this development as a foundation for analyzing the economic and social components of changing Puerto Rico's present relationship with the Federal Government.

CHAPTER 3

SUBSTANTIAL ECONOMIC GROWTH AND IMPROVED SOCIAL CONDITIONS ACHIEVED, BUT PERSISTENT PROBLEMS COMPLICATE STATUS DEBATE

Once based primarily on agriculture, Puerto Rico's economy has been transformed into a modern, industrial one. Led by manufacturing, the island's economy has achieved dramatic growth and has become integrated with the remainder of the United States. Further, social conditions, including life expectancy, housing, and education, have improved considerably. Although much progress has been achieved, serious economic and social problems, such as chronic high unemployment and widespread poverty, remain.

Concern over such difficulties is universal, but the status debate has been complicated because representatives of the different status options believe that their alternative offers the best framework for alleviating the island's problems and enhancing future development. Such social and economic considerations will be important elements in deciding and implementing any change to Puerto Rico's status and have been addressed during status deliberations of past U.S. territories. Accordingly, this chapter traces the island's development and synthesizes its social and economic characteristics.

ONCE RELIANT ON AGRICULTURE, PUERTO RICO'S ECONOMY WAS TRANSFORMED THROUGH INDUSTRIALIZATION

Puerto Rico's economy was agrarian-based until the 1940s, when the island government recognized that agriculture alone could not sustain its economy and growing population. As a result, it decided to seek economic growth through industrialization. Early attempts to industrialize through government-owned and operated enterprises, however, proved unsuccessful because they were generally unprofitable and created only a fraction of needed jobs. Puerto Rico's leaders concluded that a substantial infusion of external capital would be required to attain full employment and equalize the standard of living between the mainland and the island.

Consequently, in 1948 Puerto Rico initiated a program, known as Operation Bootstrap, to attract U.S. manufacturing investment. A comprehensive set of incentives was devised, highlighted by total exemption from Puerto Rican corporate income and property taxes. Also, U.S. laws in effect exempted Puerto Rican subsidiaries of U.S. firms from Federal corporate taxes and allowed duty-free shipments between the mainland and Puerto Rico. Tax incentives were valuable because they roughly doubled "after tax" profit and reduced the investment payout period, thereby decreasing risk.

Operation Bootstrap was the impetus for significant economic growth. Although the growth of the workforce outpaced job creation, the program led to the generation of thousands of jobs.

MAJOR ECONOMIC INDICATORS UP SHARPLY SINCE 1950

Puerto Rico's economic growth accelerated rapidly after 1950. The island's gross product--the total product or income available to residents--has increased markedly from \$755 million in 1950 to almost \$10 billion in 1979. Even when adjusted for inflation, gross product grew at impressive rates, averaging over 6 percent annually from 1950 to 1973. Growth slowed, however, as the recession and recovery years of 1973 to 1977 brought only a 1 percent average annual growth. The economy recovered in 1978 and 1979 as growth rates of 5.0 and 5.5 percent were realized.

As the economy grew, employment and personal income increased considerably. Personal income rose from \$653 million in 1950 to \$9.9 billion in 1979, while employment grew from 596,000 to 807,000. At the same time, per capita personal income grew from \$296 to \$2,934, one of the highest in the Caribbean. Although Puerto Rico's 1979 per capita income was only 48 percent of that of the lowest State, this gap has narrowed. In 1950 the island's per capita income was only 39 percent of the lowest State.

Mirroring economic growth, Puerto Rico's trade expanded substantially. Merchandise exports increased from \$244 million in 1950 to \$6.2 billion in 1979, while imports rose from \$350 million to \$7.4 billion. During this period imports consistently exceeded exports because most raw materials and intermediate goods used by the manufacturing sector are imported as are most consumer goods, including agricultural products.

Puerto Rico has an open economy. As such, trade has always been essential to Puerto Rico and the States have been its primary trading partner. Although the percentage of Puerto Rico exports to the States has declined from 95 percent in 1950, 84 percent still went to the States in 1979. Similarly, goods shipped from the States have decreased from 90 percent of total Puerto Rico imports in 1950 to 63 percent in 1979. This is primarily due to petroleum imports from foreign countries, because practically all of the island's energy requirements must be supplied from imported oil.

MANUFACTURING REMAINS THE DRIVING ECONOMIC FORCE BUT ITS STRUCTURE HAS CHANGED

Spurred almost entirely by investment of U.S. mainland firms, manufacturing has become the most important sector in Puerto Rico's economy. Manufacturing net income increased from \$89 million in 1950 to \$3.8 billion, or 46 percent of total 1979 net income. During the same time, manufacturing jobs grew from

9 percent to 20 percent of total employment. The chart below illustrates the manufacturing sector's emergence as the dominant contributor to the island's gross product.

Puerto Rico Gross Product by Sector

	<u>1950</u>	<u>1960</u>	<u>1970</u>	<u>1975</u>	<u>1979</u>
	----- (millions) -----				
Agriculture	\$132.1	\$164.0	\$ 160.9	\$ 264.9	\$ 337.3
Manufacturing	119.7	366.3	1,190.0	2,309.8	4,313.8
Contract construction and mining	30.4	101.1	379.1	464.6	365.0
Transportation and other public utilities	61.2	155.8	439.3	762.9	1,118.5
Trade (wholesale and retail)	144.3	319.1	898.3	1,349.7	2,061.0
Finance, insurance and real estate	74.5	197.7	613.8	873.9	1,315.4
Services (includes tourism)	44.7	140.9	512.2	833.7	1,260.8
Government	75.1	187.1	609.9	1,333.5	1,693.8
Commonwealth	67.4	155.6	542.1	1,144.6	1,404.8
Municipalities	7.7	31.5	67.8	188.8	289.1

Source: Economic Report to the Governor, 1979

The growth in manufacturing was accompanied by structural changes from labor to capital intensive industries. Initially, labor intensive industries like apparel and textiles were attracted to the island because Puerto Rico's wage rates in 1949 were only about 30 percent of the U.S. average. Puerto Rico's relatively low wage rates in addition to extensive tax exemptions enabled these firms to obtain rates of return on equity about three times higher than similar operations in the States.

As minimum wages increased and U.S. tariffs on imports were decreased, however, other developing countries became more competitive with Puerto Rico. Consequently, the labor intensive light industries on which the island's industrialization program was based throughout the 1950s and 1960s became increasingly difficult to attract and retain.

As a result, the Commonwealth government adopted a policy in the 1960s of promoting more competitive, higher wage, technologically oriented industries. The presence of such capital intensive firms in Puerto Rico is evidenced by the increased investment per worker. This measure rose from \$9,845 in 1960 to \$15,689 in 1970 and by 1973 climbed to \$21,901.

Changes in Puerto Rico's manufacturing sector also are evident in the distribution of employment, as shown in the chart that follows. The growth in employment from 1968 to 1979 was attributed primarily to capital intensive industries such as chemicals, pharmaceuticals, electrical and electronic equipment, and scientific

instruments. Despite a net reduction during this period, the apparel industry remained the largest manufacturing employer.

Distribution of Employment in Puerto Rican
Manufacturing Industries for Selected Years

<u>Industry Group</u>	<u>1968</u>	<u>1973</u>	<u>1979</u>	<u>Absolute change 1968-1979</u>	<u>Percentage change 1968-1979</u>
	-----000-----				
Food and kindred products	20.5	22.7	24.3	3,800	19
Tobacco products	7.0	5.6	2.2	-4,800	-69
Textile mill products	8.2	7.6	4.3	-3,900	-48
Apparel	40.2	40.7	35.4	-4,800	-11
Paper and allied products, printing and publishing	3.8	4.5	4.8	1,000	26
Chemicals	4.5	11.0	16.3	11,800	262
Pharmaceuticals	1.4	5.0	10.0	8,600	614
Petroleum refining, rubber products, plastics	6.2	6.5	7.1	900	15
Leather & leather products	11.4	6.7	6.0	-5,400	-47
Lumber & wood products, furniture & fixtures	4.9	4.9	4.1	-800	-16
Stone, clay & glass products	6.7	7.2	5.5	-1,200	-17
Primary metal products, fabricated metal products	5.0	6.7	6.0	1,000	20
Machinery, except electrical, transportation equipment	2.0	1.9	6.6	4,600	230
Electrical & electronic equipment	9.1	14.8	17.3	8,200	90
Scientific instruments	3.8	9.1	13.6	9,800	258
Miscellaneous manufacturing industries	<u>3.9</u>	<u>3.2</u>	<u>4.2</u>	<u>300</u>	8
Total	<u>137.1</u>	<u>152.9</u>	<u>157.7</u>	<u>20,600</u>	15

Source: U.S. Treasury's June 1980 Annual Report on Possessions Corporations

The U.S. Department of Commerce Economic Study of Puerto Rico ¹ cited several benefits of attracting capital intensive firms, such as increasing wage rates, upgrading workers' skills, and possibly establishing greater local ties. The study, however, stated there

¹/Issued in December 1979, this Federal interagency study led by the Department of Commerce is the most comprehensive analysis of Puerto Rico's economy ever attempted and it provides additional details on areas discussed in this chapter. Comprising over 1,000 pages, the study provides analyses on the Puerto Rican economy as a whole, the major sectors of the economy, social conditions that relate to development, and the role of Federal programs.

may be some disadvantages of the trend toward capital-intensive industry, including:

- relatively limited initial employment impact,
- possible long-run tendency of concentrating Puerto Rico income in the hands of a relatively small but skilled labor group,
- a heavy dependence on tax exemption measures in attracting inflows of external investment capital, and accordingly a vulnerability to any change in the nature of Puerto Rico-United States relationships.

OTHER ECONOMIC SECTORS
ALSO GREW SUBSTANTIALLY

In addition to manufacturing, other sectors achieved substantial growth. As shown below, net income and employment in construction, transportation, trade, and finance have increased markedly.

	<u>Employment</u>			<u>Net Income</u>		
	<u>1950</u> (thousands)	<u>1979</u> (thousands)	<u>Increase</u> (percent)	<u>1950</u> (millions)	<u>1979</u> (millions)	<u>Increase</u> (percent)
construction	27	48	78	\$ 27	\$ 335	1,141
transportation and other public utilities	28	50	79	51	900	1,665
trade (wholesale and retail)	90	154	71	102	1,381	1,254
finance, insurance, and real estate	3	21	600	52	1,081	1,979
services (including tourism)	77	142	84	42	1,109	2,540

A Commonwealth study highlighted two sectors in particular--construction and tourism--in addition to manufacturing which have been important to the island's economic growth during the past two decades. Between 1950 and 1974, the construction sector's contribution to total net income rose from 4 to 8 percent and related jobs increased from 27,000 to 79,000 or about 10 percent of total employment. Such gains were sparked by factors such as the demand for new manufacturing plants, housing, hotels, and public works.

The construction industry, however, began to decline after 1974 due to the recession and accompanying decreases in housing starts. Nevertheless, the sector remains important and appears to be rebounding. For example, 1979 construction net income was up about 16 percent from 1977.

Like the early growth in construction, tourism expanded significantly since the 1960s as total visitors and visitor expenditures have increased substantially. Puerto Rico's beaches and tropical climate are natural attractions for many mainland tourists.

The hotel industry, however, a major part of the tourism sector, experienced serious financial problems during the 1970s. In 1977, for example, the net consolidated loss for hotels was \$6.6 million. Following rapid construction in the 1960s, the number of hotel rooms increased to 8,353 by 1976 but decreased to 7,761 by 1978. Some hotels closed and others became unprofitable as the rate of growth in hotel visitors declined. The number of hotel visitors increased only 4 percent from 1970 to 1979.

IMPORTANCE OF GOVERNMENT HAS INCREASED SIGNIFICANTLY

Federal Government and Commonwealth government expenditures have become more vital to Puerto Rico's economy. Moreover, government has become the leading sector in terms of employment as manufacturing jobs grew at a slower rate in the 1970s.

Federal assistance totaled 29 percent of the 1979 island gross product, compared to 9 percent in 1950. Reflecting, in part, the national trend of greater Federal aid to governments and individuals during the 1970s, Federal disbursements to Puerto Rico increased from \$290 million in 1968 to \$2.9 billion in 1979. Transfer payments to individuals in 1979 comprised 15 percent of Puerto Rico personal income, and Federal grants-in-aid accounted for 35 percent of Commonwealth government recurrent receipts.

Puerto Rico government expenditures and employment have grown rapidly. From 1940 to 1977, government employment increased at an average annual rate of 7.2 percent compared to 1 percent for the overall economy and 2.6 percent for the manufacturing sector. By 1979, the island government employed 189,000 persons or 23 percent of the total workforce. Similarly, government operating expenditures grew from \$1.1 billion in 1970 to over \$2.0 billion in 1979 while its share of the island gross product increased from 13 percent to 17 percent.

Various factors contributed to the island government's growth. As a result of the industrialization program's success, the Commonwealth began to supply a wider variety of public services; and Federal assistance prompted the establishment of new programs. Moreover, the Commonwealth created or acquired public corporations which carry out functions normally performed by the private sector in the States. These included operating much of the sugar industry and a shipping company, along with providing telephone and electric service.

GAINS IN SOCIAL CONDITIONS REALIZED, BUT PROBLEMS REMAIN

The island's economic growth was accompanied by significant improvements in social conditions. Despite gains in the adequacy of health care, education, and housing, however, problems remain.

Better medical and sanitation services, among other factors, contributed greatly to controlling infectious diseases and reducing infant mortality rates in Puerto Rico. As a result, the island's present life expectancy is 74 years, slightly higher than the U.S. average and one of the highest in the world. Moreover, the island's infant mortality rate is only slightly higher than the U.S. average. Despite the progress toward increased life expectancy, various typical urban ills such as alcoholism, drug addiction, and mental health problems exist.

The island's housing stock and quality also increased greatly. While in 1940 80 percent of Puerto Rico's housing was considered substandard, this number was reduced to 44 percent by 1960. Various factors including island land reform and Federal assistance and mortgage insurance have continued to contribute to improved housing, but in 1978 21 percent still was classified as inadequate. Additionally, despite considerable growth in public utilities, in 1978 more than 12 percent of Puerto Rican families did not have running water.

Educational opportunities also have improved markedly. Although only half of the eligible children attended school in 1940, four of five were enrolled in 1976 and significant progress has been made in reducing illiteracy which was 80 percent at the turn of the century. The increased enrollment has made Puerto Rico the second largest school system in the United States and several postsecondary institutions have been established.

Despite progress, severe problems exist. The island's illiteracy rate is over 10 percent compared to less than 2 percent in the United States as a whole, and per pupil educational expenditures are considerably less than the lowest State. Testifying before the Congress in 1977, Puerto Rico's Secretary of Education stated that school buildings have not been able to accommodate enrollment and over 28 percent of island teachers do not have bachelors degrees. Moreover, in 1978 the National Education Association studied the island's school system and reported that schools did not meet minimum standards, physical plant conditions were deplorable, and many other serious deficiencies existed.

CHRONIC UNEMPLOYMENT AND POVERTY
PERSIST AS POPULATION GROWTH
EXCEEDS JOB OPPORTUNITIES

Although total employment in Puerto Rico grew from 1950 to 1979, population growth exceeded job creation by more than 15 percent. As a result, island unemployment continues at high levels while incomes remain relatively low. In 1979, the unemployment rate was 17 percent and over half of island families had incomes below the U.S. poverty level.

Finding employment for a rapidly expanding population traditionally has been Puerto Rico's most pressing problem. From

1950 to 1973 the island's unemployment rate hovered around 13 percent. Although reaching a low of 10.7 percent in 1970, unemployment averaged about 16 percent between 1973 and 1977, reaching 23 percent in May 1977, before declining to 18 percent in 1978.

The island's rapid industrialization created a net increase of 105,000 manufacturing jobs from 1950 to 1979 along with 190,000 jobs in other non-government sectors. During the same period, however, the agricultural sector lost 176,000 jobs while 50,000 home needlework jobs also were eliminated. Moreover, because the manufacturing sector has become increasingly capital intensive, the island's industrialization did not absorb the labor force growth.

Two factors, however, have served to stabilize employment trends in Puerto Rico--government employment and out-migration. Government employment increased from 106,000 in 1970 to 189,000 in 1979, or 78 percent. Additionally, migration to the United States totaled about 700,000 persons from 1947 to 1972. This pattern reversed itself from 1972 to 1977, but net out-migration was experienced again in 1978 and 1979.

Puerto Rico's population has grown steadily from the approximately 1 million inhabitants in 1900 to 2.7 million in 1970, reaching over 3 million in 1980. Based on current estimates, Puerto Rico's population density is approaching 1,000 persons per square mile; this is 16 times greater than that of the United States and one of the highest in the world.

Some progress has been made toward reducing average family size but the rate of population growth is still relatively high. Average family size was 5.2 persons in 1940 but declined to 4.8 in 1960 and 3.7 persons in 1979. Still, in 1978 Puerto Rico had a population increase of 1.7 percent, compared to 0.6 percent in the United States and 0.4 percent in Europe.

Moreover, the island's population has become predominately urban and young. In 1976, 62 percent was classified as urban, compared to 30 percent in 1940. As of July 1, 1978, more than one-third of the island's population reportedly lived in the San Juan metropolitan area. Further, 50 percent of the population was under 24 years of age while 70 percent was under 40.

Consequently, there will continue to be pressures on Puerto Rico to provide adequate employment opportunities. A recent economic projection indicates that the island's workforce will number 1.4 million persons by the year 2000. Even with a projected 16.3 percent unemployment rate, more than 350,000 new jobs would be needed.

PROGRAMS TO DIVERSIFY AND
STRENGTHEN ECONOMY AND REDUCE
UNEMPLOYMENT ARE BEING PURSUED

Because Puerto Rico possesses few exploitable natural resources to sustain economic growth, the island's economy is characterized by extensive trade, primarily with the United States. Many mainland-based manufacturing corporations, which provide most of the island's capital investment, import most of their raw materials and, because local markets are too small, export most finished products to the United States. This situation, combined with the fact that a substantial portion of Puerto Rico's population obtains income support from U.S. transfer payments, makes the island's economy very sensitive to mainland decisions and economic conditions.

Manufacturing will continue to be the stanchion of Puerto Rico's economy, but island government officials believe that more selective promotion of manufacturing is needed and that the economy needs to be more balanced and diversified. Noting that no one sector should dominate the economy to the degree manufacturing does today, these officials believe that other sectors also should be promoted.

One notable program initiated by the Commonwealth government involves modernizing and revitalizing agriculture to reduce dependence on imported foodstuffs and provide employment. With the advent of Puerto Rico's industrialization, the amount of land and attention devoted to agriculture was decreased. By 1979 agriculture accounted for less than 5 percent of island employment; and production of the traditional cash crops--sugar, coffee, and tobacco--declined and became unprofitable. Although production of other items like livestock and dairy products increased, the island still must import over \$1 billion in foodstuffs annually.

A 1978 Commonwealth report stated that island agriculture was based generally on outdated technology and inefficient production. As a result, Puerto Rico devised a 12-year plan to modernize the agricultural sector. If successful, the program would establish a rice industry, enable Puerto Rico to grow many agricultural products currently imported, and create about 10,000 additional jobs by 1988.

The Economic Study of Puerto Rico concluded that because the recent pace of government hiring cannot be maintained, employment in agriculture, manufacturing, and non-government service industries such as tourism must grow if Puerto Rico's unemployment is to be reduced materially. In 1978, the island government extended tax exemptions to service industries to further promote this industry. As of June 1980, nine such exemption grants had been approved, but officials believed it was too early to assess the overall effectiveness of the program.

Several other areas also are being considered to help diversify the economy. For example, although copper and nickel deposits exist, their quality has not justified commercial mining. The recent rise in market prices for these metals, as well as for the gold and silver by-products obtained in their development, may make these deposits exploitable in the future.

Investigations also have suggested the possibility that oil deposits exist in Puerto Rico. The Commonwealth government plans a \$5 to \$6 million sampling program at one promising onshore area to determine whether actual drilling for oil is justified. The government is planning to negotiate with private companies to attempt the far more expensive challenge of offshore drilling. Further exploration and testing are needed to indicate whether oil deposits exist and, if so, whether they are commercially retrievable.

Diversification of export destinations also has been cited as a means for opening up new markets for Puerto Rican products and generating additional employment. To enhance this effort Puerto Rico has begun trade missions to other countries and seminars have been sponsored to inform local businessmen about exporting their products.

Another potential employment producing strategy would be to replace certain imports with locally produced goods. Puerto Rico's Economic Development Administration estimated that import substitution could create thousands of jobs. The Economic Study of Puerto Rico was less positive in its assessment but suggested that some potential for such a program existed.

CONCLUSIONS

Since the 1940s Puerto Rico has been transformed from a primarily agrarian economy to an industrial one. Led by manufacturing the economy achieved substantial growth in the last three decades as evidenced by marked increases in gross product, personal income, and employment. Although growth slowed substantially during the recession and recovery years of 1973 to 1977, the rate of economic growth began to rise in 1978 and 1979.

As a result of Puerto Rico's industrialization, the manufacturing sector emerged as the driving force of the economy. By 1979 it accounted for 46 percent of total net income and 20 percent of total employment in addition to spurring growth in other sectors. In recent years the government sector also has become increasingly important, and in 1979 it was the largest employer, providing jobs for 23 percent of the work force.

Puerto Rico's economy is integrated with the remainder of the United States. Puerto Rico trades primarily with the States and many mainland-based manufacturing firms, attracted to the island by tax advantages and other factors, have provided most

of the investment for Puerto Rico's economic growth. Additionally, the Federal Government has become more important to the island's economy, in part because a substantial portion of the population depends on Federal transfer payments for income support.

Along with economic growth, improvements in the quality of health care, housing, and education, as well as other areas, contributed greatly to the betterment of social conditions. Puerto Rico, however, still faces serious economic and social problems. Although many jobs have been created through industrialization, widespread unemployment and poverty exist as population growth has exceeded job creation.

There will continue to be pressure to provide adequate employment opportunities for Puerto Rico's expanding and predominantly urban and young populace. One recent projection indicates that more than 350,000 new jobs will be needed by the year 2000 even if unemployment remains around 16 percent. Moreover, the island still faces certain social and health related problems and severe difficulties in its education system. Initiatives have been undertaken to strengthen and diversify the economy and provide employment, but they are still in their early stages.

Concern over the island's economic and social problems has accentuated status debates as representatives of each political party argue that an alternate political framework would better enable the island to address these problems and enhance future development. The status debate is complicated, however, because as described in the next chapter the proposed methods for achieving such goals are based upon diverse interpretations and concepts.

CHAPTER 4

PUERTO RICO'S STATUS DILEMMA:

CHOOSING FROM DIVERGENT ALTERNATIVES

Puerto Rico's political and socioeconomic development has occurred against the lingering backdrop of the status controversy. Avid debates over commonwealth, statehood, and independence have dominated island politics for decades. Such discussions have intensified because of increasing criticism that the current status does not fulfill Puerto Rico's political, social, and economic aspirations.

Dissatisfaction has grown, but debates remain impassioned and divisive. Each of the island's major political parties advocates a widely divergent status option and ardently presents its position. This chapter summarizes the status debate's recent history and explores the basic conceptual framework underlying each alternative.

LONGSTANDING STATUS CONTROVERSY HAS INTENSIFIED, BUT ELECTORATE'S VIEWS ARE UNKNOWN

Puerto Rico's ultimate status has been left open, and the concepts of commonwealth, statehood, and independence have been advocated since the island came under U.S. sovereignty. In fact, each option had a similar counterpart during the latter stages of Spanish dominion. As a U.S. territory Puerto Rico gradually attained greater self-governing authority, but status debates did not diminish after the Commonwealth was established in 1952.

Consequently, statehood, independence, and amended commonwealth proposals all have been introduced in the Congress and the Puerto Rican legislature. One proposal led to the 1964 United States-Puerto Rico Commission on the Status of Puerto Rico. Extensive public hearings were held on legal, economic, and cultural issues relating to the three status alternatives. In its 1966 report, the Commission concluded that

"* * * all three forms of political status--
Commonwealth, Statehood, and Independence--are
valid and confer upon the people of Puerto Rico
equal dignity with equality of status and of
national citizenship."

Noting that the initiative should come from the people, the Commission stated that a status referendum would be helpful and recommended that advisory bodies be established by the President and Puerto Rico's Governor to consider transitional measures to any new status.

In 1967 a plebiscite disclosed that 60.4 percent favored Commonwealth; 39.0 percent, statehood; and 0.6 percent, independence.

However, alleged boycotts by independence and statehood advocates resulted in a lower than normal voter turnout (66 percent versus the usually more than 80-percent turnout).

Subsequently, an advisory group, appointed by the President and Puerto Rico's Governor in 1973, explored ways of developing Commonwealth status and recommended that Puerto Rico be able to

- participate in international organizations and make agreements with foreign countries consistent with U.S. policy;
- set minimum wage rates and environmental protection regulations;
- take part in establishing immigration quotas;
- levy, change, or eliminate tariffs on goods imported into the island, consistent with U.S. laws and international obligations;
- have representation in the U.S. Senate as well as the House of Representatives; and
- object to certain Federal legislation and have such objections acted upon by the Congress.

These features were embodied in the "Compact of Permanent Union Between Puerto Rico and the United States," a bill introduced in the Congress in 1975. This proposal also called for establishing a U.S.-Puerto Rico commission to study the possibility of transferring Federal functions to the island and instituting a system of contributory payments to the U.S. Treasury. After several hearings and amendments, the bill died in committee.

Other initiatives included a statehood proposal, made by President Ford on December 31, 1976. The proposed legislation called for hearings and studies on statehood's effects, a statehood plebiscite, and a constitutional convention.

An independence proposal was introduced by U.S. Congressman Dellums in 1980. This proposed joint resolution stated that all U.S. powers and authority be transferred unconditionally to Puerto Rico so that the people could exercise fully their right to self-determination and independence. The resolution called for a sovereign constituent assembly, representing the island's political parties, to exercise all governmental authority. It further provided that a commission negotiate conditions and terms with the United States if the people select independence or free association. No action was taken on this bill.

Although amended commonwealth, statehood, and independence proposals have been made, the Puerto Rican people have not voted on the status issue directly since 1967. The general election results since 1952 are shown below, but these do not necessarily reflect support for each status since other issues, such as economic conditions, were involved in the campaigns.

	Party(ies) favoring <u>Commonwealth</u>	Party(ies) favoring <u>statehood</u>	Party(ies) favoring <u>independence</u>
	------(percent)-----		
1952	64.8	12.9	19.0
1956	62.5	25.0	12.0
1960	62.4	34.3	3.3
1964	59.4	34.6	2.7
1968	51.8	45.2	3.0
1972	51.0	45.5	4.5
1976	45.3	48.3	6.4
1980	47.0	47.2	5.7

Puerto Rico's local political parties are aligned according to status preferences--an historic consequence of the continuing debate. Traditionally, various parties have advocated the concepts of commonwealth, statehood, or independence. Presently, one party supports statehood, another favors improving Commonwealth status, and two parties advocate independence.

The Popular Democratic Party (PDP) supports an improved commonwealth. The PDP dominated island politics from 1940 to 1968, when it lost the governorship to statehood supporters. The PDP regained power in 1972, but lost again in 1976.

The New Progressive Party (NPP) advocates admission to the Union. The party was formed from earlier statehood parties in 1968, and later that year NPP's gubernatorial candidate was elected. It lost in 1972, regained the governor's seat in 1976, and retained it in 1980.

The two parties supporting independence are the Puerto Rican Independence Party (PIP) and the Puerto Rican Socialist Party (PSP). Formed in the mid-1940s, the PIP is dedicated to independence and democratic socialism. The PSP, committed to independence and socialism, first participated in local elections in 1976.

In addition to the intensifying debate among the island's political parties, the growing status controversy has prompted recent statements by Federal executive and legislative branch officials. In 1978 President Carter pledged to support whatever status the Puerto Rican people selected. Similarly, in August

1979, the Congress reaffirmed Puerto Rico's right to self-determination.

Both 1980 national political party platforms addressed Puerto Rico's status but varied in their positions. The Democratic party emphasized its commitment to self-determination under a free and democratic process and to Puerto Rico's right to select a relationship that could most benefit island residents--as a commonwealth in permanent union with the United States, as a state, or as an independent nation. The party also pledged to respect the Puerto Rican people's cultural heritage and to eliminate island residents' unequal treatment in Federal programs.

The Republican party vigorously supported the island's right to statehood, subject to Puerto Ricans freely selecting that status. The party stated that admission was the only logical solution within the U.S. Constitution to Puerto Rico's unequal treatment. The party recognized island citizens' right within a multicultural society to retain their language and traditions and supported Puerto Rico's right to seek admission at the earliest possible date. The Republican party further stated that the admission bill should provide for a smooth transition, so that Puerto Rico could stand economically on equal footing with the other States and gradually assume its fiscal responsibilities.

The international community also has focused on Puerto Rico's status debate. The United Nations Decolonization Committee has held numerous discussions on Puerto Rico's political status. The United States' response and other international considerations are discussed further in chapter 7.

THE STATUS OPTIONS: SIMILAR CONCERNS
VOICED, BUT IDEOLOGICAL DIFFERENCES
UNDERSCORE SPLINTERED NATURE OF DEBATE

Heightening awareness of Puerto Rico's status controversy has kindled increased interest in the various status options. Each is advocated and defended with intensity and emotion and is based upon a diverse philosophy. Moreover, each position has been shaped by Puerto Rico's social and economic environment. However, despite sharp differences, statehood, commonwealth, and independence advocates, albeit in varying degrees, have expressed some similar basic concerns.

Intensely proud of their Puerto Rican heritage, all status participants are adamant about preserving the island's language and culture. Further, all maintain that Puerto Rico has not attained a full measure of dignity and a solidified identity. Each argues that the current status is one of political and personal inferiority and does not meet the needs of the Puerto Rican people.

The desire for equality and increased political rights comprises the nucleus of each status option, but concerns over the island's serious social and economic problems also transcend partisan lines. Participants recognize that a new status will not automatically solve all the island's difficulties; however, participants assert that an alternative legal, constitutional framework is required to guide Puerto Rico's socioeconomic advancement.

Aside from these few points, however, status participants are divided sharply--both on an ideological basis as well as a political one. This intense and longstanding divisiveness has been cited as a major factor undermining Puerto Rico's ability to effectively combat its social and economic difficulties. After extensive hearings and discussions, the 1966 U.S.-Puerto Rico status commission report astutely concluded that:

"Status choices, the Commission has come to see, are in a sense political 'subcultures' within Puerto Rico's society. Each status viewpoint holds an interpretation of history, a way of life, a concept of the Puerto Rican identity, and an aspiration for a Puerto Rican destiny. Ideological differences alone make consensus difficult, but that difficulty is nurtured by the partisan political character of the status parties and by electoral competition. Thus, political opposition and ideology regularly enforce one another to intensify the conflict over status."

Since then, this historic dilemma has been accentuated by economic and financial difficulties and increased criticism of the present Commonwealth's ability to meet Puerto Rico's needs --politically or economically. Because each major political party has proposed status alternatives, the following sections summarize each option's basic political rationale as a preface to our analysis provided in the following chapters.

These synopses, based on the parties' platforms and other material, contain views on why each party believes its status is the most logical. Not included are each party's assertions about why the other two options are unfeasible. Also not detailed here are the parties' beliefs about their proposals' numerous financial, social, economic, and other benefits; however, these views are discussed in chapters 5 through 7 on a topical basis.

Statehood advocates desire equality within the American system

Since Puerto Rico became part of the United States, statehood has been a goal of certain local political parties. Advocates believe that only statehood would bring Puerto Ricans political and economic equality, dignity, and security. Maintaining that statehood is the inevitable culmination of the island's political development, proponents advocate that admission would eliminate the current status' inadequacies and foster the island's development.

Statehood advocates maintain that the present relationship is one of inequality and inferiority--one that retains "vestiges of colonialism" and relegates Puerto Ricans to second class citizens. Proponents state that although Puerto Ricans are U.S. citizens, they cannot participate fully in the American political system. Governor Carlos Romero-Barceló, a staunch statehood advocate, explains that:

"If Puerto Rico were a state, we would have seven representatives in the House, two United States senators, and nine electoral votes for President --more electoral votes than twenty-five of the existing states. But without statehood, we lack the political rights that make citizenship in a democracy truly meaningful."

Advocates assert that the island is still a territory, subject to the Congress' broad authority. As such, they state that the Congress can treat the island differently from States by excluding or restricting its participation in certain Federal activities. Moreover, they point to a recent U.S. Supreme Court case upholding such differential treatment and a "long history of discrimination and unfair treatment against the residents of Puerto Rico in fundamental Federal legislation, grants-in-aid, and other programs."

Another inequality statehood advocates cite is that Puerto Ricans have paid their "blood tax" through military participation since World War I, but island residents cannot vote for or against the Commander-in-Chief.

Advocates maintain that statehood is the key to eliminating such inequality and increasing the island's participation in shaping America. They also believe there is little known about Puerto Rico on the U.S. mainland. Governor Romero notes that "We are still looked upon as outsiders--and sometimes even as foreigners--by our fellow American citizens in the rest of the nation."

Although recognizing this problem, supporters view the granting of U.S. citizenship in 1917 as a vital factor in sustaining the statehood movement. They identify citizenship as the indissolvable link between the island and the States and maintain that statehood would bring fulfillment of the implied admission promise inherent in citizenship.

Advocates emphasize that Puerto Ricans have continually demonstrated their loyalty to American democratic principles and the private enterprise system. They point to the island's adoption of many American doctrines, traditions, and institutions and of a constitution patterned after the Federal model. They cite residents' substantial contributions to defending the Nation through military service for many years. Additionally,

advocates point to the extensive trade between the island and the States and the integration of their economies.

Proponents state that Puerto Rico has made substantial socioeconomic progress but argue that statehood is needed to resolve the island's problems. They believe statehood would provide the necessary legal instrument for assuring political equality, social justice, and economic security, as well as enhancing the island's prosperity and role in national matters. Governor Romero summarizes this sentiment as follows:

"I am convinced, both as a Latin American and as a U.S. citizen, that statehood for Puerto Rico would constitute a boon for the nation, as well as for the island....We statehooders are therefore committed to forging a society in which, while remaining faithful to our linguistic and cultural traditions, we can make a full and meaningful contribution to building a better America, in exchange for full and meaningful participation in the process by which America is governed."

Advocates maintain that statehood will reduce, rather than increase, Puerto Rico's reliance on Federal transfer payments. They believe admission would create more natural economic growth and stimulate investment in such areas as manufacturing, agriculture, and tourism by providing political security, increasing awareness of Puerto Rico, and enabling the island to better use its abundant labor supply.

Further, statehood would assure the island equal treatment in Federal programs and laws as well as full representation in the U.S. Congress. Advocates believe that equal political representation would give Puerto Rico a stronger voice in Federal legislation, strengthen Federal awareness of the island's problems, and greatly enhance Puerto Rico's ability to increase its share of Federal investments to help stimulate the economy.

Statehood advocates recognize that although admission would bring political equality it will also entail significant fiscal adjustments; but they propose this process be phased in gradually over several years. Proponents express their desire to pay Federal taxes to correct the current one-sidedness and give residents a greater sense of dignity and self-worth by contributing to common goals. They note, however, that the longstanding absence of Federal taxation puts the island in an unprecedented situation.

Supporters point out that new States have traditionally been granted a wide range of concessions and that the Congress has the broad authority to accommodate the island's special needs. Advocates argue that Puerto Rico's situation presents unique circumstances dictating a commensurate approach in devising adequate admission arrangements. Such terms should, they maintain, preserve the island's language and culture and provide for phasing in full

Federal taxation. This proposal and other examples of transitional arrangements advocates believe are indicative of the type needed are discussed further in subsequent chapters.

While recognizing that fiscal adjustments are necessary, statehood supporters assert that admission cannot be viewed solely in financial terms. They declare that the fundamental issue is their full and equal rights as citizens within a democracy and the quest for dignity. This goal, Governor Romero proclaims, "is political equality within a framework which will permit our island and our nation to prosper together."

Commonwealth proponents want to keep ties but seek greater autonomy

Traditionally, supporters of the commonwealth concept have espoused predominantly autonomist principles. Essentially, this translates into strong ties with another country--Spain and later the United States--while developing greater self-government for Puerto Rico within this broader political system. Support for these principles resulted in the island's 1897 Charter of Autonomy with Spain and fostered the present Commonwealth relationship.

In every decade since 1952 Commonwealth proponents have advocated revisions to clarify that status and expand the island's political powers. Supporters maintain that Commonwealth is a legitimate status in and of itself. They argue that the present fundamental relationship between Puerto Rico and the United States should be continued, but changes are necessary to give Puerto Rico greater flexibility and to assure the viability of the commonwealth principle.

The most recent description of the rationale for greater autonomy has been former Governor Raphael Hernández-Colón's "New Thesis," introduced on July 25, 1979. An aide to the former Governor stressed that the New Thesis outlines why greater autonomy is needed and identifies general areas where change is required, but he stated that changes to the present status are potentially exhaustive and that exact methods need to be studied and worked out in greater detail later.

The Popular Democratic Party endorsed the New Thesis' general principles in its 1980 electoral platform. The New Thesis maintains that Commonwealth status has served Puerto Rico well but needs amending so the island can deal effectively with pressing social and economic concerns. Basic U.S.-Puerto Rico ties are to be preserved, but greater political autonomy is believed necessary to enhance self-sufficiency and resolve the current confusion and lack of orientation.

Mr. Hernández-Colón maintains that the principal advantage of the autonomous system is its flexibility to accommodate the island's aspirations and particular needs within its tie to the

United States, but outside the latter's rigid internal structure. He argues that despite the 81-year relationship with the United States, the island has retained its unique cultural and linguistic features--the foundation of Puerto Rico's identity and autonomy.

The New Thesis asserts that this autonomy needs to be increased over internal matters and expanded to include authority to make arrangements with other countries. It states, however, that equally as important is preserving political, social, cultural, economic, and emotional bonds between Puerto Rico and the United States, which have profoundly affected the island's development.

These ties, particularly common citizenship, must be maintained while preserving Puerto Rico's autonomist identity, argues Mr. Hernández-Colón. He states further that when citizenship was extended it was anticipated that the island would have an autonomous political system. He notes that common citizenship is deeply honored and its privileges defended by Puerto Ricans through military service, but island residents' identity comes from being Puerto Rican, not from being U.S. citizens:

"Our Puerto Rican nationality has been given U.S. citizenship, which adds to it a special dimension of protection and political loyalty for coexistence, but not to compete with or reduce the basic and deep loyalty that for vital reasons ties us to the motherland." 1/

The New Thesis asserts that citizenship should not be viewed as a step to statehood but rather as a source of rights so that Puerto Ricans can affirm themselves as individuals while retaining their unique characteristics. This citizenship, Mr. Hernández-Colón maintains, along with Puerto Rico's right to freely pursue self-determination, strengthens the island's position to decide its future. He argues that Commonwealth status has resulted in great socioeconomic achievements but that widespread dissatisfaction and critical social and economic problems dictate a reevaluation of the present arrangement.

The New Thesis presents proposed strategies to handle the island's problems but maintains that they cannot be effectively resolved without greater autonomy. Mr. Hernández-Colón asserts that to spur economic investments and begin educational reform greater flexibility is needed. He proposes that Federal assistance to the Puerto Rican government be allocated in a block grant rather than on a program basis. Also, he states that control over communications (radio and television) is needed for educational purposes.

1/Quotation taken from English translation of the New Thesis.

Further, Mr. Hernández-Colón maintains that Puerto Rico needs to develop a human resource policy for generating employment opportunities; reduce its dependence on the Federal Government and foreign capital; remold the island's manufacturing and agricultural sectors to better use foreign investment; and institute social and educational reforms. To make any strategy work, however, he states that the island needs to be granted authority over immigration of foreigners, everything related to labor relations (wages and work conditions), use of natural resources and the sea, environmental regulations, entry of foreign products through tariff controls, and negotiations with foreign countries.

Mr. Hernández-Colón argues that many of these necessary adjustments to the Commonwealth formula were ignored when the proposed 1975 Compact of Permanent Union was not acted upon. Consequently, he states that the status issue should be pursued vigorously to effect the appropriate revisions. Similarly, in its 1980 platform the Popular Democratic Party emphasized its pledge to pursue expanding the Commonwealth's authority.

The New Thesis maintains that the Commonwealth concept should be a dynamic process that can be modified as circumstances change. Mr. Hernández-Colón asserts that contemporary Federal and international realities make adjustments necessary. He states that because of growing internal requirements, Puerto Rico needs to increase its local authority and widen its external relations in search of resources and agreements that will suit its economic and cultural needs. This situation, Mr. Hernández-Colón argues, mandates that Puerto Rico be granted greater autonomy.

Independence supporters advocate complete autonomy

Independence has been an aspiration of certain Puerto Rican groups since Spanish dominion. In fact, a brief revolt against Spain in 1868, known as the Grito de Lares, became a symbol for independence supporters. The independence option has continued to be advocated during the association with the United States. Presently, two political parties certified to participate in local elections espouse independence as their status goals--the Puerto Rican Independence Party (PIP) and the Puerto Rican Socialist Party (PSP).

The PIP, steadfastly committed to independence and democratic socialism, states that complete autonomy is required to correct the heart of Puerto Rico's very serious social and economic problems. It asserts that the colonial relationship with the United States has precluded the island from possessing the necessary political and economic authority to, among other things,

--protect and adequately develop its cultural and national identity;

- safeguard industry, agriculture, and trade; correct unemployment by establishing a rational program for replacing imports; diversify foreign trade; and regulate immigration; and
- control the monetary system, prevent the flight of financial resources abroad, and develop a wage and price policy.

The PIP regards the current situation as an intense social and economic crisis. Numerous social ills, including rising crime, poverty, drug addiction, and mental health problems, the PIP states, have their roots in the colonial capitalist structure which raises aspirations far beyond Puerto Rican reality. Additionally, it asserts that this has resulted in a state of dependence, powerlessness, and a lack of self-worth. The PIP maintains that:

"This is so because from the time our children are small they are taught in our schools that 'Puerto Rico is a small and poor country without mineral resources,' and that 'we have two flags, two anthems, two languages and two cultures.' It is repeated to the point of satiation that the Commonwealth is not a colony, that this status is 'our creation, what serves us, what we breathe and what gives us life'." 1/

This, the PIP asserts, is why Puerto Rico has an identity crisis and its people are terribly insecure over what might happen.

The PIP also emphasizes that the pattern of dependence extends to economic problems as well. It states that economic stagnation, chronic unemployment, and inflationary trends have occurred because Puerto Rican growth was created through a colonial system. This dependent model, it explains, is characterized by reliance on foreign capital, exportation of production and importation for consumption, excess consumption financed through debt, and emphasis on economic growth, rather than real development based on a fairer distribution of wealth.

The PIP platform details an alternative socioeconomic development model and outlines proposals to solve specific difficulties and to form the basis for resolving the problems of colonialism and dependent capitalism. It asserts that dependence on external capital, welfare payments, and foreign debt will continue unless the transition to independence is initiated.

1/Quotation taken from English translation of PIP 1980 electoral platform.

The PIP recognizes that this conversion would be a difficult process requiring a transitional period. It explains that as a colony almost every vital aspect of Puerto Rican life has been controlled by the United States. This integration and domination, the PIP maintains, has created a situation where independence can be adequately achieved only through an "orderly, rational and responsible transition."

While acknowledging that this process should benefit both countries, the PIP asserts that the transition should eliminate the colonial distortions which have made the island's economy dependent on U.S. needs. Accordingly, the party has developed several transition proposals, which are discussed in the following chapters. The PIP has emphasized, however, that there is no limit, constitutionally or otherwise, to the kinds of arrangements that could be established between an independent Puerto Rican republic and the United States.

Although it recognizes that a transition would be difficult, the PIP maintains that independence would bring more permanent and self-reliant economic growth. This would be based on increased production and employment, a fair distribution of wealth, Puerto Rican control of its economy, reduced foreign dependency, and a social policy and political ethic to raise the island's standard of living.

The President of the PIP, Mr. Rubén Berriós Martínez, maintains that independence is the only solution for Puerto Rico and would be best for the United States:

"The Republic of Puerto Rico, conceived in liberty and founded on rational and equitable economic principles, would protect the interests and rights of the people of Puerto Rico; free the American taxpayer of the increased cost of maintaining an unworkable economic system; and would make U.S. policies conform to the principles of liberty on which the Union was founded as well as the principles of contemporary international law."

Advocates believe that obtaining complete political autonomy will more than offset the current arrangements with the Federal Government. More importantly, however, they argue independence is the inalienable right of the Puerto Rican people and would bring dignity and full control over the island's economic, social, and cultural development.

The Puerto Rican Socialist Party (PSP), committed to socialism and the rights of workers, firmly supports independence as the solution to the island's status dilemma. The PSP states that it will never renounce this goal regardless "of the adverse changes that may come about in the status of the country." The party advocates eliminating the capitalist system and imperialism

which it believes underlies many of the island's present political, social, and economic problems.

The PSP believes that the island's political electoral process is invalid, stating that:

"The constrained limits of that process, determined by the framework of our relationship of colonial subordination to the United States, makes it impossible for there to even be a valid electoral process under the standards of bourgeois democracy." 1/

Although the PSP has participated recently in elections, it does so under the basis of maintaining its independence and "impugning, not recognizing, the validity of the colonial administration and its institutions."

The party notes other examples of colonial domination, such as the U.S. Navy occupying and using the island, Vieques, deforming Puerto Rico's national culture through the educational system, and rising crime because Puerto Rico cannot control the immigration of undesirables from the U.S. mainland. Other examples cited are deteriorating family life because of capitalist developments and alienation and persecution found in all sectors of the country. This situation, the PSP states, has occurred because Puerto Rico does not possess the legal means to solve problems facing its society.

The PSP further cites the precarious nature of the present economic structure, which is characterized by high unemployment, low income levels, high debt, and declining levels of investment. The party believes this model to have failed because so many people are impoverished while foreign capital obtains billions in profits. It points out that the only factor preventing total collapse has been the influx of substantial Federal aid.

The PSP advocates a number of social and economic solutions to increase workers' rights, combat crime, improve health care and education, and stimulate agriculture. The party points out, however, that many remedies cannot be implemented because Puerto Rico is not independent. For example, the island does not have authority to regulate immigration; impose tariffs to protect local production, particularly agriculture; and control all natural resources.

Although the PSP advocates independence, it maintains that any valid status decision can be made only after the United States totally and unconditionally transfers all powers to Puerto Rico.

1/This quotation and others in this section not attributed to individuals were taken from an English translation of the PSP 1980 electoral platform.

Mr. Juan Mari-Brás, Secretary-General of the PSP, has explained this concept as follows:

"There is only one way of decolonizing colonial territories and that is by eliminating the intervention which produces that colonization. Since the United States undertook its intervention in Puerto Rico unilaterally, without having consulted the Puerto Rican people at all, by means of an armed invasion which subsequently was ratified in a treaty between two belligerents in a war, neither one of which was Puerto Rico; and inasmuch as it has constantly pursued its intervention in our country since then, crushing the self-determination of the Puerto Rican people, the only way in which the United States can abide by mankind's mandate to decolonize Puerto Rico is by halting its intervention. Since there was no need for plebiscites, referendums or elections to carry out invasion, there is no ground to claim that they are necessary for the full and unconditional transfer of powers to the people of Puerto Rico."

The PSP is committed to boycott any plebiscite that takes place prior to a complete transfer of powers to Puerto Rico. It pledges to vigorously pursue national and international activities to prevent any such referendum which perpetuates what it considers to be the political, economic, and military subordination of Puerto Rico to the United States.

The PSP, however, urges Puerto Ricans to construct "a legal formula that will favor the most peaceful and least painful transition toward decolonization," consistent with the prior transfer of powers concept. Although reaffirming the pledge for a peaceful transition, Mr. Mari-Brás states that "we shall never refuse to confront the violence of the enemy with the violence of the Puerto Rican revolutionary spirit."

The PSP is steadfastly committed to independence as the only acceptable status. It firmly believes that complete autonomy is required to protect and nurture the island's culture, to institute a true democracy by the masses, and to enable Puerto Rico to attain control over its destiny.

CONCLUSIONS

Puerto Rico's political leaders and public conscience long have focused on one enduring dilemma--status. Ardent debates over the concepts of commonwealth, statehood, and independence have persisted for decades and eluded resolution. This divisiveness continues to keep Puerto Rico a splintered society in search of a solidified identity, an alternative political future, and greater socioeconomic advancement. Longstanding debates have intensified recently as criticism of the current status' limitations in resolving the island's problems has increased.

Dissatisfaction with the present status' inability to fulfill Puerto Rico's political, social, and economic aspirations transcends political parties. Although adamantly supporting different alternatives, the proponents of each desire to attain greater political rights, dignity, and socioeconomic development, as well as preserve the island's unique cultural characteristics. Heightening debates by the island's political parties have spurred increased national and international attention and prompted various status proposals.

The status preference of the Puerto Rican citizenry, however, has not been tested directly since 1967. Such an important decision may be requested eventually, but the status agenda presents very divergent options. Statehood supporters desire full equality within the American system. Commonwealth advocates want to maintain the existing framework but seek greater autonomy. Independence proponents want the island to become an independent nation.

Each alternative is based upon a deep-rooted ideological foundation. Argumentative positions are further shaped by Puerto Rico's changing social and economic posture as these elements are intertwined inextricably with the political status question. Debates are intense and emotional. Views frequently conflict. Severe differences often appear irreconcilable.

The quest to achieve greater political rights and overall development, however, is universal and unwaivering. Consequently, status debates will continue. Each alternative would bring greater political rights, but each also offers a different identity and type of society. Compounding these divisions, each status option also presents a myriad of financial, economic, cultural, legal, and other considerations.

Support for any status should emanate from the Puerto Rican populace, and the U.S. Government has to decide whether to approve the selected status and agree to arrangements designed to facilitate its implementation. This process will require much deliberation and numerous policy decisions.

Because the selection and established terms of any status hinge on a series of future events involving a perplexing array of concerns, discussions necessarily will evolve incrementally. Consequently, the possible outcome of any status option depends in part on further specification of status arrangements. To assist evolving status discussions, the following chapters provide an initial analytical framework by describing status change issues and potential impacts that require further detailed consideration and by identifying areas where new or transitional arrangements may be needed.

CHAPTER 5

EACH STATUS WOULD ALTER FINANCIAL AND INTERGOVERNMENTAL ARRANGEMENTS BETWEEN PUERTO RICO AND THE FEDERAL GOVERNMENT

Puerto Rico's unique relationship with the Federal Government has influenced greatly the island's government finances and socioeconomic development. This relationship, which has fostered the integral role of the Federal Government, entails a complex web of special arrangements. Consequently, any status change, to varying degrees, holds significant repercussions for the island's future and would necessitate numerous policy decisions by the Congress and Puerto Rico.

Changing this intricate and longstanding relationship would require careful consideration. To assist any status deliberations, this chapter examines how current Federal-Puerto Rico financial and intergovernmental arrangements would likely change under statehood, independence, or an amended commonwealth. It identifies elements that would be affected, explores the magnitude of changes, and discusses transitional proposals under consideration by the various political parties.

PRESENT TREATMENT SIMILAR TO STATES, BUT KEY DIFFERENCES EXIST

Puerto Rico's relationship with the Federal Government contains many special features, but it has developed similar to the Federal-State model. The island's duty-free access to U.S. markets and use of the dollar since the early 1900s have created a situation where almost three-fourths of Puerto Rico's trade is with the States. Since that time, the Federal Government also has provided Puerto Rico's defense and extended most U.S. laws to the island. Moreover, the advent of U.S. citizenship in 1917 prompted certain legal protections and enabled unrestricted migration to the States. Further, the island is treated like a State in the vast majority of Federal activities and assistance programs.

Several key departures from the traditional Federal-State relationship, however, also have contributed greatly to the island's development and revenue raising capacity. Federal tax advantages have played a key role in attracting investment--approximately 90 percent of Puerto Rico's industry reportedly has been financed by mainland-based firms. Also, since 1900, Puerto Rico's exclusion from most Federal internal revenue provisions has afforded the island government greater flexibility in establishing a local tax system. Another longstanding arrangement to provide government revenues is the Commonwealth's receipt of certain Federal excise taxes and customs collections.

On the other hand, although treated like a State in almost all Federal assistance programs, Puerto Rico is either excluded or provided reduced funding levels in certain programs, such as Supplemental Security Income, General Revenue Sharing, and Elementary and Secondary Education. Such treatment has raised questions concerning the rights of U.S. citizens residing in Puerto Rico and has been addressed recently by the U.S. Supreme Court. The Court, in two separate cases, rejected arguments that reduced funding levels and exclusion from certain Federal programs were unconstitutional.

In the most recent case the Court concluded that the Congress may treat Puerto Rico differently from States as long as there is a rational basis, because the U.S. Constitution grants the Congress authority to make all needful rules and regulations respecting the territories. The Court cited three reasons which it concluded justify different treatment: Puerto Rico residents do not contribute to the Federal Treasury; the cost of treating Puerto Rico as a State would be high; and additional amounts of Federal aid could disrupt the Puerto Rican economy.

Similarly, there are a few variations in how Federal services and regulations apply to Puerto Rico, although in most cases the island is treated like a State. One notable variation concerns Federal banking laws. For example, although national banks in one State generally are prohibited from opening branches in another State, Federal law permits, upon approval, national banks to operate branches in Puerto Rico. Additionally, the Interstate Commerce Act does not apply, and the Federal Trade Commission and the Bureaus of Census and Labor Statistics do not provide the same coverage given to States.

CURRENT RELATIONSHIP PROMPTED
INTEGRAL FISCAL ROLE OF THE
FEDERAL GOVERNMENT

The island's relationship with the U.S. Government and historic growth in Federal activities have contributed to the extensive Federal role in Puerto Rico. The chart that follows illustrates the increasing importance of Federal disbursements, despite the island's unequal treatment in several programs.

	<u>1970</u> ---(million)---	<u>1975</u>	1970 - 1975 <u>Percent</u> <u>increase</u>	<u>1979</u> (million)	1975 - 1979 <u>Percent</u> <u>increase</u>
Net transfer payments	\$ 80	\$ 599	649	\$1,483	148
Federal grants to the Government sector (note a)	<u>375</u>	<u>797</u>	113	<u>1,423</u>	79
Total Federal assistance	<u>\$455</u>	<u>\$1,396</u>	207	<u>\$2,906</u>	108
Operating expenditures of Federal Agencies in Puerto Rico	\$161	\$ 188	17	\$ 258	37
Federal assistance as a percent of island gross product	10	20	-	29	-

Source: Economic Report to the Governor, 1979

a/Includes certain customs duty and Federal alcohol and tobacco excise tax rebates.

Federal disbursements, as they do in States, substantially affect government finances as well as island residents' personal income and contribute significantly to Puerto Ricans' education, health, income security, housing, and employment opportunities. For example, about 15 percent of the island's 1979 personal income and 35 percent of Commonwealth government recurrent receipts came from Federal sources.

The Federal role has other dimensions. In addition to the importance of its tax policies, the Federal Government employs several thousand persons and spends over \$250 million to run its island operations. Additionally, Federal loans and guarantees constituted an important source of capital.

STATEHOOD WOULD BRING EQUAL TREATMENT UNDER FEDERAL LAWS AND PROGRAMS

Statehood would not change most elements of the present relationship, because the island already is treated like a State in most Federal activities. Admission, however, would alter several key aspects of Puerto Rico's relationship with the Federal Government.

Statehood would bring full equality in national political and legislative matters and end limitations on certain Federal

programs where Puerto Rico is treated differently from States. Equal treatment under statehood, however, would eliminate Federal tax advantages which have been important to the island's development and government finances. Statehood advocates maintain that Puerto Rico's unprecedented situation warrants adjustment measures designed to facilitate a transition.

Because statehood would cause numerous adjustments important to the island's future, it would require careful consideration by the Congress and Puerto Rico. Consequently, statehood's aggregate impact would be influenced greatly by the terms of admission, strategies to promote economic development and replace current special tax arrangements, and decisions regarding the island government's revenue structure.

To enhance such deliberations, the following discussion establishes a benchmark indicating the impact of immediate equal treatment under statehood in Federal laws and programs. It further examines how statehood-induced changes could affect Puerto Rico's government and residents and discusses transitional arrangements under consideration by statehood advocates.

Increased aid would benefit island governments and low-income residents

In 1979 Puerto Rico already was fully eligible for the vast majority of the over 1,000 Federal assistance programs available to individuals and State and local governments. ^{1/} Although like States, Puerto Rico was not eligible for some programs targeted to a geographic area or specific group, the island was treated differently from States in certain major programs. In fiscal year 1979 there were 20 Federal programs that excluded the island or limited Puerto Rico's participation. Although treatment as a State would have had a minimal or unquantifiable effect under 14 of these programs, it would have brought substantial additional amounts under the remaining 6.

As illustrated in the chart on the next page, Puerto Rico would have received about \$721 million in additional Federal aid if it had been a State in 1979. The actual increased amount of Federal aid which could accrue under statehood, however, would depend on various factors including

- any changes to the authorization, allocation methods, or funding levels of programs where Puerto Rico is treated differently from States;

^{1/}Appendix III discusses the nature of Puerto Rico's eligibility for 1979 Federal assistance programs.

Characteristics of Unequal Treatment and
Estimated Additional Federal Assistance in 1979
Had Puerto Rico Been Treated Like a State

<u>Federal Department</u>	<u>Program</u>	<u>How Puerto Rico's treatment differs from States</u>	<u>Estimated additional assistance under State- hood 1/ (\$ million)</u>
Education 2/	Elementary and Secondary Education (Title I)	Different allocation formula applied	\$ 68
Health and Human Services 2/	Supplemental Security Income (SSI)	Excluded	304
	Aid to Families with Dependent Children and Adult Programs (AFDC)	Federal matching rate set at 75 percent and island funding subject to a ceiling for fiscal year 1979	62
	Social Services (Title XX of Social Security Act)	Instead of being included in the formula, \$15 million are set aside for Puerto Rico	24
	Medicaid (Medical Assistance Program-Title XIX of Social Security Act)	Matching rate set at 50 percent and island funding subject to a ceiling in fiscal year 1979	82
Treasury	General Revenue Sharing	Not included	263
Plus:	Earned Income Credit payments (See pp. 128 and 129.)		31
Less:	Projected reduction in Food Stamps due to projected increases in SSI and AFDC payments		(113)
	Total		<u>\$721</u>

1/Calculations are described in appendix III. In each case, we consulted Federal officials responsible for administering the programs, and they concurred with the methods for computing estimates.

2/Department of Health, Education, and Welfare in 1979.

- budgetary decisions by the island government regarding expenditure levels in programs where the Federal Government reimburses or matches local costs; and
- specific terms of any admission legislation.

Because most of the programs which would have been affected by statehood were targeted for low-income persons, funding increases would have benefited less advantaged island residents. Additional funds under the Supplemental Security Income program (SSI) would have directly increased the income of needy aged, blind, or disabled persons. Similarly, increased Federal funds under Medicaid, Aid To Families With Dependent Children (AFDC), and Title XX of the Social Security Act would have been available to help State or local agencies assist low income residents. Federal agriculture officials noted, however, that because Food Stamp allocations have been graduated on the basis of an income definition which included SSI and AFDC payments, the estimated \$366 million increase in these programs if Puerto Rico were a State would have reduced the total 1979 Federal Food Stamp expenditure by about \$113 million.

The overall increase in Federal aid brought by statehood would have raised the island's 1979 per capita share of total Federal outlays (domestic and defense) closer to that of the lowest State. On a per capita basis Puerto Rico's actual Federal share in 1979 was much lower than any State, primarily due to its unequal treatment in several programs and the relatively small amount of defense expenditures. Any increased aid brought by statehood would improve the island's standing, and advocates have further contended that a stronger voice in Federal legislation through full congressional representation could result in additional funds.

Immediate equal treatment would greatly increase tax liabilities and likely prompt major realignments in Puerto Rico's revenue structure

Along with extending additional Federal funds, immediate equal treatment under statehood would engender profound changes to overall taxation in Puerto Rico. Although certain Federal taxes apply, for the most part Puerto Rico is not integrated into the Federal internal revenue system. In the absence of full Federal taxation, the Commonwealth government developed a tax system more akin to that of the Federal Government than those of States. Equal treatment would bring full Federal tax liabilities and likely necessitate adjustments to Puerto Rico's tax system to make it compatible with the Federal one.

The potential repercussions of such changes would necessitate deliberations by the Congress and Puerto Rico, along with numerous policy decisions regarding the scope of government services and the sources tapped to finance such activities. Recognizing the major adjustments associated with immediate changes to current tax

arrangements, statehood proponents have argued that a 20-year transitional period be included in any admission legislation so that the Federal tax system could be phased in gradually.

Although exempted from most U.S. taxes, Puerto Rico residents already are subject to Federal social security and unemployment taxation. Individual and corporate income earned outside of Puerto Rico as well as salaries of Federal employees working on the island also are taxed. Customs duties on foreign goods imported into Puerto Rico are applied fully as are Federal excise taxes on island-produced alcohol and tobacco products on mainland-bound shipments. Statehood would not affect the application of these taxes, but equal treatment would end the current arrangement whereby excise tax and customs duty collections less administrative costs are returned to Puerto Rico. Curtailing these rebates, which amounted to \$273 million in 1979, would decrease Commonwealth government revenues while increasing Federal receipts.

Immediately imposing full Federal taxation would increase substantially Puerto Rico's overall tax liability. The island is in effect exempt from Federal individual and corporate taxes on income earned in Puerto Rico along with certain excise and estate and gift taxes. If Puerto Rico had been treated like a State in 1979, its liability would have been an estimated \$1.5 billion 1/ more than the approximately half billion tax dollars actually retained by the U.S. Treasury for Federal taxes which already applied.

The estimated increased Federal taxes would have stemmed primarily from the estimated \$1.1 billion corporate liability and would have reflected, in part, the substantial profits of U.S. mainland-based firms operating in Puerto Rico. In 1979 Puerto Rico would have had a greater Federal corporate income tax liability than similar liabilities in 34 States. The U.S. Treasury Department estimated that mainland-based tax exempt firms alone had fiscal year 1979 Federal tax savings of \$838 million.

The future corporate income tax liability under statehood, however, could be influenced greatly by decisions regarding investment in Puerto Rico. Mainland-based firms have been important to Puerto Rico's economy. Statehood's potential positive and negative influences on business decisions is a fundamental question surrounding the status debate. Chapter 6 examines the relative importance of tax advantages and other factors that influence business location decisions. The chapter also discusses how a status change could affect Puerto Rico's strategies for attracting and retaining investment.

The island's Federal individual income tax liability would have increased by \$248 million on the basis of our calculations

1/Our methodology for computing these estimates is discussed in appendix IV.

from the latest available Puerto Rican tax return compilations. In contrast to the corporate levy, however, the island individual liability would have been less than any State. Because of Puerto Rico's extremely low per capita income, about 43 percent of the Puerto Rican tax returns used in our analysis would have had no Federal tax liability. 1/

In fact, about 70 percent of these Puerto Rican returns could have been eligible for an estimated total of \$36 million in earned income credits. The earned income credit is one of several Federal tax code changes which have significantly influenced the tax liability of lower income taxpayers since 1975. Others include increases in the personal exemption allowances and the zero income tax bracket along with decreases in overall tax rates.

In addition to increased corporate and individual income taxes, Puerto Rico residents also would have to pay estate and gift taxes along with additional excise taxes. During 1979 the island would have owed about \$19 million in estate and gift taxes and approximately \$146 million in added Federal excise levies on items such as gasoline and telephone services.

In conjunction with immediate equal treatment under the Federal tax system, statehood likely would prompt major changes to the island government's revenue system. For example, had it been a State in 1979, the island would not have received the \$273 million in Federal excise tax and customs duty rebates. Such lost revenue, however, would have been replaced by the estimated increased Federal aid under statehood. Although much of this aid would have been paid to individuals or targeted to increase funding in existing services, there would have been an estimated net \$320 million in General Revenue Sharing aid and Puerto Rican government funds freed up by the changed Federal share in Medicaid, AFDC, and SSI (see app. III for details).

The additional Federal aid would have offset the loss of rebates, but the island government in 1979 likely would have had to collect about the same amount of tax revenue if the range of public services were to be adequately maintained. As a State, however, Puerto Rico likely would have to change its tax system because island levies are similar to Federal taxes rather than those of State and local governments. Like in the Federal tax system, island individual and corporate income and excise levies are the major revenue producers, but Puerto Rican tax rates in many cases are higher. In contrast, property and sales taxes are the revenue mainstays of State and

1/Sixteen percent of island individual tax returns filed in fiscal year 1979 had no Commonwealth tax liability.

local governments, and income tax rates are considerably lower than the Federal ones.

Consequently, as a State, Puerto Rico would have to adjust its revenue system to make it compatible with the Federal one. Full Federal taxation likely would necessitate reducing Puerto Rican taxes in categories where Federal levies exist. To compensate for any decreases, revenue would have to be obtained from other sources to maintain government services.

Obtaining sufficient revenues to maintain the level of Puerto Rican government services while making the island tax system compatible with the Federal one present major considerations. Hypothetically, if full Federal taxation had been imposed in addition to Puerto Rico levies, the island's overall 1979 tax liability would have increased by an estimated 66 percent, primarily due to the additional Federal corporate income tax liability. Excluding this tax, the island's total liability would have increased by approximately 17 percent.

If it becomes a State, however, Puerto Rico's actual tax liability would depend upon various elements. Most notable would be any changes to U.S. tax laws and the tax structure adopted by the new State. Other important determinants would be the terms of statehood legislation, along with budgetary decisions regarding the island government's revenue system and the scope of public services. Additional factors would include economic conditions and the Puerto Rico government's financial posture. 1/

Another potentially significant but highly speculative element which could affect Puerto Rico's tax liability is the island's tax compliance difficulties. Although the Puerto Rico Treasury Department has intensified enforcement efforts, compliance with island tax laws reportedly remains a problem. Some observers believe that the Federal Internal Revenue Service (IRS) with its greater resources might improve tax compliance.

Although IRS might increase island tax compliance and total collections, there would be no way to accurately gauge the magnitude of improvements until the agency began full operations. A representative picture of Puerto Rican tax compliance would probably not be available for several years, because it would take time to inform the populace about Federal tax requirements. Accordingly, we did not adjust our tax liability calculations to include prospective increased compliance levels, but improved collection efforts could be a factor influencing the island's tax liability should it attain statehood.

1/Appendix V discusses the Commonwealth government's budget and operations.

Proponents have advocated gradual application of full Federal taxation and other transitional measures

Statehood supporters have recognized that their status option would bring increased Federal taxes and eliminate excise tax and customs duty rebates to the Puerto Rico government. They have asserted, however, that because Puerto Rico would be the first new State not already incorporated into the Federal internal revenue system, gradual introduction of Federal taxation would be logical and necessary.

Specifically, statehood advocates have suggested a 20-year transition period. During this time, Federal individual and corporate taxes gradually would be phased in while comparable Puerto Rico levies are reduced to approximate those in States. Similarly, proponents have suggested that rebates of Federal customs duties and excise taxes be phased out incrementally. It also has been proposed that corporations be permitted to retain their Federal tax advantage until the corresponding Puerto Rican tax waiver expires.

Other examples of proposals to help the new State adjust its revenue system include various forms of transitional assistance ranging from special monetary aid and land grants to setting aside Federal contracts for manufacturing firms in Puerto Rico. Statehood advocates also have suggested that the Federal Government assume the \$6.4 billion Puerto Rico public debt. Servicing this debt cost about \$700 million in 1979. This, it has been asserted, would permit channeling of local resources into satisfying the infrastructure requirements of a poststatehood economy and would free the State government from a large fixed expense during a period when major shifts in revenue sources would be taking place.

Most Federal and Puerto Rican responsibilities would not be affected, although some would need attention

With few exceptions, Federal regulations and services applicable to States also apply to Puerto Rico. For example, the Federal Government provides postal, defense, customs, and immigration services and regulates areas such as occupational safety, aviation, the environment, and maritime shipping. Our analysis and discussion with officials in almost every Federal agency revealed that admission into the Union would not affect most services and regulations.

Certain areas in which Puerto Rico has been treated differently from States, however, would need attention. Services provided by the Federal Internal Revenue Service would increase if the island became a State. Presently, IRS's Office of International Operations handles certain Federal tax matters in Puerto

Rico, such as Social Security and excise taxes, but statehood would increase responsibilities for processing and auditing additional individual and corporate returns and collecting other taxes. An IRS official estimated that these added duties would require staff and resources equivalent to a small district office and could possibly cost about \$18 million annually.

Because it is treated differently from States under certain U.S. banking laws, changes could be required if Puerto Rico is admitted to the Union. Most notably, although Federal law generally prohibits nationally chartered banks located in one State from opening branches in another State, these banks--upon the Federal Reserve's approval--can open branches in Puerto Rico. Three large branches of mainland-based national banks--Chase Manhattan, Citibank, and Bank of America--have become important to the island's banking industry and economic development. These banks hold over one-third of total banking assets and deposits and finance almost half of island bank loans. Because this arrangement could be jeopardized if Puerto Rico became a State, it would need attention during any statehood deliberations.

Several other banking provisions also would require attention. All nationally chartered banks in the States are required to join the Federal Reserve System which, among other things, makes them insured banks under the Federal Deposit Insurance Act, but Puerto Rican branches of national banks are not. Also, such branches are not subject to Federal legislation pertaining to reserve requirements or interest rates on deposits. Further, limitations on certain interstate bank acquisitions have not been applied to Puerto Rico.

In addition to certain banking regulations, Puerto Rico is exempted from the Interstate Commerce Act. Statehood likely would have little effect in this area, however, because Puerto Rico has no railroads or interstate roads, and the island already is subject to Federal maritime laws.

Like Federal activities, Puerto Rico's government responsibilities likely would not be affected significantly by statehood. Discussions with Commonwealth officials and our review of available documents revealed that the island government already provides a full range of services comparable to those performed by State and local governments. As discussed in appendix V, these services include education and public safety, along with highway construction and maintenance.

INDEPENDENCE WOULD PROMPT FAR-REACHING CHANGES

Independence would cause profound changes to virtually every aspect of Puerto Rico's relationship with the Federal Government. Independence holds far-reaching impacts, because Puerto Rico's longstanding relationship with the United States has influenced significantly the island government's financing

and economic posture in addition to having forged strong commercial and other ties to the remainder of the United States. Recognizing the magnitude and scope of change their status option entails, the Puerto Rican Independence Party (PIP) has advocated that autonomy be attained through an orderly and rational transition to self-reliance.

Eliminating the extensive Federal role: potential impacts and advocates' proposals

Because autonomy would completely revamp the intricate Federal-Puerto Rico relationship, independence's ultimate impact hinges on numerous future legal, fiscal, and other policy decisions by the Congress and Puerto Rico. The most notable decisions would entail the terms of independence; the financial structure and policies of the republic; and the new nation's success in concluding treaties with other countries and organizations concerning trade, financial assistance, and other arrangements. Other elements crucial to the new nation's development would include worldwide economic conditions and Puerto Rico's attractiveness as a place for investment.

Although the overall effects of independence cannot be measured with any certitude, elements that would change can be described and areas requiring detailed consideration delineated. The PIP has proposed certain arrangements it believes are indicative of the type needed to facilitate a transfer of powers. The following segment examines components of the present Federal-Puerto Rico relationship that would change and presents advocates' proposals.

Federal assistance would terminate, but questions surface regarding alternative funding and beneficiaries' vested rights

Because Federal assistance has become increasingly important, making up for the loss of such integral and longstanding funding sources would present a key challenge to the new nation. An independent Puerto Rico would no longer automatically be eligible for the Federal assistance currently received. These funds, amounting to about \$2.9 billion in 1979, have contributed significantly to Puerto Ricans' income and, as illustrated below, are important to government services.

Federal Contribution to Key Puerto Rico Services

<u>Services</u>	<u>Percent of total program funds</u>
Social welfare	50
Education	31
Housing	27
Health	23

Recognizing the consequences of suddenly losing Federal funds, the PIP has proposed that current funding levels be extended temporarily after independence. In lieu of the current forms of aid, however, the PIP has suggested that the Federal Government contribute to a special Development and Economic Reconstruction Fund. This fund would help finance essential government activities until the economy is reoriented, consumption patterns reduced, and other revenue sources developed.

This U.S. foreign aid would be requested for a 10-year period and decrease each year. Concomitantly, the independent nation, faced with steadily decreasing Federal assistance, would be confronted with decisions regarding levels and types of taxation and public services. Another important factor in counteracting the loss of Federal program funds could be additional foreign aid from other countries and international organizations.

Island residents' vested rights acquired through contributions to certain Federal activities would require special attention. For example, Puerto Ricans, like other U.S. citizens, have paid into the Social Security Trust Fund and served in the Armed Forces or Civil Service.

The PIP has proposed that current beneficiaries continue receiving payments after independence under the same conditions as U.S. residents. Additionally, the proposed arrangement regarding Social Security calls for returning all payments, including interest, made by Puerto Ricans who had not yet received any benefits. The moneys would be used to establish a Puerto Rican Social Security System.

Independence would bring complete local control but end longstanding economic arrangements

Independence would bring Puerto Rico the authority to establish monetary, trade, wage, and immigration policies but also would end features of its relationship with the Federal Government that have been important to economic growth. Losing duty-free access to U.S. markets, Federal tax advantages to draw U.S. investment, free migration to the States, and common currency would require fundamental changes to Puerto Rico's economic structure. The PIP has recognized that time and various transitional arrangements would be needed to establish a new institutional framework and economic order, as well as to develop alternative export markets and capital sources.

The potential effects of independence on factors influencing Puerto Rico's strategies for attracting business investment are examined in chapter 6. The chapter also describes PIP transitional proposals for introducing U.S. tariffs, negotiating the

change in currency, and extending certain credit terms and tax arrangements.

Federal services and regulation would cease, requiring numerous adjustments and additional financing

An independent Puerto Rico would have complete autonomy over its own affairs. The island no longer would be subject to Federal regulation or be the recipient of Federal services. Presently, the Federal Government regulates many areas, including shipping, immigration, communications, and the environment. Further, Federally provided services include defense; postal; census counts; and safety certifications of airplanes, drugs, and various other products.

Like the challenges of implementing a new economic system, however, the new nation would have to decide which Federally administered activities would be assumed and how such new responsibilities would be managed and financed. The manner in which the new nation chooses to govern and finance its activities would not be known until its organization was formulated. Additionally, an independent Puerto Rico's governmental activities would be influenced by any arrangements made with the Federal Government to transfer the functions.

The PIP has proposed that Federal postal facilities be transferred to the new government's postal agency and notes that efforts would be made to retain the same employees because of their expertise. The PIP also has advocated a bilateral treaty to maintain the present relations regarding international telephone, cable, radio, and television services after independence. A similar proposal has stated that until bilateral treaties are negotiated for air and marine lines, present service would continue temporarily under permits in effect before independence.

The PIP also has advocated the U.S. military's complete withdrawal and has called for negotiating the minimum time and conditions for vacating the island. The PIP, however, plans to demand the immediate cessation of activities on Vieques--an island off the coast of Puerto Rico. According to Rubén Berriós Martínez, President of the PIP, an independent Puerto Rico would not have armed forces other than a national guard.

In addition to negotiating the U.S. military's departure, the PIP has stressed that the real and personal property rights of American citizens and businesses would be honored and any expropriation justly compensated. They also have proposed that all U.S. Government property be given to the new republic. In all, the U.S. Government owns 91,351 acres in Puerto Rico. Over 75,000 acres have been acquired by either direct purchase, donation, or other means. Also, more than 15,000 acres were ceded to the United States by Spain in 1898.

ALTHOUGH MAINTAINING SPECIAL ARRANGEMENTS,
THE IMPACT OF AMENDED COMMONWEALTH PROPOSALS
HINGES ON FUTURE DECISIONS

Although emphasizing that the basic framework of the current relationship be preserved, commonwealth proponents have advocated certain changes. They have proposed that common citizenship, currency, defense, and duty-free access to U.S. markets be continued along with exemptions from most internal revenue laws and rebates of alcohol and tobacco excise taxes and customs duties. Advocates have maintained, however, that certain arrangements need revising to give the island more flexible treatment in Federal laws and programs as well as greater control over several areas regulated by the Federal Government.

Although proposals for an amended commonwealth have been made, the exact nature of any modifications are contingent upon future deliberations by commonwealth advocates and approval by the Congress. As for statehood and independence, the ultimate impact of an amended commonwealth hinges on the specific negotiated terms and subsequent policy decisions by the Puerto Rico government. Consequently, the best indication of what an amended commonwealth would entail, according to commonwealth advocates, could be obtained by examining proposals embodied in the 1975 Compact of Permanent Union and former Governor Hernández-Colón's 1979 "New Thesis."

Advocates seek discretion in using
Federal funds and greater influence
over Federal law

Commonwealth advocates have proposed changing the manner in which certain Federal funds are provided to Puerto Rico's government. As an alternative to present Federal assistance which is targeted for use in specified programs and projects, amended commonwealth proponents have advocated that certain grants-in-aid be consolidated into a block grant. They have argued that such treatment would result in greater local discretion in determining how these funds are spent. Although the method for distributing aid to the Commonwealth government would be altered, programs such as Food Stamps and Medicare, along with payments to social security, civil service, veterans, and other beneficiaries, would continue unchanged.

Another factor also could influence the flow of Federal funds to Puerto Rico. Commonwealth supporters have urged eliminating unequal treatment in Federal programs, but no specific proposals have been made. The impact of any future amendment would depend on negotiations regarding which programs would be affected and how this change would coincide with the request for a block grant allocation.

Along with achieving more local control over spending Federal funds, amended commonwealth supporters have urged a greater

voice in Federal legislation and activities affecting the island. One proposal designed to enhance Puerto Rico's influence over these matters is to grant the island representation in the U.S. Senate along with the House of Representatives. Another suggested modification has proposed that in the future:

- Puerto Rico would not be subject to Federal laws unless specifically mentioned;
- if mentioned in new Federal legislation and regulations the island would be authorized to object and have such objections acted upon by the Congress or the administering Federal agency; and
- Federal legislation and regulations already applicable to the island would be subject to review by a joint U.S.-Puerto Rico Commission.

This commission would (1) study the desirability of retaining, modifying, or eliminating the application of Federal laws, especially those pertaining to communications, shipping, and administration of the selective service, (2) study the possible transfer of various Federal functions to Puerto Rico, and (3) examine the desirability of making gradual contributory payments to the U.S. Treasury when such payments would not impede the island's social and economic development.

If any Federal functions were assumed or payments to the Federal Treasury instituted, new financial obligations inherently would be created. The amount of additional costs, however, is contingent upon decisions regarding which activities would be affected as well as the exact arrangements made to finance new responsibilities and transfer any functions. Similarly, the impacts of any contributory payments cannot be gauged until the types and methods of remuneration are established.

Control sought over broad range of Federal activities

While pressing for greater influence over future Federal actions, commonwealth proponents also have advocated amendments to increase Puerto Rico's control over several other areas. One such proposal was that all U.S. immigration laws and quotas continue to apply, but that when economic and demographic conditions warrant, the President and Puerto Rico's Governor could agree to limit or increase entry of aliens into the island.

Another proposed modification calls for increasing Puerto Rico's role in setting tariffs and quotas on goods entering the island. One such proposal was that Puerto Rico be able to levy, change, or eliminate such tariffs and quotas, so long as it was consistent with U.S. international obligations and laws as well as coordinated with the Federal Government. The proposal also stated that the island would be accorded observer status on U.S.

delegations negotiating international trade agreements and be consulted throughout the process. Further, the United States would, upon request, seek to have Puerto Rico recognized as a developing country qualified to receive preferences associated with that status.

Commonwealth supporters also have advocated that Puerto Rico be granted autonomy in establishing wage rates and other labor related factors along with primary control over the island's ecology. They further have proposed that Puerto Rico be permitted when consistent with U.S. policy to enter into commercial, technical, and other agreements with foreign countries and participate in international organizations.

All of these proposals are intended to strengthen the island's control over areas presently within Federal jurisdiction. They are advocated primarily as instruments to promote Puerto Rico's economic development and are discussed in chapter 6.

CONCLUSIONS

The intricate Federal-Puerto Rico relationship has been built upon an array of unique and longstanding features. This framework has developed similar to the Federal-State model, but contains many special elements. These arrangements--similarities as well as differences--have greatly influenced the island's financial structure and socioeconomic development.

Because Puerto Rico has been treated like a State in most Federal laws, activities, and assistance programs, financial and intergovernmental ties have grown considerably. Despite restrictions in several major programs, the Federal Government has become increasingly important to island personal income and government revenues. Additionally, common currency and market have resulted in extensive trade with the States while U.S. citizenship and defense arrangements have prompted legal and other protections. Certain Federal tax advantages have played a major role in attracting substantial U.S. investment. Also, the island's exemption from most Federal internal revenue laws, along with rebates of certain Federal collections, has enhanced the island's revenue raising capacity.

These important arrangements and other aspects of the island's unique relationship with the Federal Government inherently would be affected--although to varying degrees--by each status option. The short- or long-term impacts of statehood, independence, or amended commonwealth, however, hinge on numerous issues which can be resolved only by the Congress and Puerto Rico. The most important determinants would be the terms of any status change legislation, policy decisions by the Puerto Rican government, and the island's ability to attract and retain business investment as well as finance public services. Although any status' outcome depends on future events, the range

of issues and potential impacts to be deliberated are different for each status option.

Statehood would not change most elements of the present relationship but would bring equal treatment in the Federal revenue and expenditure system along with full participation in national political and legislative matters. Admission would eliminate tax exemptions and special arrangements as well as limitations in certain Federal programs. Statehood would bring substantially increased Federal aid to individuals and governments. Equal treatment, however, also would greatly increase Puerto Rico's overall tax liability and likely prompt major revisions to the island government's revenue system and economic strategies to attract investment. Recognizing the uniqueness and importance of the longstanding Federal tax arrangements, statehood proponents have advocated a gradual phase in of Federal taxation over a 20-year period and various other transitional measures.

Independence would bring Puerto Rico complete autonomy and prompt far-reaching changes. Because it would change virtually every aspect of Puerto Rico's relationship with the Federal Government, independence would necessitate reorienting the island's economic structure and development as well as the government's activities and finances. The new nation would have to make numerous adjustments to compensate for the longstanding and integral Federal role in Puerto Rico. Recognizing that independence would entail challenges, advocates have maintained that a transitional period would be necessary because of factors inherent in the island's past development.

Amended commonwealth proposals maintain the essential character of the present relationship but are designed to bring more autonomy over areas under the Federal purview. Suggested changes generally would grant Puerto Rico more flexibility in using Federal funds, a greater voice in Federal legislation, and increased authority over functions ranging from setting tariffs to negotiating treaties with foreign countries. Although some changes have been suggested, more definitive proposals are contingent upon future decisions by commonwealth advocates and the Congress.

Because each status option would engender numerous financial and other impacts, a status change would hold important repercussions for the island's economic development. The following chapter describes how a status change could affect Puerto Rico's strategies for attracting and retaining investment.

CHAPTER 6

A STATUS CHANGE WOULD PROMPT REASSESSMENT OF STRATEGIES FOR ATTRACTING BUSINESS

INVESTMENT TO PUERTO RICO

Puerto Rico's industrialization program was based on attracting external investment, and much of the island's industry has been financed through investment by mainland-based manufacturing firms. The island's economic growth, to a great extent, has hinged on its ability to attract industry by offering tax exemptions, low labor costs, duty-free access to U.S. markets, and other incentives that translated into higher corporate profits.

Because programs for promoting Puerto Rico's industrialization were devised to take advantage of its relationship with the Federal Government, altering the present arrangements or changing the island's status most likely would necessitate revising strategies to attract and retain business investment. This chapter discusses how statehood, independence, or amended commonwealth could affect business location factors such as tax exemptions, labor rates, shipping costs, trade relations, capital availability, and energy costs.

EXEMPTIONS FROM INCOME AND PROPERTY TAXES HIGHLIGHT PUERTO RICO'S TAX ENVIRONMENT

Puerto Rico's tax environment has been a major attraction to business since 1948, when the island began offering qualified local, U.S., and foreign firms--primarily in the manufacturing sector--exemptions from Puerto Rican income, property, and municipal taxes. This program complemented existing Federal legislation which exempted from Federal taxation earnings of certain mainland-based firms operating in Puerto Rico. Considerable tax exemptions remain in effect, but certain important changes have been made at both the Federal and Puerto Rico levels.

The Federal tax exemption provision, formerly section 262 of the Revenue Act of 1921, was made section 931 of the 1954 Internal Revenue Code. Under section 931, qualifying U.S. corporations could operate in Puerto Rico without paying Federal taxes on income earned there and on income derived from investing those earnings in Puerto Rico and foreign countries.

Businesses saw a major drawback in section 931, however, because dividends paid by a Puerto Rican subsidiary to a U.S. parent corporation were taxable. To avoid this taxation, a subsidiary typically accumulated earnings from its Puerto Rico operations and often invested them overseas until the tax exemption expired. At that time, the subsidiary would

be liquidated into its parent because such liquidations were free from any Federal or Puerto Rico income tax.

Between 1973 and 1976 a congressional committee considered eliminating the exemption. Subsequently, another committee required an annual report from the U.S. Department of the Treasury on the provision's operation. Additionally, through the 1976 Tax Reform Act, the Congress made several changes and moved the tax exemption provision from section 931 to section 936 of the Internal Revenue Code. Foreign income of U.S. corporations' Puerto Rico subsidiaries, known as possessions corporations, was made taxable, and parent corporations could receive dividends from their Puerto Rico subsidiaries tax free. This was done in part because of concern about U.S. corporations' Puerto Rico subsidiaries investing their profits outside the States.

Anticipating the revision of the U.S. Internal Revenue Code, Puerto Rico changed its method for taxing the dividends paid to parent corporations by tax exempt firms. Prior to 1976 the rate of this tax (known as the tollgate tax) was 15 percent, but collections were small because it applied only if the parent could claim a foreign tax credit. Subsequently, Puerto Rico reduced its tollgate tax to 10 percent, and the tax applied even if the parent was denied a foreign tax credit.

The 10 percent tollgate tax could be reduced to 7 percent if 25 percent of a year's industrial development income was invested in certain ways for 8 years and to 5 percent if 50 percent of such income was invested in certain instruments for 5 years. Also, liquidating dividends of post 1977 industrial development income would be subject to a 4 percent tollgate tax.

Before 1978 possessions corporations paid virtually no dividends to their U.S. parents. During that year, however, possessions corporations distributed to their U.S. parents \$1.5 billion. Puerto Rico estimated that dividend repatriation in both 1979 and 1980 was \$1.4 billion. The tollgate tax amounted to \$49 million in 1978, \$65 million in 1979, and about \$80 million in 1980.

Additionally, in June 1978 Puerto Rico altered its long-standing policy of offering total tax exemption to qualified corporations. A revised Industrial Incentives Act required that firms receiving new exemption grants pay taxes on part of their earnings. The act also offered firms exemption period extensions and certain other inducements to encourage conversion to the new law and partial taxation.

Two main reasons for enacting the new law were (1) the Commonwealth government's need for additional revenues to develop the island's infrastructure, and (2) the government's desire to eliminate the inequity whereby individuals bear the largest share of the tax burden while many corporations paid no taxes. Puerto Rico's Economic Development Administration, for example,

estimated that exempt profits increased from 0.6 percent of net manufacturing income in 1948 to 71.2 percent in 1976.

The new act primarily affected larger firms, most of which were U.S. subsidiaries, because it totally exempted the first \$100,000 of a firm's income if it earned less than \$500,000. We were informed that more than 95 percent of all local tax-exempt manufacturing firms earn less than \$500,000 annually, and about half of these firms earn less than \$100,000.

The tax exemptions offered under the new act are still significant, beginning at 90 percent and decreasing gradually over the life of the grant, as follows:

<u>Year of grant</u>	<u>Percent of income exempt from income and property taxes</u>	<u>Approximate maximum effective income tax rate</u>
1 - 5	90	4.50
6 - 10	75	11.25
11 - 15	65	15.75
16 - 20	55	20.25
21 - 25	50	22.50

Depending on the zone in which it locates, a firm receives an initial exemption of 10 to 25 years. In addition, the firm can apply for an extension of 10 years with a 50-percent exemption for the first 5 years and between 35 and 50 percent for the next 5 years. The new act also encouraged conversions of existing tax exemption grants by offering 10-year extensions in return for becoming partially taxable. Some of the other major provisions of the new act gave special exemptions to certain industries and allowed alternative ways to calculate taxes in certain circumstances.

Although the new act required paying some taxes, many holders of existing exemption grants requested conversion. The combination of Federal and local exemptions still represents significant incentives unavailable in the States. Over 500 applications--about one-third of existing grants--were received. The Commonwealth government estimated that tax revenues under the new act would be about \$10 million in 1981 and rise to about \$45 million in 1985.

Aside from firms operating under an exemption, businesses in Puerto Rico are taxed at rates similar to those levied by the Federal Government. The island's corporate tax structure is based on the U.S. Internal Revenue Code of 1939 and is comparable in many respects to the current Federal tax code. Corporate tax rates start at 22 percent of net income and rise to 45 percent on all income over \$300,000. Federal corporate income tax rates begin at 17 percent and rise to 46 percent on all income in excess of \$100,000. Additionally, Puerto Rico tax rates

apply to gross income, less allowable deductions, which is defined in much the same way as the Federal tax code.

EACH STATUS OPTION TO VARYING DE-
GREES WOULD AFFECT THE LIABILITIES
OF TAXABLE FIRMS

Although tax exemptions have been granted to many firms, primarily in the manufacturing sector, the vast majority of businesses (including corporations, partnerships, and proprietorships) pay full Puerto Rico taxes. For example, in 1977, of the approximately 14,100 firms operating on the island, over 12,700 (90 percent) were taxable. These included over 11,800 Puerto Rico businesses, about 880 mainland-based firms, and approximately 40 foreign enterprises.

Taxable firms are important to Puerto Rico's economy. They employed about 400,000 persons, or about 50 percent of island employment, and contributed \$5.3 billion, or 49 percent of gross domestic product. As discussed below, each status alternative would have varying effects on the tax liabilities of these businesses.

Firms currently paying island taxes likely would not be affected substantially by statehood even though Federal levies would be applied fully. Presently, Puerto Rico and foreign firms, as well as U.S. firms operating under a section 936 exemption, are not required to pay Federal taxes on income earned from Puerto Rican sources, but the island taxes at rates comparable to the Federal ones. Additionally, although U.S. firms without a section 936 exemption are subject to Federal taxes, they can totally, or in large part, offset their Federal liability by claiming a foreign tax credit for Puerto Rico taxes paid.

Although any decision on how to make the Puerto Rico tax system compatible with the Federal one rests entirely with the island government, statehood likely would prompt substantial reductions in island corporate rates to approximate those in States. Because State tax rates are much lower than the Federal counterpart--the average for all States is 6 percent--and State taxes paid are deducted from income subject to Federal tax, the combined Federal-Puerto Rico liability for currently taxable businesses under statehood would likely approximate that of firms in the States and remain relatively close to the present island levy.

For example, if Puerto Rico adopted the average State tax rate of 6 percent, the effective combined Federal and island maximum tax rates would increase to 49 percent, or 4 percentage points higher than the current island maximum rate of 45 percent. Although the maximum combined Federal and Puerto Rico tax rates under statehood would total 52 percent, 46 and 6 percent respectively, firms would pay an effective rate of 49 percent because State taxes would be deductible from income subject to

Federal taxation. Of course, if Puerto Rico becomes a State the actual tax liability of any firm would depend largely on the tax system adopted by the island government and the Federal tax system at that time.

Under independence, the island would be the primary jurisdiction to tax Puerto Rican source income. As discussed in chapter 5, an independent Puerto Rico would be confronted with numerous decisions regarding its tax system, and it is impossible to determine with any certitude the type of corporate tax system the new nation might adopt. Any U.S. firm operating in Puerto Rico, however, most likely would be able to reduce its Federal liability by taking a foreign tax credit for any island taxes paid.

Amended commonwealth proposals have not suggested any fundamental changes in the tax arrangements between Puerto Rico and the Federal Government. Like statehood and independence, however, any changes regarding the Puerto Rico tax system depend on future island government decisions.

SUDDENLY ELIMINATING FEDERAL CORPORATE TAX EXEMPTIONS WOULD ENTAIL RISKS TO FUTURE BUSINESS DEVELOPMENT IN PUERTO RICO

Although the number of tax exempt firms operating in Puerto Rico constituted only about 10 percent of all businesses, their contribution to the economy is much greater. Out of the 14,100 firms located on the island in 1977, only 1,360 were exempt from Federal and Puerto Rico taxes (607 mainland-based, 731 Puerto Rico, and 22 foreign). Ninety-four percent of these businesses, however, are concentrated in and make up most of the island's manufacturing industry--Puerto Rico's most important economic sector and largest contributor to island gross product. In the manufacturing sector during 1977, tax exempt firms accounted for about 87 percent of net profit, 71 percent of payroll costs, and 76 percent of employment. In total, tax exempt firms employed about 117,000 persons, or about 16 percent of total island employment.

Attracting mainland-based investment has been the cornerstone of Puerto Rico's industrial development strategy. In 1977 the approximately 590 U.S. tax exempt manufacturing firms accounted for 82 percent of that sector's net profit and 50 percent of its employment. Moreover, the U.S. Department of Commerce Economic Study of Puerto Rico estimated that about 90 percent of the island's industry has been financed by mainland-based firms. The study also noted that in view of the lack of Puerto Rican capital formation, future manufacturing development will depend very heavily on capital inflows and that continuation of Federal tax exemption is "virtually the sine qua non for attracting more U.S. investment capital to Puerto Rican industry."

The combination of Puerto Rico and Federal tax exemption has been a powerful inducement for locating in Puerto Rico and has

resulted in substantial tax savings for U.S. firms operating on the island. The U.S. Treasury Department estimated that in calendar year 1979 these firms had Federal tax savings of \$859 million, and by the early 1980s this figure will increase to over a billion dollars annually.

Much of this tax savings has accrued to the two leading growth industries in Puerto Rico, the predominantly mainland-based pharmaceutical and electrical and electronic equipment industries. For example, the effect of Puerto Rican tax exempt earnings on parent firm profits has been substantial for many pharmaceutical companies comprising over half of some parent firms' total profits. As shown below, during 1978 pharmaceutical firms accounted for more than 49 percent of total U.S. tax savings, and the electrical and electronic equipment firms accounted for an additional 15 percent.

Manufacturing Income and Related Tax Savings
in 1978 for Section 936 Firms

<u>Industry</u>	<u>Income</u> (millions)	<u>U.S. tax savings</u>	
		<u>Amount</u> (millions)	<u>Percent of total</u>
Pharmaceuticals	\$1,084	\$412	49.1
Electrical and electronic equipment	320	125	14.9
Food products	153	51	6.1
Chemicals	193	53	6.3
Apparel	57	22	2.6
All other	<u>478</u>	<u>176</u>	<u>21.0</u>
Total (note a)	<u>\$2,285</u>	<u>\$839</u>	<u>100.0</u>

Source: The U.S. Treasury's June 1980 Annual Report on Possessions Corporations.

Note a: Includes data for possessions corporations in Puerto Rico and elsewhere, but non-Puerto Rican operations accounted for only 0.2 percent of all net income.

Tax exempt U.S. pharmaceutical and electrical and electronic equipment firms' contribution to the Puerto Rico economy has been substantial. During 1977 they employed over 16,000 persons and paid them about \$140 million. This was about 11 percent of total manufacturing employment and 13 percent of payroll. Their contribution was not as large as the apparel industry, however, which provided 25 percent of manufacturing employment and 16 percent of payroll.

The provision of the U.S. tax code exempting certain U.S. businesses from Federal taxation could be rescinded at any time. Additionally, equal treatment under tax laws brought by statehood would end Federal exemptions as would autonomy under independence.

Of course, Puerto Rico under any status could continue to offer exemption from its taxes.

In the event of statehood, exempt mainland-based firms would become subject to Federal taxes. Their liability would increase from the 0 to 12 percent now paid in Puerto Rican taxes ^{1/} up to a maximum Federal rate of 46 percent as well as any island taxes imposed. The levels of Puerto Rico taxes would depend on whether or not the island government would continue to offer local exemptions and what corporate tax system they might adopt. Any island tax paid could be used to reduce income subject to Federal taxation.

Statehood also would increase substantially the tax liability of more than 700 Puerto Rican and foreign firms that are exempt from Puerto Rico and Federal income taxes. The contribution of these firms to Puerto Rico's economy, although much smaller than U.S. firms, is important. They provided more than 23 percent of manufacturing employment and 21 percent of payroll in 1977.

Like for statehood, mainland-based firms operating under section 936 most likely would lose their exemption if Puerto Rico became an independent nation. Puerto Rico could continue to offer U.S. firms exemption from its taxes, but this would have little benefit without exemption also from U.S. taxes. Because the foreign tax credit most likely would remain in effect with independence, however, U.S. firms operating in Puerto Rico would be able to claim any taxes they pay to Puerto Rico as a credit against their Federal taxes. Additionally, local and foreign firms could still be granted Puerto Rican tax exemption, but it is unknown whether the independent nation could afford to grant widespread exemptions, because it would lose revenues and services currently provided by the Federal Government.

Because Federal tax exemption has promoted Puerto Rico's manufacturing sector and was a primary reason for many firms locating on the island, eliminating the Federal exemption would be difficult to overcome, particularly if it is rescinded suddenly. The loss of this exemption through statehood or independence, or under the current Commonwealth status, would reduce the island's ability to attract and retain businesses because profits would be decreased significantly.

^{1/}According to a June 1980 U.S. Treasury report, for certain firms which converted to partial taxation or applied for exemption under Puerto Rico's 1978 Industrial Incentives Act, the maximum corporate income tax rate currently ranges from 3 to 12 percent but will increase gradually in 5-year increments. Firms with grants awarded prior to the 1978 act who have not converted, however, pay no income tax but are subject to the tollgate tax of up to 10 percent on dividends transferred to parent corporations.

In 1978 the Puerto Rico Economic Development Administration (EDA) analyzed tax exemption decrees. This study examined 149 cases in which firms were granted Puerto Rican tax exemptions in 1960-62 and actually established operations. Although EDA was unable to obtain the current status of operations in 46 cases, of the other 103 cases:

- 62 had apparently discontinued operations;
- 31 were still operating under an extension or modification of the original tax exemption grant; and
- 10 were continuing in taxable status, with 6 paying taxes and 4 reporting losses.

EDA concluded that very few corporations continue as taxpaying operations in Puerto Rico once their exemptions expire. One of the reasons cited for this was the "tax shock" a firm experienced going from total tax exemption to full taxation.

Other analyses performed by EDA concluded that the maximum income tax rate Puerto Rico could impose on the tax exempt sector and still be attractive to business is about 18 percent. The Economic Study of Puerto Rico found that most manufacturing concerns contacted believed a maximum corporate rate of 20 to 25 percent could be applied while maintaining business activity on the island. Similarly, officials of the Puerto Rico Chamber of Commerce and the Puerto Rico Manufacturers Association said that most industries could afford only to pay some taxes in Puerto Rico.

One EDA economist has stated that if tax exemption were removed producers in Puerto Rico would have several alternatives: (1) they could produce abroad with cheaper labor, closer raw materials, and perhaps closer markets, (2) they could produce on the mainland closer to most markets but with higher labor and tax costs, or (3) they could quit producing altogether. The analyst concluded that these alternatives implied a reduction in employment and profits in Puerto Rico, and some combination of them likely would occur unless other incentives were initiated to offset the loss of tax exemption.

Proponents of statehood and independence recognize the difficulties of suddenly losing tax exemptions but believe their status alternative offers the best framework for guiding future economic development. Statehood advocates believe the Puerto Rican economy has reached the point where industrial tax exemption can begin to be phased out. They believe statehood will increase political stability, heighten awareness of Puerto Rico, and lead to more industry locating on the island.

Statehood proponents believe that the revised industrial incentives act will demonstrate that business can operate in

Puerto Rico paying its fair share of taxes and that business would be able to accommodate full taxation after a transition period of some 20 years. These officials believe that the Industrial Incentives Act of 1978 will ease the "tax shock" problem by phasing in taxes over the life of a firm's tax exemption grant. The government hopes that when exemptions expire, firms will continue to operate paying full taxes.

Independence advocates do not see a need for continued wide-scale industrial tax exemption, primarily because they would not make manufacturing the primary sector of the economy. Agriculture would be given more attention, and Puerto Rico would attempt to produce more of what it consumes. All existing tax exemptions would be phased out, and new exemptions would be granted selectively when needed for development.

Advocates of amended commonwealth maintain that, given Puerto Rico's lack of natural resources and large population, continued Federal and local tax exemption is necessary to promote economic development and stimulate job creation. They believe that Puerto Rico always should have the flexibility to offer up to 100-percent exemption from taxes to any firm. They are opposed to the revised industrial incentives act because, in their opinion, it does not provide enough flexibility. For example, commonwealth advocates believe labor intensive industries should be given 100-percent tax exemption, but high profit industries like pharmaceuticals may require less to attract them to Puerto Rico.

OTHER FACTORS IMPORTANT TO BUSINESS WILL ALSO BE AFFECTED BY A STATUS CHANGE

Although tax exemption has been an important incentive, it is not the only business location determinant. Other elements, such as manpower availability and cost and political stability, also are key factors; and like tax exemption, their importance varies by industry and firm. Tax exemption allows a firm to retain a larger portion of its earnings, but it is only valuable to an enterprise operating profitably. The following segments discuss factors important to a firm's profitability--labor costs, shipping costs, trade relations, capital availability, and energy costs--and identifies whether and how they would be affected by a status change.

U.S. wage laws would apply fully under statehood; amended commonwealth proposals and independence would bring increased local control

Historically, a major factor attracting industry to Puerto Rico has been the relatively low cost of labor. The application of U.S. minimum wage standards to Puerto Rico and the extremely low wages paid in other countries, however, have narrowed the island's advantage. Though labor in Puerto Rico can no longer

be characterized as cheap, it is still less expensive than on the U.S. mainland. In 1978, average island manufacturing wages were only 56 percent of those in the States. In addition, Puerto Rico's worker productivity and the total cost of fringe benefits compete favorably with the States.

The average hourly manufacturing wage in Puerto Rico is well below that of any State, but it has been rising more rapidly. Between 1950 and 1978, the average hourly wage in Puerto Rico increased 719 percent compared to 311 percent in the States. As a result Puerto Rico's economy has changed from one concentrating on low wage, low skill, labor-intensive industries to one approaching the structure of the U.S. economy.

In 1940 it was recognized that wages on the island were significantly lower than those in the United States. The 1940 amendments to the Fair Labor Standards Act (FLSA) provided that covered Puerto Rico employees would have their minimum wage determined by a wage order procedure rather than congressional fiat. This procedure established a series of committees to determine the Puerto Rican minimum wage for each industrial group without exceeding the U.S. statutory minimum, curtailing employment, or giving Puerto Rico a competitive advantage over the States. Over the years, minimum wage rates for an increasing number of industries in Puerto Rico have attained parity with mainland minimums.

From 1952 to 1978 the average manufacturing wage increased from a level equal to 60 percent of the U.S. statutory minimum wage to one equal to 130 percent of the U.S. minimum wage. The Economic Study of Puerto Rico reported that, as of December 31, 1977, about two-thirds of all Puerto Rico workers covered by FLSA were eligible for the U.S. minimum wage. The 1977 amendments to the act provided the means to bring most of the remaining covered workers up to parity with the U.S. minimum wage.

An indication of Puerto Rico's existing competitive wage advantage relative to the States is shown below:

Average Hourly Manufacturing Wage in 1978

	<u>All Mfg.</u>	<u>Apparel</u>	<u>Chemicals</u>	<u>Equipment</u>
U.S. average	\$6.17	\$3.94	\$7.01	\$5.83
Michigan	8.13	NA	7.79	7.16
Ohio	7.29	4.24	6.97	6.50
California	6.43	4.03	7.22	5.94
Louisiana	6.42	3.44	9.06	6.53
New Jersey	6.20	4.73	7.12	6.05
Florida	5.01	3.44	6.29	5.13
Georgia	4.88	3.47	5.87	5.50
Mississippi	4.56	3.34	5.79	5.03
North Carolina	4.47	3.44	5.58	4.91
Puerto Rico	3.44	2.80	4.60	3.69

NA: Not available

Puerto Rico also competes with foreign countries. The island's average hourly manufacturing wage is higher than some competing nations, as shown in the following chart.

Average Hourly Manufacturing Wage in 1977
------(in dollars)-----

Puerto Rico	\$3.11	Italy	\$2.66	Brazil	\$1.12
U.S.	5.67	United Kingdom	2.63	Argentina	1.01
Canada	6.00	Venezuela	1.83	Hong Kong	.88
Germany	4.82	Spain	1.77	Taiwan	.57
Japan	3.47	Mexico	1.29	Korea	.54

Fringe benefits also affect labor costs, and a high level of mandatory fringe benefits exists in Puerto Rico, including Federal requirements for unemployment compensation and Social Security. A study conducted for the Governor's Advisory Council on Labor Policy, which covered office and production employees not exempt from FLSA, concluded that the average cost of mandated fringe benefits in Puerto Rico was equal to 21 percent of firm's payroll compared to 8.8 percent in the States.

When the study considered all fringe benefits, both mandatory and voluntary benefits, however, total island fringe benefits averaged about 31 percent of a firm's payroll compared to 36 percent in the States. The Economic Study of Puerto Rico also concluded that total fringe benefits as a percent of payroll were less in Puerto Rico than in the States.

Although wage rates and fringe benefits can be contrasted with the States, productivity comparisons are difficult to make. For one reason, most Puerto Rico industrial groups have a higher ratio of production workers to total employees than in the States, because island manufacturing firms are production units rather than complete corporations. The 1972 Census of Manufactures found that the value added per wage dollar in Puerto Rico was \$4.03 compared to \$3.36 in the United States, while the value added per employee was slightly lower in Puerto Rico.

Because U.S. labor laws currently apply in Puerto Rico, statehood would not alter significantly the difference between manufacturing wages in Puerto Rico and the 50 States. The Executive Director of Puerto Rico's Financial Council believes that by the year 2000 sections of the United States will be labor scarce while Puerto Rico with its expanding and young populace will continue to have a labor surplus. In his opinion this could serve to widen the gap between the U.S. and Puerto Rican average manufacturing wage and provide the island with a business location advantage.

Amended commonwealth proponents believe that the narrowing of the gap between the average hourly wage in Puerto Rico and the U.S. mainland is seriously hindering the island's ability

to attract new industry. A major cause of this, they believe, is the movement to parity with the U.S. statutory minimum wage. Hence, advocates believe Puerto Rico should be given the power to determine a flexible minimum wage for the island's workers and be granted authority to set other labor related policies.

Under independence U.S. labor laws would no longer apply in Puerto Rico. Puerto Rico could determine its own labor policies and minimum wage levels, but it would seem doubtful that an independent Puerto Rico would roll back its minimum wage levels to the extreme poverty level of those countries currently attracting low wage, labor-intensive industries. In addition, Puerto Rico as an independent republic could alter other labor policies to lower effective costs for business without changing wage rates.

Statehood should not change shipping costs, but the effect of an amended commonwealth or independence is speculative

Because Puerto Rico lacks the natural resources to supply industry and is far from mainland markets, transportation costs have been a disadvantage to businesses operating on the island. In addition, under existing Federal law, Puerto Rico must use U.S. ships for trade with the mainland. Some studies suggest these requirements result in higher shipping costs, but others contend that the use of foreign vessels would not lower costs.

Island economies are very dependent on shipping, and as much as 99 percent of Puerto Rico's external trade has been by ship. The island relies heavily on raw material imports from the States, and most finished goods are exported to the States. Transportation costs are therefore higher than for mainland locations which are closer to raw materials and markets.

Presently, U.S. shipping laws and trade regulations apply to Puerto Rico. Additionally, maritime trade between States, territories, and possessions--including Puerto Rico but not the Virgin Islands--must be carried on U.S. built, owned, and operated ships.

The Economic Study of Puerto Rico cited studies in 1965, 1969, and 1975 which showed that foreign vessel operating costs were 10 to 20 percent lower than U.S. vessels. A 1979 Harbridge House, Inc., study estimated that it cost the Puerto Rico petrochemical industry more than \$21 million annually to use U.S. rather than foreign ships. The Economic Study of Puerto Rico noted, however, that although open competition might temporarily lower rates of foreign shippers, some observers believe that in the long run these lower prices may not prevail. It also cited some disadvantages to open competition, including lost business to Navieras, the Puerto Rican government-owned shipping corporation and the largest carrier of U.S.-Puerto Rico trade;

reduced employment of Puerto Rican crewmen on other U.S. ships; and less assurance of ship availability in a national emergency.

The relatively high cost of transportation would continue to be a disadvantage to firms operating in Puerto Rico, regardless of a status change. Statehood should not affect shipping costs because U.S. maritime laws and regulations already apply, but it has been suggested that Puerto Rico be served by U.S. vessels which receive subsidies similar to those received by vessels engaged in international trade. An independent Puerto Rico no longer would be required to use U.S. ships in its trade with the mainland and could establish its own maritime regulations and restrictions. The impact this could have on shipping costs and businesses depends on the policies adopted by the new nation. The impact of amended commonwealth also would hinge on future decisions, because advocates have suggested that Federal laws affecting shipping be studied to determine whether they be retained, modified, or eliminated.

Effects on trade arrangements vary by status option

Puerto Rico is within the economic boundaries of the United States. Businesses export products to the States without tariffs and quotas or concern about fluctuations in foreign exchange rates. These factors give firms an advantage over those operating in foreign locations.

Puerto Rico depends on external trade, primarily with the States, for the bulk of its economic activity. Because changes in U.S. trade policies can have major effects on Puerto Rico's economy, the United States has solicited input from Puerto Rico during every round of trade negotiations since 1947. American trade policy is formulated primarily upon national interests, however, rather than regional or local concerns. As a result, changes in U.S. trade policies do not always benefit Puerto Rico.

Realizing the potential negative impact of trade policy changes on certain areas in the United States, the Congress enacted the Trade Act of 1974. This act provided for trade adjustment assistance for workers whose firms' production and sales were greatly affected by imports. The assistance consists of benefits such as cash allowances, counseling and placement services, training benefits, job search expenses, and relocation assistance. Through March 31, 1979, 73 petitions for such assistance were filed by various Puerto Rico firms and 52, affecting over 4,300 workers, had been approved.

Advocates of the three status positions believe that Puerto Rico's present influence on U.S. trade policies is not adequate to safeguard the island's interests. Amended commonwealth proponents believe that Puerto Rico must be granted greater power to act in this area, including the right to impose tariffs on goods arriving on the island and to enter into trade and other agreements

with foreign countries. Statehood supporters believe that, as a State with a congressional delegation, Puerto Rico would be able to influence U.S. trade policies more effectively.

Independence proponents believe that an independent Puerto Rico could best protect the island's interests by setting its own trade policies and negotiating its own trade agreements. The Puerto Rican Independence Party (PIP) has advocated that a 10-year transition period be granted for gradually imposing U.S. tariffs at 10-percent increments on Puerto Rican products entering the States. This would allow Puerto Rico time to adjust to losing unrestricted trade with the mainland. The PIP also has proposed that companies already operating under a tax exemption grant be allowed duty-free access to mainland markets until the grant expires, but no longer than 10 years.

Businesses would retain unrestricted access to the U.S. mainland with either statehood or amended commonwealth. Under independence, however, businesses could expect to lose free access to U.S. markets and would have to consider foreign exchange fluctuations. In addition to its proposal for tariffs, the PIP also suggests a gradual transition for establishing a Puerto Rico monetary system.

The effects of a status change on capital cost and availability differ

Puerto Rico's capital market is highly integrated with the U.S. market. Potential Puerto Rican investments compete for funds with other potential investments on the basis of risk and rate of return. Hence, creditworthy investments in Puerto Rico are financed as they are in the States.

Another facet of Puerto Rico's capital market is the availability of section 936 funds--the profits earned by U.S. tax-exempt firms which have not been reinvested or repatriated to the U.S. parent corporation. Conflicting evidence exists, however, on whether the cost and availability of credit have been significantly affected by section 936 funds. The U.S. Treasury reported in June 1980 that the large inflow of financial assets of "936" corporations had a virtually imperceptible impact on net capital flows into Puerto Rico. Although there was a large inflow of 936 assets, there were offsetting flows out of Puerto Rico, mainly through the banking system.

At the end of 1978, of the \$6.5 billion in financial instruments held by section 936 firms, about \$3.9 billion were invested in Puerto Rico, as follows:

<u>Type of investment</u>	<u>Amount</u> (billions)
Deposits in Puerto Rican banks	\$2.0
Puerto Rico source Government National Mortgage Association mortgages	.8
Loans to other section 936 corporations	.1
Puerto Rican government bonds	.8
Other investments in Puerto Rico	<u>.2</u>
Total	<u>\$3.9</u>

Most section 936 firms have avoided placing their funds in long-term investments such as Puerto Rico government bonds. As a result, most section 936 funds have been tied to short-term investments, including repurchase agreements or certificates of deposit issued by local banks. Although this has helped the Puerto Rican government by providing capital for much of its short-term financing, it has not been a major factor in the long-term loans necessary to finance real investment, either by the public or private sectors.

Despite businesses' reluctance to invest section 936 funds in long-term instruments, Puerto Rico has not had problems floating bond issues. For example, a \$300 million bond issue sold by the Government Development Bank in May 1980 was heavily oversubscribed. A major attraction of Puerto Rican bonds is the triple tax exemption which they enjoy because a bondholder residing in any of the 50 States pays no Federal, State, or local tax on income from Puerto Rican government securities.

In the event of statehood, section 936 would no longer apply to U.S. firms operating in Puerto Rico, and their profits would not necessarily be part of the island's capital market. Because of the island's integration with U.S. capital markets, however, the loss of these funds should have little effect on capital availability to business and government. As a result, statehood would not significantly affect the cost or availability of credit for businesses operating in Puerto Rico.

Statehood, however, likely would end the present arrangement where interest earned on Puerto Rican bonds is exempt fully from State and local income taxes in all 50 States in addition to Federal taxes. The effect statehood would have on bonds issued while the island was a Commonwealth might need to be addressed during any deliberations over admission legislation. Although bonds issued after statehood would compete on an equal basis with those issued by other State and local governments, the extent of the influence that statehood's political permanence might exert on interest rates on Puerto Rican bonds would depend on the investment community's perception as to statehood's impact on the island's economic and political stability.

With independence, Puerto Rico's capital market would no longer be integrated with that of the United States, and bond

issues would lose their current U.S. tax advantage. An independent Puerto Rico, however, would be able to establish its own monetary policy, apply for loans from sources such as the World Bank and International Monetary Fund, and seek foreign aid from the United States and other nations. The PIP has advocated that credit terms and guarantees extended to Puerto Rico by U.S. Government agencies remain in effect until the original contractual terms expire and that the United States continue to recognize the Federal tax exemption for the island's public debt incurred under the control of American citizens and companies until its expiration.

American businesses operating in an independent Puerto Rico would still have access to the U.S. capital market, but changes in the investment community's perception of political and economic stability could affect capital availability and interest rates. Also, investors would have to consider foreign exchange fluctuations in decisions regarding Puerto Rican investments.

Amended commonwealth advocates believe that the island needs to be granted greater authority to seek external resources. For example, they believe Puerto Rico should be permitted to participate in international organizations and enter into financial, industrial, agricultural, technical, and other agreements with foreign countries.

Energy costs will remain high regardless of a status change

Puerto Rico relies almost exclusively on imported oil to supply its energy requirements. Lower cost oil imported from foreign sources gave Puerto Rico an important cost advantage in developing its petrochemical industry in the 1960s and early 1970s. Since 1974, however, this situation has reversed as prices for domestic oil have remained below those for foreign oil.

Puerto Rico meets only a small fraction of its energy needs with its own resources, primarily hydro-electric power which supplies a small percent of the island's electricity. The rest of its energy needs are supplied almost entirely from petroleum-based products. Electricity has been more expensive in Puerto Rico than in the States.

Puerto Rico's electrical system is owned and operated by the government's Electric Power Authority. Because almost all of its electricity is generated by oil-fueled power plants, the cost of electricity has soared along with the cost of oil. The average cost per kilowatt hour for industrial customers increased from \$1.29 for the year 1971-72 to \$4.55 for 1977-78. In the United States, average electrical costs per kilowatt hour in 1977 were about 70 percent of those in Puerto Rico. Further, because Puerto Rico is an island, its electrical system is not interconnected with other systems to help meet peak needs. This

situation requires a higher reserve margin than is normal and contributes to higher energy costs.

Puerto Rico has attempted to develop alternative sources of energy to reduce its use of oil. As is the case elsewhere, this has proven difficult. An attempt to build a nuclear power plant has been postponed indefinitely, and efforts to derive energy from the sun, wind, and ocean are still in experimental stages. Other proposals to deal with the island's energy problem involve further development of hydropower, the use of sugar cane to produce a fuel such as gasohol, and the importation of coal. Also, offshore oil deposits may exist, but the evaluation of this prospect is still in the preliminary stages.

Energy costs would be largely unaffected by a move to statehood, but statehood advocates contend a congressional delegation might be able to obtain increased Federal funding for energy development. An independent Puerto Rico would be able to negotiate oil purchase agreements with other countries. Similarly, amended commonwealth advocates have proposed that the island be granted the authority to enter into commercial agreements with foreign countries. Under any status, the island most likely would have to pay world prices for oil.

CONCLUSIONS

Puerto Rico's industrial growth over the last 30 years has come about largely as the result of extensive investment by U.S. manufacturing firms. The island's attractiveness to industry has been enhanced by its ability to offer extensive tax exemption, low wages relative to the U.S. mainland, and free access to U.S. markets. Because past programs for promoting Puerto Rico's industrialization were devised to take advantage of its relationship with the Federal Government, altering the present arrangements or changing the island's status most likely would necessitate revising strategies for promoting business investment.

Although the extent and nature of such revisions will vary by status option, the effect of a status change on the island's ability to attract or retain business investment will largely hinge on numerous future decisions by Puerto Rico and the Congress. A status change holds significant consequences for future development and could alter the business community's perception of the island's attractiveness as a place for investment. Consequently, careful consideration would be required during any deliberations on how a status change might affect the island's economy and what adjustment measures might be needed.

Amended commonwealth proposals would maintain the present basic arrangements with the Federal Government. As such, common currency, duty-free access to U.S. markets, and

tax exemptions would continue. Advocates of Commonwealth status believe that Puerto Rico should have the flexibility to grant whatever tax exemptions it deems necessary and that such exemptions will be needed for the foreseeable future.

They further believe that Puerto Rico should be granted greater authority in certain key areas to enhance future development. These areas include permitting Puerto Rico to set its own wage rates and labor related policies; apply tariffs on certain goods entering the island; enter into commercial, trade, and other agreements with foreign countries; participate in international organizations; and review Federal legislation to determine whether certain Federal laws should be retained, modified, or eliminated. The impact amended commonwealth might have on businesses operating in Puerto Rico, however, would depend upon the terms actually approved by the Congress and actions taken by the government to implement any new authority.

Statehood would not change many business location factors, but it likely would require reassessing economic development strategies. For example, Puerto Rico as a State would still offer businesses duty-free access to U.S. markets, use of the dollar, an ample supply of labor, low wage costs relative to the mainland, and access to capital markets. Equal treatment in U.S. tax laws under statehood, however, would eliminate the current arrangements exempting certain mainland-based firms operating in Puerto Rico and local enterprises from Federal taxation.

Because tax exemption has played a significant role in attracting the investment required for the island's industrialization and economic growth, losing this provision, particularly if it is rescinded suddenly, would entail some risks to future growth and require devising an alternative economic development strategy. Advocates believe statehood's intrinsic benefits would spur economic development but assert that full Federal taxation should be phased in over 20 years to help facilitate the adjustment period and reorient the island's development.

Independence would require fundamental changes to Puerto Rico's strategies for promoting business development. An independent Puerto Rico would be able to set its own monetary policy, establish wage rates and labor related programs, apply tariffs, and negotiate trade agreements with other countries. Also, the new nation could join international organizations and seek funds from sources like the World Bank and the International Monetary Fund.

Because past economic strategies to attract investment were based on the island's relationship with the Federal Government, however, major adjustments would be required and some risks encountered. Among other factors, an independent Puerto Rico would lose duty-free access to U.S. markets, common currency with the United States, and Federal tax exemptions granted to U.S. firms

operating on the island. Advocates believe that the authority obtained through independence would help the island attain greater economic development and self-sufficiency; but, recognizing that many adjustment measures would be required, they have proposed various methods to facilitate a transition.

CHAPTER 7

STATUS DEBATE HAS MANY

ADDED DIMENSIONS

Each status option would bring an alternate political framework and engender financial considerations, but additional concerns may be deliberated by the Puerto Rican people and/or the Congress. Most notably, preserving and enriching Puerto Rico's culture is of paramount importance to all status participants and island residents. Other factors also may prompt attention depending on the status being deliberated. These include international considerations, Puerto Rico's location in the strategically significant Caribbean region, implications for continued U.S. citizenship, Congressional apportionment decisions, and the potential increase in politically motivated violence.

CULTURAL CONVICTIONS ARE IMPORTANT AND EMOTIONAL CONCERNS

Proponents of each status option are adamant about preserving the island's distinct culture and Spanish language, but each alternative offers a different solution to achieve that goal. Commonwealth supporters argue that association with the United States has enhanced the island's culture, and only an autonomous commonwealth will continue to enhance it while preserving Puerto Rico's cultural identity. Statehood advocates maintain that the American system contains diverse ethnic and linguistic groups and, accordingly, admission would permit the island's distinct cultural identity to continue and develop. Independence proponents believe that U.S. sovereignty has been detrimental, and only through complete autonomy can the island's culture flourish and be protected.

Although these positions illustrate the controversy surrounding the cultural issue, the components of culture and the various arguments are highly subjective. Like different ethnic groups in the United States, Puerto Rico's culture and linguistic traditions are shaped and preserved primarily by its people. Government can, however, influence language policies affecting public education and government business.

One contention within the status debate is that should Puerto Rico petition to become a State, continued use of Spanish as the official language may be jeopardized. Statehood opponents believe that the Congress would require English as the official language, thus destroying Puerto Rico's culture. Statehood advocates assert, however, that (1) such a requirement is unlikely and without a constitutional basis and (2) no legal or other obstacle exists to Puerto Rico's admission as a Spanish-speaking State. Consequently, they argue, statehood would not adversely affect the island's culture. Statehood advocates also maintain that Puerto Rico would be a cultural asset

to the United States, but others contend that admitting a Spanish-speaking State would create problems.

Like many controversies surrounding the status debate, the language question will depend upon future decisions by Puerto Rico and the Congress. These determinations will likely involve weighing conflicting emotional opinions and assessing varied considerations, including Puerto Rico's unique circumstances, past statehood admissions, and United States' as well as other nations' actions to accommodate linguistic minorities.

Puerto Rico's culture is distinct,
and the Spanish language dominates

Puerto Ricans are extremely proud of their unique heritage, which stems from Spanish, Indian, African, and European/American cultures. This blend has resulted in a diverse and distinctly rich culture that has evolved gradually.

The Spanish had substantial influence while dominating Puerto Rico from 1493 until 1898. After the Spanish arrived, the island's original inhabitants, the Taino Indians, were forced into slavery. As the Indian population began to diminish, African slaves were imported to work the mines and sugar cane fields.

The Spanish also brought their language--a characteristic which has endured to the present day. Although Spanish and English are both official government languages, Spanish is more widely used in conducting government business and is the medium of educational instruction and daily communication throughout the island. Almost all newspapers as well as television and radio programs are in Spanish.

Since 1898 the United States also has influenced Puerto Rico's culture. Migration between Puerto Rico and the mainland has contributed to a cultural and social interchange. American influence has also been substantial in education, particularly in introducing English.

Language policy historically has
fluctuated, but efforts to improve
English proficiency continue

The number of Puerto Ricans who read, write, and speak English comfortably has increased considerably. Many are bilingual, and others can speak conversational English. A majority, however, are not considered officially bilingual. Puerto Ricans long have received English instruction, but its extent has varied greatly due to fluctuating policies. Examples of early policies follow:

- Between 1900 and 1905 Spanish was the medium of elementary level instruction, with English taught

as a subject. In the secondary level English became the medium of instruction.

--Between 1905 and 1916 English became the medium of instruction in all grades, and reading in English was taught before children were instructed to read in Spanish.

--Between 1916 and 1934, Spanish was the medium of instruction in grades 1 through 4. Grade 5 was a transition year when half the subjects were taught in English and half in Spanish. Grades 6 through 12 were taught in English.

--In 1934 English continued as the medium of instruction in the secondary schools; however, Spanish was used throughout the elementary level. Also, time devoted to English in grades 7 and 8 doubled to 90 minutes.

Language policy fluctuations continued after President Roosevelt stated in 1937 that Puerto Rico should become bilingual. Following several changes, Spanish was established in 1942 as the medium of instruction for grades 1 through 6; junior high classes were conducted in English with some subjects taught in Spanish; and both English and Spanish were used in high school instruction.

Emphasizing English as the language of instruction created much controversy. This policy was dropped in 1948, and Puerto Rico was given total control of its education system. According to the 1966 status commission report, it was argued that the English requirement was "pedagogically unsound, creating obstacles to education, and that the use of English rather than Spanish symbolized a colonial status."

Since 1948 Spanish has been the medium of public school instruction with English taught at all levels beginning in the first grade. Puerto Rico's formal English curriculum has two broad objectives: to develop a student's ability to understand, speak, read, and write English; and establish habits of using English to communicate.

Island educators believe that as U.S. citizens Puerto Ricans must have the opportunity to master English, the language through which many political and socioeconomic decisions are made affecting the island. Further, they believe English is important to all Puerto Ricans because it is the predominant international medium of communication.

Option for conducting Federal court proceedings in Spanish is advocated

Federal District Court proceedings for the District of Puerto Rico have been in English since 1900. Although the

U.S. House of Representatives approved a bill in 1980 to permit using Spanish in the Court for a 12-year period, it was not passed by the Senate. This proposed legislation allowed initial pleadings to be in Spanish. Further pleadings and proceedings could be in Spanish when requested by a criminal defendant or upon agreement of all parties in civil cases. The bill also provided that individuals who can speak, understand, read, and write Spanish may serve on a grand or petit jury if the trial or proceeding is to be in Spanish.

Hearings on the proposed legislation disclosed that most defendants, parties, and witnesses, particularly in criminal cases, were primarily or solely Spanish-speaking. Also, because the ability to understand, read, write, and speak English adequately are prerequisites for grand and petit jury service, about half the population cannot serve as jurors. Further, judges, attorneys, and court personnel are primarily Spanish-speaking.

Proponents argued that because Spanish is part of Puerto Rico's cultural heritage and will continue as the dominant language, the bill offered a resolution to the U.S. District Court's unique problem. Opponents raised several concerns, including possible additional delay and expense in preparing records, as well as the need for additional personnel and facilities.

Four States admitted between
1812 and 1912 had language
requirements imposed

Although no constitutional provision prescribes an official U.S. language, English always has been the common tongue as well as the language of government and education. In the past, four States with large groups of non-English speaking residents had language conditions in Federal legislation enabling the State to be formed.

Admitted in 1812 as the Nation's 18th State, Louisiana had both French and Spanish heritage. Louisiana's enabling act provided that

"the laws which [Louisiana] may pass shall be promulgated, and its records of every description shall be preserved, and its judicial and legislative written proceedings conducted, in the language in which the laws and the judicial and legislative written proceedings of the United States are now published and conducted."

Similarly, Oklahoma's population contained a large number of American Indians when it became a State in 1907. Consequently, Oklahoma's enabling act provided that instruction in its public school system be conducted in English.

New Mexico and Arizona were admitted as States in 1912 with large numbers of Spanish-speaking residents. The enabling acts of both provided that school instruction be conducted and legislators be proficient in English.

New Mexico's Constitution contained provisions protecting the rights of Spanish-speaking residents. It required that laws be issued in English and Spanish for 20 years after admission, teachers be trained in both languages, and children of Spanish descent never be denied a public education. All of these provisions are still in New Mexico's Constitution.

Recent legislation designed to protect rights of linguistic minorities

In recent years, greater attention has been focused on ensuring non-English speaking residents full participation in American life. Hispanics particularly are a large and growing U.S. minority. In 1978 the Bureau of the Census estimated that Hispanics living in the 50 States and the District of Columbia numbered 12 million. Some estimate that by the year 2000, Hispanics will overtake Blacks as the largest minority.

Many Hispanic immigrants continue to speak Spanish after they arrive in the United States. A 1976 survey found that 80 percent of Hispanics live in households where Spanish is spoken and about one-third usually speak Spanish. Hispanics' view that their language is essential to maintaining cultural identity is reportedly part of a much broader movement of various U.S. ethnic groups to retain their native languages and traditions.

Federal legislation protecting the rights of linguistic minorities has been passed in several areas, including voting rights, education, and social services. Notwithstanding the controversy surrounding some of these measures, the basic intent has been to protect non-English speaking residents' rights. For example the Bilingual Education Program of 1968 was established to meet the special educational needs of limited English-speaking children from low-income families. Also, the Voting Rights Act amendments of 1975 were designed to facilitate registration and voting by persons whose primary language is other than English.

Assisting non-English speaking Americans has extended to other Federal activities. For example, the 1977 Food Stamp Act and regulations specify how and when bilingual materials and personnel must be used. Also, 1980 Census questionnaires were printed in Spanish for the first time.

Various measures used by other countries to accommodate different language groups

International attempts to recognize and protect linguistic groups have increased since the turn of the century. The League

of Nations' Covenant provided some protection to linguistic minorities along with racial and religious minorities. Moreover, the United Nations Charter consistently lists language along with race, sex, and religion as an impermissible ground of differentiation in the realization of human rights and fundamental freedom.

Nations composed of different language groups have employed various means to protect linguistic freedom and preclude discrimination. Although no universal rule exists, actions taken range from specific legal or constitutional guarantees to less formal arrangements. A 1976 Southern Illinois University Law Journal provided the following examples of how other countries have attempted to accommodate different language groups, but the relative success of these efforts can be gauged only by those involved:

- Legal equality of more than one national language for all practical and official purposes (Canada, Finland, and South Africa).
- Legal equality of all national languages, some of which are designated official (Switzerland and Belgium).
- Constitutionally protecting linguistic minorities, but the dominant national group's language is considered the official state language (Yugoslavia, Rumania, and China).
- Designating an official state language while recognizing auxiliary state languages (Ireland and The Philippines).

Widely divergent methods proposed
to preserve Puerto Rico's language
and culture

Maintaining and developing Puerto Rico's unique cultural identity is a vital concern of all political parties. Each, however, steadfastly advocates a different formula as the best solution.

Commonwealth advocates maintain that the island's culture and language have retained their indigenous characteristics despite Puerto Rico's 82-year relationship with the United States. Commonwealth supporters argue that a harmonious blend of American and Puerto Rican culture presently exists. They believe that the current arrangement has created unbreakable ties and an important mutually beneficial cultural interchange.

Commonwealth proponents also believe that U.S. citizenship is respected and honored but that Puerto Rico's identity

stems from its distinct nationality. They believe that only an autonomous commonwealth can preserve and enhance Puerto Rico's culture and language while maintaining the protections inherent in its relationship with the United States.

Statehood advocates view admission as the culmination of Puerto Rico's political development and entirely consistent with America's multicultural composition. They point to the American system's openness and flexibility in admitting and protecting diverse ethnic and linguistic groups. Additionally, they maintain that Puerto Rico as a Spanish-speaking State can make significant contributions, particularly to relations with Latin America, in exchange for equal participation in the American system.

Statehood advocates assert that their culture is too strong and resilient to disappear and that making the island an equal partner in sharing U.S. sovereignty would strengthen their culture and permit it to flourish. Attaining statehood, they believe, would make U.S. citizenship more meaningful and assure Puerto Ricans full and equal political rights.

Independence advocates believe that Puerto Rico has been prevented from preserving and adequately developing its cultural identity. They see a direct correlation between political autonomy and the ability to enhance their national identity. Asserting that Puerto Rico has had a vigorous capacity for resisting assimilation, they argue that the island is a well-defined homogeneous society with all the components of a national identity, except sovereignty.

Independence supporters believe that U.S. sovereignty and influence have been extremely detrimental to their culture and have been responsible for many social and economic problems. They believe independence is the peoples' inalienable right and the only way Puerto Rican culture can flourish without restraint.

INTERNATIONAL CONSIDERATIONS AUGMENT STATUS DEBATE

Puerto Rico's status has engendered international discussion by the United Nations and some Caribbean and Latin American countries. On the basis of past interest, such discussion may increase with a status change, but divergent views exist regarding how each status alternative would be perceived by the international community.

Puerto Rico's status under continuing consideration by U.N. committee, despite U.S. opposition

The United Nations, since its inception, has monitored the political evolution of non-self-governing territories. The U.S. voluntarily placed Puerto Rico in this category, and annual information

on the island's political development was reported. After the Commonwealth was established the United Nations removed Puerto Rico's non-self-governing designation in 1953 and announced that

"* * * in the framework of their Constitution and of the compact agreed upon with the United States of America, the people of the Commonwealth of Puerto Rico have been vested with attributes of political sovereignty which clearly identify the status of self-government attained by the Puerto Rican people as that of an autonomous political entity."

This action, however, did not end United Nations consideration. Cuba attempted, but failed, to initiate discussion of Puerto Rico's status before the U.N. Decolonization Committee in the mid-1960s and before the General Assembly in 1971. In 1972, however, the Committee discussed the island's status and adopted a resolution recognizing "the inalienable right of the people of Puerto Rico to self-determination and independence * * *."

Since then discussions have been held annually and other resolutions adopted by the Committee. In 1978 and in 1979 the resolution also called for transferring all powers to the Puerto Rican people. This has been interpreted as a condition for changing their status. In 1980, the Committee again held hearings, reiterated its prior resolutions, and, in addition, urged the U.S. Government to present a plan for decolonizing Puerto Rico.

The U.S. Government, however, has stated that Puerto Rico should not be included by the United Nations in its consideration of non-self-governing territories. The United States maintains that self-determination has occurred and was recognized in 1953 when the U.N. General Assembly removed Puerto Rico from the non-self-governing list. Moreover, the U.S. has repeatedly affirmed its support for the "continuing right of the people of Puerto Rico to self-determination."

In its official statements, the United States also has said that it would not object to Puerto Rico inviting the United Nations or other appropriate international bodies to observe any status referendum. Further, in addition to reiterating its prior position, the United States in 1980 opposed the Committee "recommending any actions that, if carried out, would tend to limit the political status options open to the people of Puerto Rico."

Although expressing different views, representatives from all major Puerto Rican political parties have testified at least once before the Decolonization Committee. In 1978 Governor Carlos Romero-Barceló, a statehood advocate, testified that the Puerto Rican people have the means to change their political status; therefore, Committee intervention is "neither necessary

nor appropriate, and is totally unacceptable to the people of Puerto Rico."

Former Governor Rafael Hernández-Colón, a commonwealth supporter, also testified in 1978. He stated that because the United States has not recognized the Puerto Rican people's will as expressed in the 1967 plebiscite, the United Nations has an important role. Mr. Hernández-Colón recommended that the U.N. General Assembly require the United States to recognize the Puerto Rican people's will to modify the terms of association, so that the Free Associated State will be brought to full self-government.

For many years, independence supporters, representing both the Puerto Rican Independence and Socialist parties, have actively participated in the Committee's hearings. They contend that Puerto Rico is a colony and the United Nations should force the U.S. Government to give the island its independence.

Status positions include hypotheses of international acceptance

Status participants advance different hypotheses about international acceptance of the three status alternatives. Like many other issues in the status debate, these hypotheses often are contradictory.

Statehood proponents argue that admitting Puerto Rico would evidence ethnic harmony and prove to the international community that the United States is not a colonialist power. They believe that a Spanish-speaking State would strengthen the U.S. image in Latin America by affirming that Hispanics are looked upon, not with disdain, but as equals.

On the other hand, opponents assert that statehood would precipitate widespread international opposition. According to them, Caribbean and Latin American countries would view statehood as forced annexation. In the view of one status participant, statehood "would certainly poison U.S.-Latin American relations for many decades."

Independence advocates believe that complete autonomy would be favorably accepted by the international community. They point to nonaligned nations' conferences which have endorsed Puerto Rican independence. For example, a September 1979 conference of nonaligned countries held in Cuba supported Puerto Rico's anti-colonial struggle and asserted that the United States should transfer its powers so Puerto Ricans could freely determine their status.

Opponents assert that independence is not viable because it is not supported by most Puerto Ricans. Some believe that many Puerto Ricans would move to the U.S. mainland if the island became independent. A further contention is that many Latin American and

Caribbean governments privately have reservations about an independent Puerto Rico because it could eliminate the stability which U.S. presence provides, but these countries do not publicly express this view because of nationalist sentiment.

Commonwealth advocates believe that the island's right of self-determination was exercised in 1952 when the Commonwealth was established. They believe, however, that the current arrangement must be amended to bring full self-government. On the other hand, it has been contended that Commonwealth in any form only would perpetuate international criticisms of the island's status.

Status proposals offer Puerto Rico varying positions in the international community

The U.S. Government represents Puerto Rico in international government organizations and negotiations. In this regard, Puerto Rico is treated like States, which the U.S. Constitution precludes from making agreements with another State or foreign power.

The island, however, has shown some interest in joining certain international groups. In one such instance, a congressional Committee report noted that congressional authorization was necessary before Puerto Rico could join the Caribbean Development Bank. The report cited the U.S. Constitutional provisions prohibiting States' involvement in foreign affairs and granting the Congress power to "dispose of and make all needful Rules and Regulations respecting" territories. Although a few hypothesize that these provisions do not apply because of the island's Commonwealth status, the United States traditionally has represented Puerto Rico.

This situation would not change should Puerto Rico attain statehood. Although admission would eliminate contentions regarding the inapplicability of the Constitutional provision precluding State involvement in foreign affairs, questions have arisen regarding the island's continued separate participation in certain events such as sports contests. A U.S. State Department official commented that because organizations sponsoring such events are not typically official government bodies, continued separate Puerto Rican participation depends on the organizations' rules and decisions.

Independence would clearly enable Puerto Rican participation in international forums as a separate government. Additionally, Puerto Rico would be eligible for foreign assistance from the United States, other nations, and international agencies. With independence would also come the responsibility of negotiating treaties and agreements with the United States and other countries, foreign businesses, and international organizations. Treaties in many important areas, such as trade and defense, would be vital to the new republic's economic development and security.

Amended commonwealth proponents advocate granting Puerto Rico certain rights in foreign affairs. For example, the 1975 proposed Compact of Permanent Union included the following provision:

"The United States will have responsibility for and authority with respect to international relations and defense affecting the Free Associated State of Puerto Rico. The Free Associated State may participate in international organizations and make educational, cultural, health, sporting, professional, industrial, agricultural, financial, commercial, scientific, or technical agreements with other countries consistent with the functions of the United States, as determined by the President of the United States and the Governor of the Free Associated State on a case-by-case basis."

Another provision proposed granting the island observer status with U.S. trade negotiating delegations and consulting Puerto Rico on positions and decisions. The Compact also proposed that the United States, upon request and agreement of Puerto Rico, seek to have the island designated eligible for regional or worldwide preferences available to developing countries.

STATUS DEBATE MAY INCLUDE STRATEGIC DEFENSE CONCERNS

Since 1898 Puerto Rico has afforded the United States a secure position for protecting U.S. interests and training military personnel. In addition, Puerto Ricans have served in the U.S. Armed Forces since 1917. In return, the island has received protection and certain economic advantages from this common defense relationship.

This relationship, however, has prompted controversy. Independence advocates long have condemned the U.S. military presence. Additionally, many residents have opposed the use of Puerto Rico's offshore islands, Culebra and Vieques, for military exercises. Training on Culebra has ceased, but the continued use of Vieques has drawn protest from all political parties.

All U.S. Armed Force branches operate to some extent in Puerto Rico, but the Navy uses the island most extensively. U.S. Naval Station Roosevelt Roads, on Puerto Rico's eastern coast, is the United States' largest naval base. In congressional testimony, high-ranking Naval personnel have described the Puerto Rico operating region as the world's best naval training area. Without Puerto Rico, they state, the Atlantic fleet would be unprepared to defend U.S. interests and support American allies. In addition to affording a major training facility for the U.S. Navy and allied forces, Roosevelt Roads provides a strategic U.S. presence.

Although U.S. military bases in the Caribbean were greatly reduced after World War II, Puerto Rico is still considered strategically important. The island's central location is considered valuable as a communications and control center as well as an intermediate staging area for military operations elsewhere. Also, the island provides the potential for expanded military operations if necessary, and it affirms American presence in the Caribbean--a region considered vitally important to the United States.

U.S. interests in the Caribbean have been described as including significant domestic and security concerns. Protecting U.S. citizens and property as well as maritime boundaries and fisheries and controlling illegal immigration and narcotics are mentioned as domestic considerations. Security concerns arise because much of the United States' petroleum supplies and other strategic materials, such as bauxite, travel sea routes from the Panama Canal and South America.

Recent events have focused more attention on the Caribbean's strategic importance. Although many Caribbean islands are still politically associated with larger nations, including the United Kingdom, France, the Netherlands, and the United States, several have recently achieved independence. In contrast to 1959, when only 3 independent islands existed, there were 12 in 1979 with others expected to become independent.

While affirming these islands' sovereignty, this trend has also raised concerns about the region's political and economic stability. In late 1979 testimony before a House Subcommittee, a U.S. Deputy Assistant Secretary of State described the region as "an area of endemic weakness and potentially serious instability." He also stated that most islands are too small in size and population to be economically viable and even the larger islands were suffering. Another complicating factor is that because the Caribbean is composed of many islands with different languages and cultures, it lacks regional unity. Further, Cuba, the Caribbean's largest and most populous country, reportedly has been moving to strengthen its regional role.

The Caribbean's posture and Puerto Rico's defense relationship with the United States may be factors during status deliberations, but discussion would vary depending on the status option. Statehood would guarantee U.S. presence, and amended commonwealth also would most likely continue the present arrangement. Should independence be chosen, however, provisions regarding U.S. military operations would have to be negotiated between Puerto Rico and the U.S. Government.

INDEPENDENCE WOULD RAISE COMPLICATED ISSUE OF CITIZENSHIP

If Puerto Rico chooses independence, questions will arise about continued U.S. citizenship of Puerto Ricans both on the

island and the approximately 1.7 million domiciled elsewhere in the United States. The effect of a new nation's formation on inhabitants' nationality or citizenship has been a complicated issue in international and domestic law. Some general principles exist, however, and the Puerto Rican Independence Party has made a proposal concerning this issue.

U.S. courts have seldom addressed sovereignty changes, but general principles exist

Although rarely addressed in U.S. courts, some principles have been formulated in cases involving conquest or cession of territory as well as domestic citizenship. At the end of the 19th century, the U.S. Supreme Court held that the nationality of a territory's inhabitants becomes that of the government under whose sovereignty they pass, subject to their right of election to retain their former nationality. In another case, the Court held that every independent nation has the right to determine what classes of persons should be entitled to its citizenship in accordance with its own constitution.

Both these decisions are consistent with the view in international law that the predecessor state's law determines which persons have lost their nationality, and the newly independent state's law determines which persons have acquired its nationality.

A corollary issue is determining which nationals or citizens are affected by a sovereignty change. Generally, this involves deciding whether the new status is conferred on persons domiciled in the new state, those born there regardless of domicile, or both. Although U.S. case law on this question is limited, a U.S. Court of Appeals suggested that domicile, at the time of a sovereignty change, was the crucial factor.

When the Republic of the Philippines achieved independence, questions arose regarding the continued U.S. nationality of its citizens. Although jurisprudence regarding the Philippine situation is minimal, a U.S. District Court held that Philippine citizens lost their U.S. nationality immediately upon independence. The status of Philippine citizens, however, is not analagous to Puerto Ricans because most Filipinos were U.S. nationals at the time of independence, but not U.S. citizens.

The difference in legal status between U.S. nationality and citizenship is important. Citizenship is a status of constitutional dimension protected by the Fourteenth Amendment, while nationality is a status conferred by statutory law. In this regard, recent U.S. Supreme Court decisions have held that a U.S. citizen has a constitutional right to remain a citizen unless that status is voluntarily renounced.

In view of the constitutional and judicial protection conferred upon U.S. citizens, it is not clear what act or acts would constitute a voluntary renunciation. It could be argued that a formal individualized renunciation is necessary and that a change in sovereignty alone would not cause an automatic loss of U.S. citizenship.

International treaty provisions have resolved nationality problems

In the past when sovereignty changes occurred, treaty provisions often addressed nationality problems. For example, when Spain ceded Puerto Rico and other territories to the United States, the Treaty of Peace allowed territorial inhabitants to either retain their Spanish citizenship or adopt their territory's nationality. The treaty provided that inhabitants could preserve their Spanish citizenship by declaring their decision within 1 year. The absence of such a declaration was considered as renunciation of Spanish allegiance and adoption of the territory's nationality.

Some citizenship questions addressed by independence party proposal

Should Puerto Rico become an independent nation, an agreement between the United States and Puerto Rico on the citizenship question would seem probable. Some questions which most likely would be addressed include:

- Which Puerto Ricans would automatically be citizens of the new republic; those domiciled on the island, those born on the island and domiciled elsewhere, or both?
- Would citizens of the new republic automatically lose their U.S. citizenship, or would formal renunciation be necessary?
- Could citizens of the new republic also remain U.S. citizens? (Although the United States allows dual citizenship in some cases, it may neither be desired by an independent Puerto Rico nor reasonable to extend it to an entire population.)
- Which Puerto Ricans who are not automatically citizens of the new republic would be given the choice of becoming citizens?
- What formal procedures for choosing and renouncing citizenship would be established?

The Puerto Rican Independence Party's (PIP) 1980 political platform contains a proposal regarding citizenship. The proposal states that U.S. citizens born in Puerto Rico and residing on

the island at the time of independence will become citizens of Puerto Rico unless they desire to retain their U.S. citizenship. Those persons who declare this desire within 6 months of independence would acquire the status of resident foreigner. Resident foreigners would be guaranteed personal and property rights, but not political rights or the right to occupy public offices.

The proposal further states that U.S. citizens residing in Puerto Rico, but not born on the island, could request Puerto Rican citizenship. Additionally, Puerto Ricans residing outside Puerto Rico at the time of independence would be allowed to become Puerto Rican citizens within 1 year of independence. If 1 year has passed these persons could apply for Puerto Rican citizenship after residing on the island for 1 year.

This proposal appears generally consistent with principles of international and domestic law because (1) it allows for choice and (2) place of domicile is the determining factor. Although the PIP proposal does address many elements of the citizenship question resolution of this issue could only be accomplished through negotiation between Puerto Rico and the U.S. Government.

A change in citizenship could affect unrestricted migration

Another consideration related to citizenship is Puerto Rican migration to the U.S. mainland. Common citizenship has fostered close ties between Puerto Rico and the remainder of the United States and has afforded Puerto Ricans unrestricted access to the States for employment and other reasons. Puerto Rican migration has helped the island's overcrowding, possibly alleviating some economic problems. Although the large net outmigration of the 1950s and 1960s has ended, Puerto Ricans continue to move between the island and the mainland in great numbers.

Losing U.S. citizenship may result in limiting migration, because an independent Puerto Rico would likely be subject to U.S. immigration laws. In this regard, the Puerto Rican Independence Party calls for the U.S. Government to grant an annual Puerto Rico immigration quota for 10 years after the republic is established. Like other areas, however, the impact on migration would depend on the negotiated terms of independence.

STATEHOOD WOULD PRESENT CONGRESSIONAL APPORTIONMENT DECISION

Should Puerto Rico be admitted as a State, the Congress could either reapportion the present 435 House of Representatives seats or increase the House size to accommodate the new State's representation. Because its population was greater than 25 States following the 1970 census, the island would have been eligible for representation equal to or greater than half the States.

U.S. Constitution provides
basis for State representation

Congressional composition was discussed widely at the 1787 Constitutional Convention. Conflicts between large and small States led to the compromise arrangement which provides equal State representation in the Senate, while representation in the House of Representatives is apportioned according to each State's population.

The U.S. Constitution established representation for the first Congress and prescribed that regular censuses provide the population basis for subsequent apportionments. Additionally, the Constitution provides that each State have at least 1 member of the House of Representatives, and the maximum number of representatives cannot exceed 1 for every 30 thousand persons.

Increases occurred frequently
in the House size until 1912

The admission of new States and population increases caused the House of Representatives to grow from 65 members representing 13 States to 435 members representing 50 States. New States' admission or enabling acts normally prescribed at least one representative until the next apportionment. Apportionment acts from 1850 to 1911 allowed for increasing the House size should a new State be admitted, and House membership was increased following each decennial census until 1911.

In that year an apportionment act fixed House membership at 433 and provided that Arizona and New Mexico each have 1 representative should they become States. In 1912 both were admitted and the House size set at the present 435. Although a 1929 act changed the method for apportionment, it did not change the House size.

Since 1929 only two States have been admitted--Alaska and Hawaii in 1959. Their admission acts entitled them to 1 representative until the next reapportionment, temporarily increasing House membership to 437. Following the 1960 census, however, the House was reapportioned, dividing the 435 seats among the 50 States. The 1929 act, as amended, continues to dictate apportionment despite numerous attempts to increase the House size.

SPORADIC POLITICALLY MOTIVATED VIOLENCE
PRESENTS AN UNCERTAIN FACTOR IN RESOLVING
STATUS CONTROVERSY

Like many other areas throughout the world, Puerto Rico's history has included isolated incidents of political violence. Because these incidents have been described as generally stemming from dissatisfaction with the island's political status, the present debate has included discussing the potential for future violence. This possibility, however, is afforded varied

significance by the different status proponents. Whether violence would increase is speculative, but past history makes it a factor with uncertain dimensions in attempting to resolve the island's status controversy.

Dissatisfaction with political status
has caused isolated incidents of violence

Puerto Rican dissatisfaction with Spain's authoritarian control led to a powerful home rule movement in the 1800s. Although most Puerto Ricans sought to gain greater autonomy peacefully, a small separatist movement emerged, and several isolated uprisings occurred. One such occurrence in 1868, the "Grito de Lares," is generally considered a symbol of the proindependence struggle and is celebrated as a local holiday to mark the revolt against Spain. By the end of the 19th century, Puerto Rico had obtained greater participation in managing its own affairs through the Charter of 1897, but the Spanish-American War ended Spain's rule.

Although most Islanders were hopeful that U.S. presence would bring improvement, dissatisfaction with U.S. policies began to grow in the early 20th century. During this time a small group of anti-American residents formed the Nationalist Association and embarked on a campaign to invoke independence sentiment. The Nationalists, frustrated in their peaceful attempts, became increasingly hostile in the 1930s to dramatize their cause. Along with the turmoil caused by this group's violent actions, the island was also suffering the depression's severe economic hardships.

The latter part of the 1930s witnessed further Nationalist violence. Following the 1936 assassination of a police chief and subsequent police retaliation, in 1937 the "Ponce Massacre" occurred, which left 19 dead and more than 100 injured. Attempts were also made to assassinate a Federal judge in Puerto Rico and the island's appointed Governor. These terrorist attacks were widely condemned in both Puerto Rico and the States.

During the movement for Commonwealth status the Nationalists again launched a terrorist campaign on the island and the U.S. mainland. In 1950 Nationalists attempted to force their way into the Governor's mansion in San Juan while simultaneous uprisings occurred in six other Puerto Rican towns. Two days later, an attempt was made to assassinate President Truman by two mainland Puerto Ricans, who were part of the Nationalist movement.

After these attacks the Governor and Puerto Rican press expressed their sorrow, emphasizing that the small Nationalist group had little sympathy from the vast majority of Puerto Ricans. Many mainland newspapers also urged that the Nationalist uprising be kept in perspective and that it not affect the upcoming Commonwealth status.

In 1954 Nationalists wounded five Congressmen on the floor of the U.S. House of Representatives. Many arrests and convictions followed these incidents, and the Nationalist organization dissipated.

Other terrorist groups seeking independence, however, have surfaced. Consequently, politically motivated crimes continue to occur sporadically both in Puerto Rico and the States. In 1979 groups espousing independence claimed responsibility for attacking U.S. military personnel in Puerto Rico, killing several people. Also, many bombing incidents in the 1970s and other violence on the mainland resulting in several deaths are believed linked to a clandestine terrorist organization dedicated to Puerto Rican independence.

Possibility of increased violence discussed

Politically motivated violence has occurred sporadically and the possibility of continued violence has been raised by many different persons. Although most consider political violence a possibility, its extent and importance is given different weight.

Representatives from antistatehood political parties have repeatedly made statements that statehood for Puerto Rico would unquestionably result in increased violence. They believe that attempts to resist assimilation would result in numerous violent attacks both in Puerto Rico and the United States.

Statehood supporters believe that violent incidents are not representative of the island's political sentiment or stability and that the status question should not be affected by criminal actions and threats of a few. Puerto Rico's prostatehood Governor has stated there is no reason whatsoever to believe that the advent of statehood would result in any significant upsurge in violence. He has further suggested that violence has tended to historically increase as a colony moved towards independence because of infighting among groups striving to lead the government, whereas colonies moving towards integration have remained tranquil.

FBI officials in both Washington and Puerto Rico believe the number of Puerto Ricans involved in political violence is small, and most island residents do not support this type of activity. Further, they believed it difficult to predict whether there would be any increase engendered by a status change.

CONCLUSIONS

Each status option presents political and financial considerations, but the status debate has other dimensions as well. Most notably, language and culture are important and emotional concerns that transcend political ideologies. Statehood, commonwealth, and

independence proponents each believe that their status offers the optimum way to preserve and enhance the island's culture.

These positions represent essentially different convictions on what type of society and identity is best for Puerto Rico. This topic is of paramount importance to status proponents and island residents, and such a decision can be properly resolved only by Puerto Rico.

Although each status option offers a different formula for preserving the island's culture, all participants also are adamant about retaining Spanish as the island's official language. Statehood opponents have questioned continued use of Spanish following admission, but statehood advocates assert that no obstacle exists to admission as a Spanish-speaking State.

The U.S. Constitution does not prescribe an official U.S. language, but English has always been the common tongue as well as the language of government and education. Four States admitted between 1812 and 1912 were required to use English in their schools and/or legislatures because they had large groups of non-English speaking residents.

In addition to past U.S. history, however, language deliberations would likely include other factors. Puerto Rico represents a unique situation because Spanish is its dominant language and an integral feature of its cultural identity. Further, Hispanics rapidly are becoming the largest U.S. minority, and Federal laws have been passed recently to protect the rights of non-English speaking persons.

Because of these factors and various civil rights changes that have occurred since the last State with language requirements was admitted almost 70 years ago, it is not clear the extent to which language would be an issue in any deliberations. Further clarification of this issue is contingent upon future decisions by Puerto Rico and the U.S. Government should the island decide to petition for admission as a Spanish-speaking State.

In addition to cultural concerns, a status change may include international considerations. Statehood, commonwealth, and independence each offer Puerto Rico a different position in the international community. Also, interest by the U.N. Decolonization Committee and certain Caribbean and Latin American countries bring an added feature to the status debate. Further, divergent hypotheses exist regarding international opinion about status choices.

Puerto Rico's location in the strategically significant Caribbean region also may be a factor in status deliberations. Statehood would guarantee the current defense arrangements between Puerto Rico and the Federal Government. This relationship also would most likely not change with commonwealth status.

Should independence be chosen, however, provisions regarding U.S. military operations would have to be negotiated between Puerto Rico and the U.S. Government. Also, should Puerto Rico opt for independence, citizenship questions would require negotiation. The Puerto Rican Independence Party has made proposals concerning the U.S. military presence and citizenship in its 1980 political platform.

Should Puerto Rico be admitted as a State, the Congress will be faced with an apportionment decision. It could either reapportion the presently mandated 435 seats in the House of Representatives or increase the House size.

In addition to legal, cultural, and international concerns, status participants have discussed the potential for future violence, but their views differ markedly. In the past, sporadic incidents of political violence have occurred stemming from dissatisfaction with the island's political status. Whether violence associated with a status change would increase is speculative, but past history makes it a factor with uncertain dimensions in attempting to resolve the status debate.

SYNOPSIS OF THE HISTORY OF PUERTO RICO'SSTATUS IN UNITED STATES COURTS

Prior to attaining Commonwealth status in 1952, Puerto Rico was considered an unincorporated territory of the United States. Since that time there has been much debate, study, and speculation on whether Puerto Rico's status has changed. Although the United States Supreme Court has not directly considered the status of the Commonwealth of Puerto Rico, the issue has been discussed in several lower Federal courts. The precise legal definition of the term "Commonwealth," however, has not been determined.

PRE-COMMONWEALTH LEGAL STATUS
DEPENDENT ON INSULAR CASES

In the early 20th century, the United States Supreme Court addressed the status of territories in a group of decisions known as the Insular Cases. These decisions considered primarily the status of Puerto Rico and the Philippines acquired by the United States from Spain in the 1898 Treaty of Peace.

In Downes v. Bidwell, 182 U.S. 244, 287 (1901), the Court was faced with the immediate issue of whether merchandise brought into New York from Puerto Rico was subject to the payment of duties, as prescribed by Puerto Rico's First Organic Act, 31 Stat. 77, April 12, 1900 (Foraker Act). An answer to that question involved a determination of whether the duties were levied in such a way as to be repugnant to Art. I, § 8, cl. 1 of the United States Constitution. ^{1/} That determination depended on whether Puerto Rico was considered an incorporated or unincorporated territory.

The difference between incorporated and unincorporated status, in part, lay in the extent of applicability of the United States Constitution. If a territory were unincorporated, authority of the Congress over it was plenary, ^{2/} that is, limited only by the "fundamental parts" of the Constitution. 182 U.S.

^{1/}That clause states that "The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the Common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States."

^{2/}The Congress' authority is exercised both as an incident to its right to acquire territory and on the territorial clause of the Constitution, Art. IV, § 3, cl. 2. Dorr v. United States, 195 U.S. 138, 146 (1904). The territorial clause states: "The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States * * *."

at 290-91, 341-44. However, if incorporated, then the entire Constitution would be applicable, and the Congress would thereby be limited by all the provisions of the Constitution in exercising its authority. Although several cases already had held that territorial inhabitants enjoyed the protection of personal and civil rights implicit in principles of constitutional liberty, those decisions made no distinction between incorporated and unincorporated territories. Murphy v. Ramsey, 114 U.S. 15, 44-45 (1885); Church of Jesus Christ of Latter Day Saints v. United States, 136 U.S. 1, 44 (1890).

In assessing whether Puerto Rico had been incorporated, Justice White compared the provisions in other territorial acts and that of Puerto Rico and found that:

"There has not been a single cession made from the time of the Confederation up to the present day, excluding the recent treaty with Spain, which has not contained stipulations to the effect that the United States through Congress would either not disincorporate or would incorporate the ceded territory into the United States." 182 U.S. at 318-19.

Although the Treaty of Peace contained no such provisions, it stated:

"Spain cedes to the United States the Island of Porto Rico and other islands now under Spanish sovereignty in the West Indies, and the Island of Guam in the Marianas or Ladrones * * *. The civil rights and political status of the native inhabitants of the territories hereby ceded to the United States shall be determined by the Congress." Id. at 339-40.

On the basis of the quoted treaty provision, Justice White concluded that the express purpose of the treaty was not only to leave the status of Puerto Rico to be determined subsequently by the Congress, but to prevent the treaty from operating to the contrary. Id. at 340. Accordingly, he found that since the Congress did not expressly incorporate Puerto Rico, it could establish a government not subject to all the restrictions of the Constitution. Thus, because the Congress was not bound by the uniformity clause, it could impose duties on goods coming into the United States from Puerto Rico. 182 U.S. at 340-42.

Several years after Downes, the Court considered questions involving the status and applicability of the United States Constitution to Hawaii, the Philippines and Alaska. Hawaii v. Mankichi, 190 U.S. 197 (1903); Dorr v. United States, 195 U.S. 138 (1904); Rasmussen v. United States, 197 U.S. 516 (1905). In those cases, the Court found Hawaii and the Philippines to be unincorporated but Alaska to be incorporated.

In Mankichi, Justice White considered whether Hawaii had been incorporated by the Newlands Resolution of 1898, 30 Stat. 750, prior to its being specifically incorporated into the Union by its First Organic Act in 1900. 31 Stat. 141. In finding that the islands were not incorporated by the Newlands Resolution, Justice White, in part, pointed to the following:

"By the resolution the islands were annexed, not absolutely, but merely 'as a part of the territory of the United States,' and were simply declared to be subject to its sovereignty. The minutest examination of the resolution fails to disclose any provision declaring that the islands are incorporated and made a part of the United States or endowing them with the rights which would arise from such relation. On the contrary, the resolution repels the conclusion of incorporation. Thus it provided for the government of the islands by a commission, to be appointed by the President until Congress should have opportunity to create the government which would be deemed best." 190 U.S. at 219.

On the other hand, in Rasmussen the Court found Alaska to be incorporated in view of:

- (1) Article 3 of the treaty with Russia which provided that the people of Alaska should enjoy all the rights, advantages and immunities of citizens of the United States; and should be maintained and protected in the free enjoyment of their liberty, property, and religion.
- (2) The actions of Congress concerning internal revenue taxation and extension of United States laws relating to customs, commerce and navigation over Alaska and establishing a collection district in Alaska.
- (3) The recognition of the incorporated status of Alaska in prior decisions of the Supreme Court. 197 U.S. at 520-25.

The status of Puerto Rico was again considered by the Supreme Court in Balzac v. Puerto Rico, 258 U.S. 298 (1922), several years after the enactment of the Organic Act of 1917, 39 Stat. 951 (The Jones Act). That act established a revised civil government for Puerto Rico; provided for a bill of rights including substantially all the guaranties of the United States Constitution other than those relating to indictment by grand jury and right of jury trial in criminal and civil cases; and with minor exceptions provided United States citizenship to Puerto Ricans. The issue presented to the Court was whether a defendant was entitled to a jury trial

for a misdemeanor, the Puerto Rican Code providing only for jury trials in felony cases. 258 U.S. at 302.

Although the Court acknowledged that citizenship was an important factor in determining whether a territory was incorporated, it held that the Organic Act of 1917 did not incorporate Puerto Rico into the Union. Moreover, it noted that:

"Incorporation has always been a step, and an important one, leading to statehood. Without, in the slightest degree, intimating an opinion as to the wisdom of such a policy, for that is not our province, it is reasonable to assume that when such a step is taken it will be begun and taken by Congress deliberately and with a clear declaration of purpose, and not left a matter of mere inference or construction." Id. at 311.

COMMONWEALTH STATUS

Prior to 1952 there was little question that Puerto Rico was an unincorporated territory. Since the establishment of the Commonwealth, however, the status question has been the subject of fervid public debate and ambiguous and conflicting statements by courts.

Some believe that the Commonwealth is an entirely new entity and that Puerto Rico is no longer a territory within the meaning of the territorial clause of the United States Constitution. See Cosentino v. International Longshoremen's Association, 126 F. Supp. 420, 422 (D.P.R. 1954). Others consider the Commonwealth another type of unincorporated territory, the word "territory" limited to the "constitutional word for an area which is part of the United States and which is not a state." Leibowitz, A. H., The Applicability of Federal Law to the Commonwealth of Puerto Rico, 56 Geo. L.J. 219, 243 (1967). Still others contend that Puerto Rico's status was changed little by forming the Commonwealth. See e.g., Detres v. Lions Building Corp., 234 F. 2d 596, 599-600 (7th Cir. 1956).

The United States Supreme Court has not directly considered the status of the Commonwealth. In Examining Board v. Flores de Otero, 426 U.S. 572, 596 (1976), however, the Court stated that: "Puerto Rico occupies a relationship to the United States that has no parallel in our history." On the other hand, recently the Court, per curiam, found that the Congress was empowered under the territorial clause of the Constitution to treat Puerto Rico differently from the States so long as there was a rational basis for doing so, and it held that Puerto Rico could receive less assistance than the States under the Aid to Dependent Children program, 42 U.S.C. §§ 601 et seq. Harris v. Rosario, 64 L. Ed. 2d 587, 588 (1980). Although it could be argued that this holding suggests that the Court still views Puerto Rico as an unincorporated territory of

the United States, since the status issue was not directly considered, it is uncertain that the rationale of the case would extend beyond its particular facts.

In some instances, Federal appellate courts have suggested that the compact creating the Commonwealth did nothing to change Puerto Rico's status. In one case, the United States Court of Appeals for the Seventh Circuit stated:

"The legislative history of the Act providing for this last change in the government of Puerto Rico shows very definitely that those members of Congress most responsible for its enactment thought that the Act would not change Puerto Rico to some political entity other than a territory. The Senate Report explaining and recommending the passage of this bill, U.S. Code Congressional and Administrative Service, 1950, Volume 2, page 2682 stated:

'It is important that the nature and general scope of S3336 be made absolutely clear. The bill under consideration would not change Puerto Rico's fundamental political, social, and economic relationship to the United States.'

"Again, on page 2683 of the same volume, the Report stated:

'This bill does not commit the Congress * * * to the enactment of statehood legislation for Puerto Rico in the future. Nor will it in any way preclude a future determination by the Congress of Puerto Rico's ultimate political status.'" 234 F.2d at 599-600.

Decisions of the United States Court of Appeals for the First Circuit also seem to indicate that Puerto Rico's status did not change in 1952. ^{1/} However, the statements made by that court are less clear than those in Detras, supra. Thus, in Guerrido v. Alcoa Steamship Co., 234 F.2d 349, 352 (1st Cir. 1956), the court noted that Puerto Rico was neither a State nor a territory which had been incorporated into the Union preliminary to statehood, citing Balzac. Yet, in another instance Judge Magruder, a long-time student of Puerto Rican affairs, stated:

^{1/}Prior to 1961, decisions of the Supreme Court of Puerto Rico were appealed to the United States Court of Appeals for the First Circuit. Since 1961 appeals from the Supreme Court of Puerto Rico are treated similarly to those of a State and are heard by the United States Supreme Court. 28 U.S.C. § 1258 (1976).

"Puerto Rico has thus not become a State in the federal Union like the 48 States, but it would seem to have become a State within a common and accepted meaning of the word." Mora v. Mejias, 206 F.2d 377, 387 (1st Cir. 1953).

On the other hand, the United States Court of Appeals for the Third Circuit found that Puerto Rico's status had changed after 1952, though it concluded that Puerto Rico did not exercise the sovereignty of an independent nation.

"There can be no doubt that as a matter of political and legal theory, and practical effect, Puerto Rico enjoys a very different status from that of a totally organized but unincorporated territory, as it formerly was. The government of the Commonwealth derives its powers not alone from the consent of Congress, but also from the consent of the people of Puerto Rico. However, under the terms of the "compact" the people of Puerto Rico, do not exercise the full sovereignty of an independent nation, since they do not have control of their external relations with other nations. Further, as United States citizens the citizens of Puerto Rico are assured that their right to due process of law is protected by the federal Constitution." Americana of Puerto Rico, Inc. v. Kaplus, 368 F.2d 431, 435-36 (3d Cir. 1966), cert. denied, 386 U.S. 943 (1967).

The United States District Court for Puerto Rico has decided a number of cases which peripherally have touched on the status question. That court consistently has found that Puerto Rico's status has changed since the establishment of the Commonwealth. In one case, in purely informal comments on Puerto Rico's status, a judge of that court said:

"I am satisfied that Puerto Rico is no longer a Territory in the sense that the term is used in the Constitution and the cases * * *. [I]f the Congress of the United States proposes in the future to make a statute applicable to Puerto Rico * * * generally speaking, it will have to make it so other than by use of the term 'Territory'." Cosentino v. International Longshoremens Ass'n, 126 F. Supp. 420, 422 (D.P.R. 1954).

Fourteen years later, the same court stated:

"It is clear, however, that the compact does exist as a binding agreement, irrevocable

unilaterally between the people of Puerto Rico and the Congress of the United States, transforming Puerto Rico's status from territory to commonwealth, or Estado Libre Asociado.

* * * * *

"In short, in respect to domestic authority, the status of the Commonwealth essentially parallels that of the states." United States v. Valentine, 288 F. Supp. 957, 981 (D.P.R. 1968).

APPLICABILITY OF THE UNITED STATES CONSTITUTION

The extent to which the provisions of the United States Constitution were applicable to Puerto Rico both as an unincorporated territory and a Commonwealth has been considered in some cases. The determinations made by courts, however, with few exceptions have been vague.

Pre-Commonwealth Era

In Downes v. Bidwell, supra, the Court found that the uniformity clause was not one of the fundamental parts of the United States Constitution which would apply to Puerto Rico as an unincorporated territory. Although the Court did not establish a listing of provisions which were or were not fundamental, Justice White did provide a general outline on what constitutional provisions might be applicable.

"* * * it does not follow that there may not be inherent, although unexpressed, principles which are the basis of all free government which cannot be with impunity transcended. But this does not suggest that every express limitation of the Constitution which is applicable has not force, but only signifies that even in cases where there is no direct command of the Constitution which applies, there may nevertheless be restrictions of so fundamental a nature that they cannot be transgressed, although not expressed in so many words in the Constitution.

"Albeit, as a general rule, the status of a particular territory has to be taken in view when the applicability of any provision of the Constitution is questioned, it does not follow when the Constitution has absolutely withheld from the government all power on a given subject, that such an inquiry is necessary. Undoubtedly, there are general prohibitions in the Constitution in favor of the liberty and property of the citizen which are not mere regulations as to the form and manner

in which a conceded power may be exercised, but which are an absolute denial of all authority under any circumstances or conditions to do particular acts. In the nature of things, limitations of this character cannot be under any circumstances transcended, because of the complete absence of power." 182 U.S. at 291, 294-95.

In another opinion Justice Brown provided additional guidance:

"Whatever may be finally decided by the American people as to the status of these islands and their inhabitants--whether they shall be introduced into the sisterhood of States or be permitted to form independent governments--it does not follow that, in the meantime, awaiting that decision, the people are in the matter of personal rights unprotected by the provisions of our Constitution, and subject to the merely arbitrary control of Congress. Even if regarded as aliens, they are entitled under the principles of the Constitution to be protected in life, liberty and property." 182 U.S. at 282-83.

Following this Insular decision, other cases further defined which parts of the Constitution were or were not applicable to Puerto Rico as an unincorporated territory. A factor that might have contributed to courts rarely expounding on which rights and protections in the United States Bill of Rights applied was the enumeration of substantially the same rights, with the exception of the grand and petit jury trial provisions, in Puerto Rico's revised Organic Act of 1917.

During the pre-Commonwealth era, the Sixth Amendment right of trial by jury, Balzac v. Puerto Rico, 258 U.S. 298 (1922), Fifth Amendment protection of grand jury indictment, Puerto Rico v. Tapia, 245 U.S. 639 (1918), the Commerce Clause (Art. 1, § 8, cl. 3), and prohibition against the imposition of duties or imposts on imports (Art. 1, § 10, cl. 2), Buscaglia v. Ballester, 162 F.2d 805, 806-07 (1st Cir. 1947), cert. denied 332 U.S. 816, and the Uniformity Clause (Art. 1, § 8, cl. 1), Downes v. Bidwell, 182 U.S. at 342, specifically were held inapplicable to Puerto Rico. Other protections which appeared not to apply were the Seventh Amendment right to trial by jury in civil suits, Puerto Rico v. Shell Co. Ltd., 302 U.S. 253, 258 (1937) and the Fifth Amendment protection against double jeopardy, Grafton v. United States, 206 U.S. 333, 345, 354-55 (1907).

Also, during this period the only constitutional provisions judicially 1/ found applicable to Puerto Rico were due process, Balzac v. Puerto Rico, 258 U.S. 298, 312-313 (1922), and the Eighteenth Amendment prohibition, 2/ Ramos v. United States, 12 F.2d 761, 762 (1st Cir. 1926). Other parts of the Constitution which, in all likelihood, were applicable to pre-Commonwealth Puerto Rico were the right to habeas corpus, Eisentrager v. Forrestal, 174 F.2d 961, 965 (D.C. Cir 1949), rev'd on other grounds sub. nom. Johnson v. Eisentrager, 339 U.S. 763 (1950) and the Fifth Amendment right to just compensation, Mitchell v. Harmony, 54 U.S. (13 How.) 115, 133-34 (1852).

Post-Commonwealth Period

With the formation of the Commonwealth, the privileges and immunities clause of Article IV § 2, cl. 1 of the United States Constitution continued to be applicable through the Federal Relations Act 3/ Pub. L. No. 600, § 4, July 3, 1950. That clause provides: "The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States." Although some courts have urged that Puerto Ricans as American citizens should be afforded greater United States constitutional protection, the rights of American citizens guaranteed by the privileges and immunities clause are not extensive. See Slaughter-House Cases, 83 U.S. (16 Wall.) 36, 79-80 (1873). 4/

In Torres v. Puerto Rico, 442 U.S. 465, 471 (1979), the United States Supreme Court held that the Fourth Amendment to the United States Constitution was applicable to Puerto Rico, though not deciding whether that amendment applied directly or through the Fourteenth Amendment. The Court also set forth other constitutional provisions found in previous Supreme Court cases to be applicable to Puerto Rico. They are the First Amendment free speech clause, Balzac, supra, at 314, the due process clause of either the Fifth or Fourteenth Amendment, Calero-Toledo v. Pearson Yacht Leasing Co., 416 U.S. 663, 668-69 n.5 (1974) and the

1/In 1947, the privileges and immunities clause of Article IV, § 2, cl. 1 of the United States Constitution was made applicable by an amendment to the Jones Act, "as though Puerto Rico were a state of the Union." Pub. L. No. 362, § 7, Aug. 5, 1947, 61 Stat. 772-73.

2/Presumably, the Twenty-First Amendment (repeal of prohibition) was also applicable.

3/This provision was the only section of the Jones Act Bill of Rights which was not repealed by Pub. L. No. 600, Act of July 3, 1950, 64 Stat. 319.

4/The privileges and immunities guaranteed by the Fourth and Fourteenth Amendments are the same. 83 U.S. at 75.

equal protection guarantee of either the Fifth or Fourteenth Amendment, Examining Board v. Flores de Otero, 426 U.S. 572, 599-601 (1976). 1/

Prior to Torres several Federal court decisions suggested that the Equal Protection clause was applicable to Puerto Rico. E.g., Marquez v. Aviles, 252 F.2d 715, 717 (1st Cir. 1958), cert denied, 356 U.S. 952. In Rodriguez Cintron v. Richardson, Civ. Action No. 1099-72 (D.P.R. 1975) 2/ the Court held that the Puerto Rican plaintiffs were entitled to benefit from the principles of equal protection read into the Fifth Amendment. This determination by the United States District Court for Puerto Rico recently found apparent support in a ruling by the United States Court of Appeals. Molina-Crespo v. Califano, 583 F.2d 572, 574 (1st Cir. 1978).

In an instance in which the constitutionality of sections of an abortion statute were challenged, the United States District Court for Puerto Rico suggested that Puerto Rico should be treated as a State under the Fourteenth Amendment (due process and equal protection).

"None of this makes clear just which specific provisions of the United States Constitution apply in Puerto Rico. But it does follow undeniably that at least those 'fundamental' protections of the United States Constitution, which were restraints upon the power of the pre-commonwealth government, remain in effect after formation of the Commonwealth and restrict its powers.

* * * * *

"Finding such great similarity in the practical and theoretical application of the tests used as to both states and unincorporated territories, we may assume that the notion of 'fundamental rights,' which has undergone such a metamorphosis in the context of interpretation of the Fourteenth Amendment, must be deemed to have had a similar expansion as to Puerto Rico. In addition, we think that we may safely assume that when a personal right has been found applicable to the states via the Fourteenth Amendment, we may then assume that such right is applicable

1/The Court also stated that in Califano v. Torres, 435 U.S. 1,4 n.6 (1978) it assumed without deciding that the constitutional right to travel extends to the Commonwealth. 442 U.S. at 470.

2/Unpublished opinion.

to Puerto Rico, regardless of the theoretical means used to achieve such a result. After all, citizens of Puerto Rico, in common with citizens of states, are citizens of the United States." Montalvo v. Colon, 377 F. Supp. 1332, 1339, 1341 (D.P.R. 1974) (Per Curiam).

* * * * *

Presently, it is uncertain whether the right to a jury trial in a criminal case, guaranteed both by Article III, § 2, cl. 3 and the Sixth Amendment to the United States Constitution, is applicable to Puerto Rico. Although in 1959 the United States Court of Appeals for the First Circuit found those provisions inapplicable, Fournier v. Gonzalez, 269 F.2d 26, 28-29 (1st Cir. 1959), in 1976, the United States District Court for Puerto Rico held the Sixth Amendment applicable. Justiniano Matos v. Gaspar Rodriguez, 440 F. Supp. 673, 674 (D.P.R. 1976). Moreover, recently, a Federal district court found unconstitutional provisions in American Samoan laws and regulations denying the right to jury trial. King v. Andrus, 452 F. Supp. 11, 17 (D.C. D.C. 1977). The later decisions may reflect the United States Supreme Court's holding that the right to a jury trial in a criminal case is fundamental. Duncan v. Louisiana, 391 U.S. 145, 149 (1968).

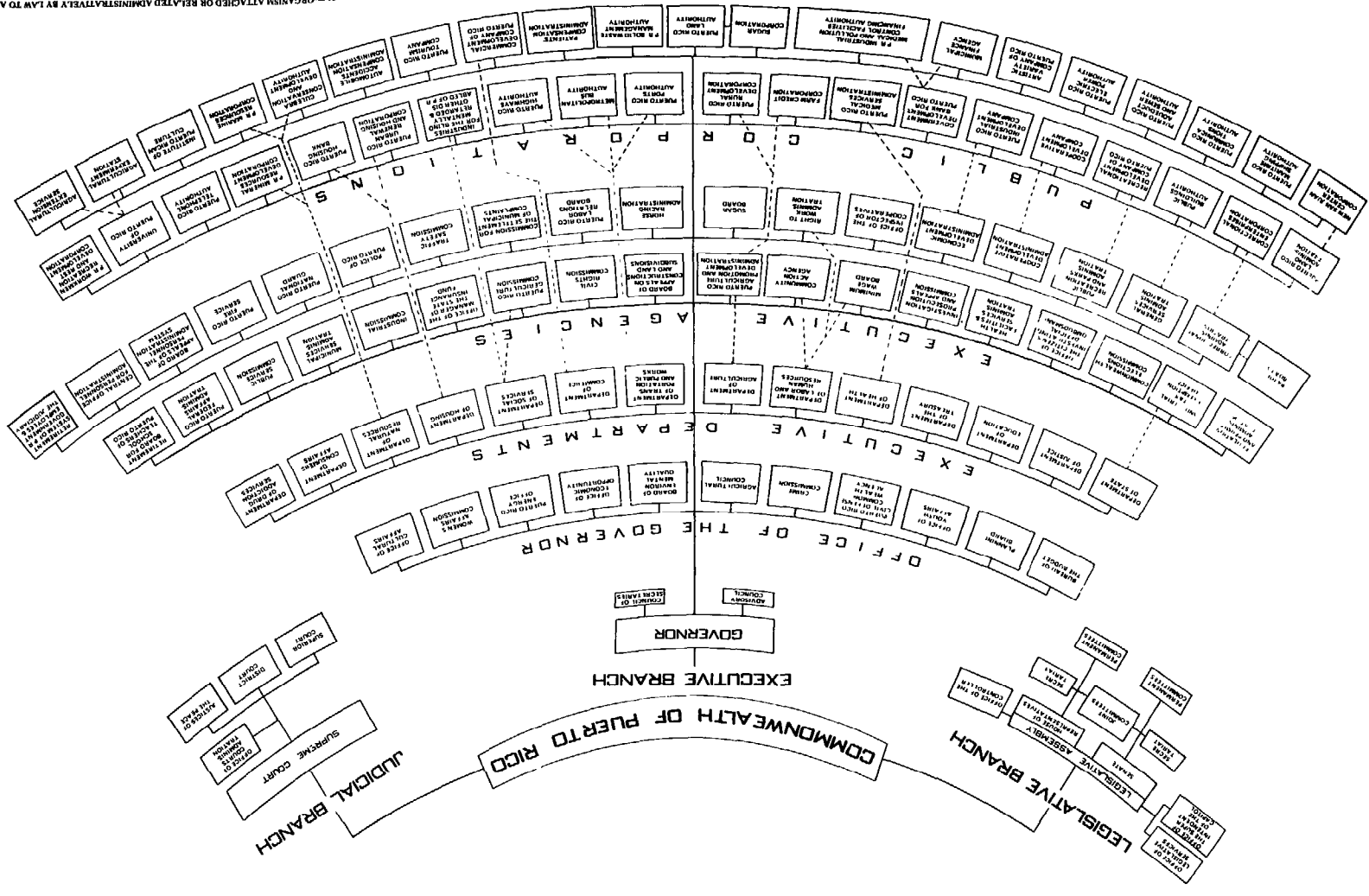
FUTURE DETERMINATIONS

It should be clear from the above that the question of Puerto Rico's status and constitutional relationship to the United States since the establishment of the Commonwealth in 1952 has not been judicially determined nor subject to thorough analysis by the courts. What the courts will do in the future is uncertain. In any case, it is questionable that the rationale behind the Insular Cases would be currently applicable. Indeed, in Reid v. Covert, 354 U.S. 1, 14 (1957), cited in a concurring opinion in Torres v. Puerto Rico, 442, U.S. at 476, Justice Black stated that "neither the [Insular Cases] nor their reasoning should be given any further expansion."

Although the United States Supreme Court might be presented with a case requiring an analysis of Puerto Rico's relationship to the United States, it is uncertain it would render a decision on such a controversial political issue. In the past, the Court has invoked the doctrine of political question and refused to consider an issue when it could more properly be resolved in the political sphere. Wright, C. A., Law of Federal Courts § 14 (3d Ed. 1976).

The Commonwealth status issue has been left unresolved. Although some might argue that the Commonwealth's relationship to the United States should be defined more precisely and would look to the courts for that definition, others would urge that ambiguity allows for greater flexibility and that a decision on the island's status should come from the Puerto Rican people and the responsible political branches of government.

ORGANIZATION CHART OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO



Source: The Budget in Brief for fiscal year 1980, Commonwealth of Puerto Rico, Office of the Governor, Bureau of the Budget, September 1979.
 --- DEPARTMENT OR AGENCY, BUT AUTONOMOUS IN ITS OPERATION ---

METHODS FOR ESTIMATING THE AMOUNT OF
ADDITIONAL FEDERAL AID PUERTO RICO WOULD
HAVE RECEIVED IF IT HAD BEEN A STATE IN 1979

Puerto Rico was treated like a State in the vast majority of the over 1,000 Federal domestic assistance programs available to individuals and State and local governments in 1979. However, our analysis of the Catalog of Federal Domestic Assistance, discussions with Federal and Puerto Rico program officials, and examination of applicable legislation and past studies revealed that the island's funding levels were restricted in about 20 programs.

The amount of increased aid Puerto Rico would have received if it had been a State in fiscal year 1979 was unquantifiable or would not have affected funding levels in 14 of these programs (see p. 126). The remaining 6 programs, however, would have brought substantial additional assistance. On the other hand, statehood-induced increases in Federal income support programs would have reduced Federal expenditures for food stamps.

Methods used to estimate how much additional aid Puerto Rico would have received if it had been a State in 1979 are discussed below. Federal officials responsible for each program either performed the actual calculations or concurred with our approach. The actual amount Puerto Rico would receive under statehood, however, would be affected by the terms of admission; any change in the authorization, allocation, or funding methods or levels in any program where the island is treated differently from a State; and island government budgetary decisions in programs where the Federal Government reimburses or matches island costs.

Supplemental Security Income

Supplemental Security Income (SSI)--authorized by Title XVI of the Social Security Act--provides income for needy aged, blind, or disabled persons. SSI replaced the adult income maintenance assistance programs commonly referred to as Aid to the Aged, Blind, and Disabled (AABD) provided as grant funds to the 50 States and the District of Columbia. Puerto Rico and the other territories, were excluded from the SSI legislation, which provides substantially higher benefit levels to individuals. They do, however, continue to receive funding under the AABD programs.

Equal treatment under statehood would end the current arrangement and extend full SSI benefits to residents of Puerto Rico. Because legislation has been proposed to fully include the Commonwealth of Puerto Rico, the Federal Department of Health and Human Services, Division of Supplemental Security Studies, estimated the cost of extending SSI to island residents.

The Department made its fiscal year 1981 estimate of \$386 million by projecting the number and income levels of potential

beneficiaries and applying these results to 1981 SSI benefit levels. To obtain an estimate for fiscal year 1979, we factored out two cost of living increases. This adjustment resulted in an estimated \$317 million in total program funds for 1979. Further, since SSI would replace AABD benefits, the \$13 million received for these programs also was subtracted. With these adjustments, Puerto Rico would have received \$304 million in SSI funds had it been a State in 1979.

While extending SSI to Puerto Rico would have provided increased benefits to eligible residents, it also would have reduced the financial obligations of the island government. The \$4.3 million paid to match 1979 Federal AABD payments would have been freed up for other purposes, because SSI is 100 percent federally funded.

Aid To Families With Dependent Children

Another income maintenance program that would be affected by statehood is Aid To Families With Dependent Children (AFDC) --Title IV of the Social Security Act. This program provides Federal funds which assist States in furnishing financial assistance, rehabilitation, and other services to needy dependent children and their guardians.

Although there are no statutory limitations on the amount of funds a State may receive, Puerto Rico is restricted to a maximum funding level of \$72 million for AFDC and other programs. 1/ Additionally, Puerto Rico's matching rate is fixed at 75 percent 2/, while those for States are derived by one of two formulas which in part employ the proportion of State to national per capita income. According to Commonwealth officials, these restrictions have precluded Puerto Rico from establishing an AFDC program which meets island needs.

Equal treatment under statehood would eliminate the \$72 million ceiling and the fixed matching rate. Instead, Puerto Rico's AFDC Federal matching percentage would be calculated like those for States, and the Federal share could increase to 83 percent. As a result, Puerto Rico could expand its AFDC program, while paying a smaller share of total costs. The Puerto Rico Secretary of Social Services estimated that an expanded AFDC program would have cost a total of \$133 million in fiscal year 1979.

1/These include AABD and its social services which would be eliminated if Puerto Rico were eligible for SSI and Title XX of the Social Security Act (see pp. 122 and 123).

2/Prior to a change in legislation which became effective in fiscal year 1979, the Federal share was set at 50 percent with the ceiling fixed at \$24 million.

Because the Federal Government would have provided 83 percent of the total program costs, its share would have been \$110 million, representing a \$62 million increase in its 1979 AFDC funding. Even though Puerto Rico's matching rate would be reduced to 17 percent, its 1979 costs would have grown by \$7 million because total program expenditures would have increased substantially.

Medicaid

While SSI and AFDC provide income to needy residents, Medicaid assists States in financing health care services for public assistance recipients and other needy individuals. Under this program, the Federal Government provides from 50 to 83 percent of a State's total Medicaid costs, and there is no limitation on the amount of Federal funds that can be received.

Puerto Rico's treatment differs from that accorded States. Most notably, while States' matching rates are determined by a formula similar to the one used for AFDC, Puerto Rico's is set at the lowest available to any State--50 percent. ¹/ This restriction combined with a \$30 million limit on the total Federal Medicaid assistance Puerto Rico may receive, reportedly has limited the island's ability to fully meet Medicaid recipients' needs.

A recent Commonwealth government estimate, adjusted to account for inflation, suggested that a full Medicaid program in fiscal year 1979 would have cost approximately \$135 million. Because equal treatment under statehood would eliminate the \$30 million ceiling and raise the Federal contribution to 83 percent, the Federal Government would have paid \$112 million, or \$82 million more than it did in fiscal year 1979.

The lifting of restrictions which would accompany statehood would permit Puerto Rico to expand its Medicaid program while substantially reducing island financial obligations. Although the island government contributed \$83 million to Medicaid in 1979, it would have been responsible for only \$23 million had it been a State. The \$60 million in freed up funds would have been available for other purposes.

Social services

This program--authorized by Title XX of the Social Security Act--provides financial aid for States' social services programs benefiting public assistance recipients and other low-income

¹/Other aspects of Puerto Rico's treatment also are different and have become important to the viability of the island's Medicaid program. For purposes of analysis, it was assumed that these provisions would be maintained, but the actual effect of equal treatment would be subject to the terms of admission.

persons. Title XX replaced and expanded certain social service programs formerly operated as adjuncts to States' AFDC and AABD programs. Puerto Rico was not defined as a State in Title XX legislation and still operates its programs under AFDC and AABD. Despite this exclusion the island receives Title XX funds to provide social services, but on a basis different from States.

For the States, Title XX allocations are determined by a formula which allocates funds using the proportion of State to national population. For most of these funds, States must match 25 percent of total program costs. 1/ However, in 1979 Puerto Rico received about \$15 million in Title XX funds after States certified that they would not use their entire allotment. 2/ Also, compared to States, the island was required to match a greater share of total program costs.

In fiscal year 1979 Puerto Rico expended about \$20 million for social services. About \$15 million came from Title XX and \$5 million from the AFDC/AABD ceiling.

Equal treatment under statehood would extend fully Title XX to Puerto Rico and replace the social services programs operating as adjuncts to AFDC and AABD. Like States, the island's funding would be determined by the population formula, and its required matching share for most of the total program costs would be reduced to 25 percent.

Had it been a State, Puerto Rico would have been entitled to \$43.6 million in Title XX assistance--an increase of \$23.6 million above actual 1979 funding. Because the island government would have been responsible for a smaller share of program costs, the sizeable funding increase would have required only about \$200,000 in additional Puerto Rico expenditures.

Elementary and Secondary Education Act

Puerto Rico's funding is also limited in the Elementary and Secondary Education Act of 1965, as amended, (ESEA-Title I) which provides State and local educational agencies with financial aid to supplement programs for educationally disadvantaged children. Among the States, 1979 Federal funding levels for ESEA-Title I programs were determined by a formula which used a State's average per pupil expenditure and the aggregate number of educationally deprived children as a basis for calculation. In applying the

1/One of the Title XX programs is 100 percent federally funded.

2/This treatment had caused uncertainty in the availability of Title XX funds for Puerto Rico. Recent legislation, effective in fiscal year 1980, eliminated this problem by guaranteeing an annual set-aside of \$15 million.

formula, all States are guaranteed a per pupil expenditure at least 80 percent of the national average and are limited to 120 percent of the national average. In addition, a separate method was used to allocate funds covering various ESEA-Title I administration expenses.

Although Puerto Rico's 1979 funding level for administration costs was computed by the same method used for States, the island was not protected by the 80-percent guarantee 1/ in the allocation formula for other ESEA-Title I programs. Because Puerto Rico's per pupil expenditure was considerably lower than the national average, this exclusion limited the island's share in these programs.

Equal treatment under statehood would extend to Puerto Rico the 80-percent minimum guaranteed to States in the ESEA-Title I allotment formula. This change alone would have brought the island an estimated increase of \$67 million. Also, an additional \$670,000 would have been available in State administration assistance because these grants equal 1 percent 2/ of total ESEA program funding. Overall, the island would have received an increase of about \$68 million in ESEA-Title I funds if it had been a State in 1979.

General Revenue Sharing

Unlike Federal disbursements which are targeted for specific uses, General Revenue Sharing (GRS) assistance can be used for a broad range of purposes. GRS funds are allocated to States by formula, and in 1979 the overall State entitlement was distributed as follows; one third to the State government and two-thirds to general purpose local governments. 3/

The island has not been included in the GRS program, but equal treatment under statehood would have extended such aid to Puerto Rico in 1979. At our request, the U.S. Treasury's Office of Revenue Sharing (ORS) estimated how much 1979 GRS funds the island would have received had it been a State. We supplied ORS with the basic information needed to calculate a hypothetical revenue sharing allotment for Puerto Rico. This data was obtained from Federal and Puerto Rico government reports and extrapolations from our 1979 Federal tax estimates.

1/Our analysis of recent education amendments, which became effective after fiscal year 1979, showed that the 80-percent minimum would apply to Puerto Rico if its per pupil expenditure rose to that of the lowest State.

2/This was raised to 1.5 percent after fiscal year 1979.

3/Recent legislation extending the GRS program excludes State governments from receiving fiscal year 1981 disbursements. The States may be included in future fiscal years if the Congress appropriates funds.

Using this data ORS estimated that Puerto Rico governments would have received about \$263 million in GRS aid had the island been a State in 1979. Puerto Rico would have received the eighth highest total share of funds among the States and the District of Columbia and would have ranked first in per capita allotments. According to ORS, Puerto Rico's relatively large revenue sharing allocation was due primarily to its low per capita income.

Food stamps

Although equal treatment would have increased aid in the preceding programs, Federal expenditures in the food stamp program which already treats Puerto Rico like a State would have decreased. This aid--which supplements the food purchasing capability of needy residents--has become the largest single Federal assistance program in Puerto Rico. Because food stamp benefit levels are based on an income definition which includes SSI and AFDC payments, the statehood-induced increased funding for these programs would reduce Federal food stamp benefits.

A recent Department of Agriculture study calculated that for every dollar of increased Federal income support payments to Puerto Rico, food stamp assistance would decrease by 31 cents. Accordingly, the estimated \$366 million of additional AFDC and SSI payments would decrease food stamp expenditures in Puerto Rico by \$113 million.

Federal Programs Which Treat Puerto
Rico Differently from States, but
Amounts Were Unquantifiable or Would
Not Have Affected Puerto Rico's Funding
Levels Had It Been a State in 1979

College Work-Study

Work Incentive Program (WIN)

Vocational Rehabilitation Services for SSI Beneficiaries

Health Care Financing Administration Research

State Medicaid Fraud Control Units

Special Benefits for Persons Aged 72 and Over (Prouty)

Assistance Payments - State and Local Training

Assistance Payments - Research

Fish Restoration

Wildlife Restoration

Longshoremen's and Harbor Workers' Compensation

Airport Development Aid Program

Weatherization Assistance Program for Low-Income Persons

Energy Conservation for Institutional Buildings

METHODS FOR ESTIMATING TAXATIONIN PUERTO RICO IF IT HAD BEEN A STATE IN 1979

Along with extending additional Federal program funds, immediate equal treatment under statehood would engender profound changes to taxation in Puerto Rico. Because it is not fully integrated into the U.S. internal revenue system, the island is in effect exempt from most Federal individual and corporate taxes on income earned in Puerto Rico, most estate and gift levies, and certain excise taxes. The absence of full Federal taxation also has permitted the Commonwealth government to establish a taxation system with rates and structure more akin to the Federal system than those typical of States.

Equal treatment under Federal tax laws would eliminate the present exemptions and most likely would cause the Puerto Rican government to make adjustments to its tax system. To gauge the potential magnitude of full Federal taxation, we estimated Puerto Rico's Federal tax liability if it were treated like a State in 1979.

If Puerto Rico were to attain statehood, however, the exact tax changes and their impacts would depend on a variety of elements which are currently unknown. Among these would be the Federal and Puerto Rico tax structures at the time of the status change; the terms of admission established by the Congress and Puerto Rico; and the necessary policy decisions made by the Puerto Rican government regarding the scope and level of public services to be provided and what sources should be tapped to finance such activities. Other elements which could affect island tax liabilities and descriptions of the methods employed for making Federal calculations are discussed in the following segments.

PUERTO RICO'S INCREASED
FEDERAL TAX LIABILITY

Presently, despite exemptions, island residents and businesses must pay Federal taxes on income earned outside Puerto Rico, and social security and Federal unemployment levies apply fully. Also, although rebated to Puerto Rico, Federal excise taxes are collected on island-produced alcohol and tobacco products shipped to the United States. In all, the U.S. Treasury retained Puerto Rico source taxes totaling about \$450 million in 1979. If Puerto Rico had been treated like a State in 1979, however, the island's Federal liability would have been considerably higher, as amounts owed for individual and corporate income taxes, along with excise and estate and gift levies, would have increased.

Individual income tax

Although island residents currently pay Federal taxes on income earned outside Puerto Rico 1/, completely integrating Puerto Rico into U.S. tax laws would bring Federal taxation on individual income earned in Puerto Rico as well. This additional Federal liability (see p. 129) was calculated from summaries of the latest available Puerto Rican individual income tax return data. The Puerto Rican and Federal tax systems have many similar elements because the island generally patterned its laws after the Federal tax code. Therefore, we estimated island residents' Federal tax liability by applying 1979 Federal tax rates, allowances for dependents, average deductions, and earned income credit criteria to the latest available Puerto Rican tax information.

Many Puerto Rican taxpayers would have been eligible for the earned income credit. This provision of the U.S. Tax Code grants a credit of up to \$500 to taxpayers who earned less than \$10,000 and have at least one child dependent. Basically, the credit is used to offset any taxes due, but the Government sends payment for whatever amount the earned income credit exceeds any taxes owed. Moreover, persons who met eligibility criteria, but had no tax liability, also receive payment.

We estimate that 43 percent of island individual tax returns used for our analysis would have had no Federal tax liability, 2/ and about 70 percent of these returns would have been eligible for earned income credits totaling over \$36 million. This is not surprising, because minimum levels subject to taxation are generally higher in the Federal system than the Puerto Rican system, and island residents' average income is about half that of the lowest State.

To determine how many Puerto Rican taxpayers would have been eligible for the earned income credit, we asked the Puerto Rican Treasury Department to apply the appropriate criteria to island income tax returns. This computerized information provided us with the number of eligible taxpayers in each adjusted gross income level and filing status. Using this data and the average adjusted gross income for each income class up to \$10,000, we obtained the average earned income credit.

Corporate income taxes

Similar to the approach taken for calculating individual income taxes, applying Federal tax laws to summarized Puerto Rican tax

1/Federal individual income taxes paid by residents of Puerto Rico amounted to about \$28 million in 1978, the latest year for which data were available.

2/Sixteen percent of island individual tax returns filed in fiscal year 1979 had no Commonwealth tax liability.

Estimated 1979 Federal Individual Income Taxes In Puerto Rico

<u>Adjusted Gross Income</u>	<u>Number Of Returns</u>	<u>Estimated Federal Taxes</u> (see note a)	<u>Total Earned Income Credit</u>	<u>Earned Income Payments To Taxpayers</u>	<u>Earned Income Credit Used To Offset Taxes</u>
Under \$2,000	19,458	\$ 0	\$ 421,525	\$ 421,525	\$ 0
2,000 under 4,000	33,341	0	3,730,943	3,730,943	0
4,000 under 6,000	60,210	2,813,877	14,495,500	14,106,271	389,229
6,000 under 8,000	66,468	8,858,545	13,382,406	11,642,927	1,739,479
8,000 under 10,000	49,441	10,895,086	4,007,872	1,316,630	2,691,242
10,000 under 15,000	72,216	48,482,902	-	-	-
15,000 under 20,000	37,888	54,496,300	-	-	-
20,000 under 25,000	17,125	40,415,732	-	-	-
25,000 under 30,000	8,003	27,567,295	-	-	-
30,000 under 50,000	7,854	45,131,421	-	-	-
50,000 under 100,000	1,691	26,307,972	-	-	-
100,000 under 500,000	<u>206</u>	<u>11,174,955</u>	<u>-</u>	<u>-</u>	<u>-</u>
Subtotal	373,901	\$276,144,085	\$36,038,246	\$31,218,296	\$4,819,950
Less: Federal Internal Revenue Service estimate of indivi- dual taxes actually paid by residents of Puerto Rico on income from sources outside Puerto Rico (see note b)		<u>28,117,000</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total		<u>\$248,027,085</u>	<u>\$36,038,246</u>	<u>\$31,218,296</u>	<u>\$4,819,950</u>

a/Net of earned income credit used to offset taxes due.

b/Latest available data was for 1978.

return data would have been the most accurate method for estimating the island's Federal corporate income tax liability. 1/ The Puerto Rico Treasury Department, however, does not enter all corporate tax returns into its computer system. As a result, there was no data base available to employ a methodology similar to that used in the individual income tax calculations.

As an alternative, we employed the basic method used by the United States Treasury Department in projecting the Federal corporate tax expenditure of mainland-based tax exempt firms in Puerto Rico (also known as 936 corporations), 2/ and adopted the procedure to calculate the Federal liability of all island businesses. The Treasury methodology basically involved multiplying the effective rate of taxation levied on U.S. corporations by the net income earned by the tax exempt firms. To account for various provisions of the U.S. tax code, such as the investment tax credit and the fact that corporate tax rates are graduated based on a firm's net income, the effective rate of taxation was set by Treasury at 38 percent for 1979.

In extending this methodology to estimate the total Federal corporate income taxes, we obtained the Puerto Rico Planning Board's figure for the 1979 net incomes of all corporations operating on the island--\$2.932 billion. 3/ This number was then multiplied by the 38 percent effective tax rate used in the Treasury report. Because the calculation derives the aggregate liability of corporations in Puerto Rico, the \$16.5 million in actual 1979 Federal collections (income earned from sources outside Puerto Rico are taxed by the Federal Government) was subtracted to avoid double counting. If Federal corporate tax levies had been applied fully in 1979, island businesses would have owed an estimated \$1.1 billion.

Federal excise taxes

Although the island is exempted from most Federal excise taxes, Puerto Rican-produced alcohol and tobacco products shipped to the United States are taxed at the full rate. After administrative costs are deducted, however, these collections are returned to the Puerto Rican Treasury. Equal treatment under statehood would bring

1/Tax exempt businesses located in Puerto Rico are required to file annual returns and keep the same records as their non-tax-exempt counterparts.

2/Treasury's estimates are included in their annual reports to the Congress on the operation and effect of the possessions corporation taxation system.

3/Planning Board officials informed us that the net income figure is derived by subtracting corporate losses from income. This would tend to understate total taxable income and, hence, the estimated corporate tax liability.

full Federal excise taxation and end the alcohol and tobacco tax rebates.

In the absence of the Federal levies, Puerto Rico developed its own excise tax system which long has been one of the island government's largest revenue sources. Because of the inherent differences in the two systems, the advent of Federal excise taxes would not affect the majority of commodities currently taxed by the Puerto Rico government. ^{1/} There are, however, certain items which would have been subject to additional Federal tax; these included alcoholic beverages, cigarettes, gasoline, and others.

Federal excise tax liability estimates for these items, shown in the following chart, are generally based on the data for the applicable Puerto Rican levy. Descriptions of the data and methods employed for each calculation follow the chart.

Estimated additional Federal excise taxes

<u>Type of excise tax</u>	<u>Estimated 1979 Federal collection</u> -----(millions)----
Alcoholic beverages	\$ 72.6
Gasoline	28.1
Cigarettes	18.3
Telephone service	6.7
Tires and tubes	4.8
Diesel fuel	2.2
Lubricating oil	.7
Trucks, truck parts, and accessories	(a)
Other	<u>12.7</u>
Total	<u>\$146.1</u>

^{a/}Satisfactory data for making this estimate was unavailable, but it appears that amounts would be negligible.

^{1/}Television sets, radios, candy, public shows, hotel rooms, and matches are a few examples of items subject to Puerto Rico tax that had no 1979 Federal excise tax equivalent.

Alcoholic beverages

Both Puerto Rico and the Federal Government levy excise taxes on distilled spirits, beer, and wine. Although the Federal Government already collected full excise taxes on alcoholic beverages produced for shipment to the United States, imports ^{1/} and products manufactured for local consumption also would have been subject to Federal taxes. The following chart summarizes our alcoholic beverage excise tax estimates.

<u>Type of alcoholic beverage</u>	<u>Estimated Federal liability for 1979</u>
Distilled Spirits	\$59,096,090
Beer	12,895,692
Wine	<u>597,384</u>
Total	<u>\$72,589,166</u>

Distilled spirits: According to Puerto Rico 1979 excise tax data, 5,628,199 gallons of distilled spirits would have been subject to the Federal levy. This figure was multiplied by the Federal rate of \$10.50 per gallon to obtain the Federal liability for distilled spirits.

Beer: The total gallonage of island-produced and imported beer was 44,467,906 in 1979. The Federal liability was estimated by multiplying this gallonage by the Federal tax rate of 29 cents per gallon.

Wine: Because the Federal tax varies by type of wine, we estimated Puerto Rico's liability by (1) applying the percentage of all wine in each Federal category nationwide to Puerto Rico's total 1979 gallonage of 1,322,899 and (2) multiplying these figures by the appropriate Federal levy.

Gasoline taxes

There was no way to determine the number of gallons of gasoline exempted under Puerto Rico law which would have been taxable under the Federal system. As a result our gasoline tax estimates were based on 1979 Commonwealth collections.

Puerto Rico levied a gasoline excise tax of 16 cents per gallon while the Federal rate was 4 cents, or 25 percent of the Puerto Rican rate. The 1979 Federal liability for gasoline was calculated by multiplying total collections--\$112,412,853--by 25 percent.

^{1/}Puerto Rican excise taxes are substituted for Federal excise taxes on alcoholic beverages imported from foreign countries.

Cigarette taxes

The Commonwealth government imposed a 53 cent excise levy on each "taxable" ^{1/} pack of cigarettes sold in Puerto Rico in 1979, while the Federal rate was 8 cents a pack, or \$4.00 per thousand cigarettes. The Federal liability was obtained by multiplying the total number of cigarettes sold in Puerto Rico --4.586 billion--by the Federal rate.

Telephone service taxes

The Federal excise taxes covering toll telephone and local telephone and teletypewriter services was 3 percent of the total charges in 1979. ^{2/} Because Puerto Rico does not have a similar tax, we based our estimates on fiscal year 1979 data from the Puerto Rican Communications Authority and Puerto Rico Telephone Authority collections which would be subject to the Federal levy. Added together, they collected \$223,804,515 for these services. This figure was then multiplied by the 1979 Federal rate.

Federal tax on tires and tubes

Puerto Rico imposed excise taxes of 8 cents per pound on tires and 9 cents per pound on inner tubes, while the U.S. tax on both items was 10 cents. Because we were unable to obtain a detailed breakdown of Puerto Rican tires and tube sales data, the total 1979 revenue obtained from these sources was used as the basis for our estimate. The Federal levy was roughly 25 percent greater ^{3/} than the Puerto Rico tax, so we multiplied the Puerto Rico 1979 collections of \$3,873,806 by 125 percent to obtain the estimated Federal liability.

Diesel fuel

The Federal excise tax on diesel fuel was half of the corresponding Puerto Rico 8-cent levy. Puerto Rico exempted from taxation diesel fuel used for agricultural and governmental purposes. Although some of this fuel likely would have been taxable under Federal law, we were unable to obtain data regarding the taxable and non-taxable gallons. Therefore, we made our Federal liability estimate by taking half of \$4,409,132--the total 1979 diesel fuel revenues.

^{1/}The Commonwealth government grants certain exemptions to the excise tax on cigarettes. The cigarettes exempted from Puerto Rico taxes would have been subject to the Federal levy.

^{2/}This tax was reduced to 2 percent in 1980.

^{3/}Because about 96 percent of 1979 U.S. excise tax collections in this category were for tire sales, we used the percent difference between the Puerto Rican and Federal levies on tires.

Lubricating oil

Because Puerto Rico did not tax lubricating oil and specific data was unavailable, the basic procedure employed for the other calculations--applying Federal tax rates to Commonwealth government information--could not be used in this instance. As an alternative, we computed U.S. collections for lubricating oil as a percent of those for gasoline, and multiplied the result--2.4 percent--by the estimated Federal gasoline collections in Puerto Rico.

Other Federal excise taxes

There are several remaining major excise taxes that had no specific Puerto Rican equivalent. These excise taxes, which included firearms, fishing equipment, air transport, foreign departures, and highway use of large vehicles, amounted to total U.S. collections of \$1.9 billion in 1979. In the absence of the data needed to make a direct calculation for these items, we estimated the island's liability by multiplying Federal collections by the ratio of consumer expenditures in Puerto Rico to those of the United States.

Estate and gift tax liability

Similar to the approach used in estimating Puerto Rico's Federal individual income tax liability, applying prospective Federal rates to data detailed by size of estates and gifts taxed in 1979 would have yielded the most accurate estimate. We were unable to obtain such information, however, so an alternative method was devised.

Because Federal estate and gift taxes have a strong correlation to per capita personal income ¹/₁, we made our estimate by applying the ratio of estate and gift tax collections to the 1979 personal income for Mississippi--the lowest income State--to Puerto Rico's 1979 personal income. This resulted in an estimated liability of \$19 million.

SEVERAL FACTORS COULD AFFECT
PUERTO RICO'S TAX LIABILITY
UNDER STATEHOOD

Our estimates were based on available data and provide a hypothetical picture of how much additional taxes Puerto Ricans would have owed in 1979. There are, however, a variety of factors which would affect the island's future liability if it attained statehood. Among these are the terms of any statehood legislation, any changes in the U.S. tax code, the tax structure adopted by the new State,

¹/The linear correlation coefficient for combined per capita Federal estate and gift taxes and State per capita personal income was .98 in 1979.

business investment decisions, and economic conditions. For example, statehood proponents advocate that Federal taxes be phased in gradually over a 20-year period. Under this proposal, Puerto Rico would be liable for an increasingly larger portion of the full liability.

Another factor which could affect Puerto Rico's tax liability is the impact of the U.S. Internal Revenue Service (IRS) on the island's tax compliance problem. Although the Puerto Rican Treasury has intensified its efforts to deal with this situation and has met with some success, several observers believe that IRS might improve compliance levels and perhaps increase collections.

Although the Federal IRS--with its greater resources--could have some effect on compliance, translating this into an estimate for increased collections would involve much speculation. There is currently no basis for systematically comparing compliance levels between Puerto Rico and the States. Although the Puerto Rican Treasury has performed various tax compliance investigations, the results cannot be used to reflect islandwide behavior, because samples reportedly were not scientifically drawn.

Even if comparisons could be made, it would be difficult to predict the degree of additional compliance IRS might obtain in Puerto Rico or to estimate the impact on collections. For example, IRS studies indicate that tax compliance varies not only throughout different regions in the country, but also among various types of taxpayers. Accordingly, we did not attempt to adjust our tax liability computations to include prospective increased compliance levels.

HIGHLIGHTS OF FINANCIAL OPERATIONS
OF PUERTO RICO GOVERNMENT

Government in Puerto Rico includes the Commonwealth, or central government, and its public corporations as well as 78 municipalities. The great majority of governmental functions are administered by the central government and the public corporations. Only limited responsibilities have been delegated to the municipalities.

COMMONWEALTH OR CENTRAL GOVERNMENT

The central government's most important revenue sources are individual and corporate income taxes, excise taxes, and Federal assistance. The chart on the next page shows the Commonwealth government's major revenue sources.

Major revenues of the
Commonwealth of Puerto Rico

	1979 <u>Actual</u> -----(millions)-----	1981 <u>Budgeted</u> -----	<u>Percent of total 1981 revenues</u>
Commonwealth sources			
Income taxes			
Individual	\$ 487.7	\$ 562.0	
Business	205.1	289.0	
Tollgate	65.0	40.0	
Total income taxes	\$ <u>757.8</u>	\$ <u>891.0</u>	32
Inheritance and gift taxes	11.1	12.0	(a)
Excise taxes			
Alcoholic beverages	125.6	139.0	
Motor vehicles and accessories	110.2	117.2	
Five percent general tax	83.5	88.0	
Cigarettes	72.4	80.0	
Electric and gas appliances	33.6	34.0	
Other	61.3	64.6	
Total excise taxes	\$ <u>486.6</u>	\$ <u>522.8</u>	19
Property taxes	101.0	107.0	4
Licenses	29.6	31.0	1
Nontax revenues			
Lottery	45.3	48.0	
Permits, fees, fines, and forfeits	31.6	22.0	
Other	35.1	55.1	
Total nontax revenues	\$ <u>112.1^{b/}</u>	\$ <u>125.1</u>	4
Total Commonwealth sources	\$ <u>1,498.2</u>	\$ <u>1,688.9</u>	<u>60</u>
Non-Commonwealth sources			
Federal grants	538.1	796.2	
Federal excise tax rebates	209.2	263.0	
U.S. customs duty rebates	64.2	72.0	
Total non-Commonwealth sources	\$ <u>811.5</u>	\$ <u>1,131.2</u>	<u>40</u>
Totals	\$ <u><u>2,309.7</u></u>	\$ <u><u>2,820.1</u></u>	<u>100</u>

^{a/}Less than 0.5 percent.

^{b/}Does not add due to rounding.

The Commonwealth government is highly centralized and performs services similar to those provided by mainland State and local governments, such as education, public health and welfare programs, police and fire protection, and economic development activities. The appropriations section of the Commonwealth budget for fiscal year 1981, as shown below, provides some additional insight into the services provided.

<u>Appropriations</u>	<u>Amount</u> (thousands)
Operating expenses:	
Appropriations controlled by the Bureau of the Budget	\$ 60,000
General government	136,927
Education	912,658
Health	290,330
Welfare	658,213
Economic development	211,865
Public safety and protection	262,890
Transportation and communication	48,586
Housing	52,226
Contributions to municipalities and assistance to nonprofit organizations	122,595
Special pension contributions	8,975
Debt service - bonds	<u>167,563</u>
Total operating expenses	\$2,932,828
Capital improvements	<u>171,315</u>
Total appropriations	<u>\$3,104,143</u>

The Commonwealth general fund is the principal fund used for government operations and accounts for the major portion of Commonwealth revenues and expenditures. Various special funds include proceeds from Federal grants, bond sales, and resources set aside for bond redemption.

Puerto Rico's Constitution requires the Commonwealth budget to be balanced. It was balanced with current year revenues in all but the recession years of 1974 and 1975 when the Commonwealth

issued \$215 million in short-term notes to meet current expenses. The last of these notes were retired in fiscal year 1980.

The Commonwealth budget does not include public corporations' budgets totaling \$2.7 billion, or the budgets of the municipalities. Information obtained from the Commonwealth's Municipal Services Administration and the Economic Report to the Governor showed that the fiscal year 1980 budgets of the municipalities totaled about \$540 million.

PUBLIC CORPORATIONS

Puerto Rico's 43 public corporations are governmental entities of the Commonwealth, with varying degrees of independence from the central government, particularly with respect to the custody of funds. Most public corporations are governed by boards appointed by the Governor with the advice and consent of the Senate, but some public corporations are subsidiaries or departments of the central government.

Most public corporations obtain revenues from charges for services or products, but many are subsidized by the central government. The larger public corporations finance capital improvements through the sale of bonds.

Most of the island's public corporations provide public utilities or social services, in some cases performing services normally associated with the private sector in the States. Examples follow.

- The Electric Power Authority owns and operates generating and distribution facilities which supply 99 percent of all electric power consumed in Puerto Rico.
- The Government Development Bank is the financial adviser and fiscal agent for the Commonwealth government, the public corporations, and the municipalities, particularly in the issuance of bonds and notes. To aid in the island's economic development, the bank also makes loans to public corporations as well as private enterprises.
- The Telephone Authority purchased the Puerto Rico Telephone Company from the International Telephone and Telegraph Corporation in 1974. The authority operates the island's principal telephone system. Areas not covered by this system are served by another public corporation, the Communications Authority.
- The Public Buildings Authority plans, acquires, leases, and constructs office buildings, schools, courthouses, police and fire stations, warehouses, hospitals, and related facilities for lease to government agencies.

- The Industrial Development Company participates in the Commonwealth-sponsored economic development program by providing physical facilities, general assistance, and special incentive grants to manufacturers.
- The University of Puerto Rico, with more than 50,000 students, is the island's largest institution of higher learning.
- The Sugar Corporation was created in 1973 to consolidate ownership and management of the Commonwealth's interests in the sugar industry. These interests consist primarily of owned and leased land, mills, and refineries. The corporation grows its own cane, buys cane grown by private firms, processes the cane, and sells the crude, refined sugar, and molasses.
- The Urban Renewal and Housing Corporation carries out activities related to (1) providing housing for moderate income families, (2) federally aided public housing, (3) urban renewal, and (4) other housing activities financed by Commonwealth appropriations.
- The Ports Authority owns and operates the island's major airport and seaport facilities.
- The Maritime Shipping Authority operates three shipping lines, acquired in 1974, serving Puerto Rico and the U.S. mainland.
- The Land Administration is responsible for the use of land. It acquires and maintains land reserves for developing agricultural and manufacturing facilities and for constructing housing, commercial, health, school, recreational, and other public facilities.
- The Housing Bank and Finance Agency is principally engaged in insuring and servicing mortgages originated by the Urban Renewal and Housing Corporation.

The following table presents financial data on selected public corporations. Although not fully comparable due to accounting differences, this data provides some insight as to the size of these activities.

Financial Data on Selected Public Corporations
for Fiscal Year 1979

<u>Public Corporations</u>	<u>Total assets</u>	<u>Total liabilities</u>	<u>Net assets</u>	<u>Fiscal year 1979 revenues</u>
	------(millions)-----			
Electric Power Authority	\$1,940.4	\$1,671.4	\$ 269.0	\$ 669.8
Highway Authority	1,482.9	727.9	755.0	134.7
Government Development Bank	1,301.1	1,199.8	101.3	110.5
Aqueduct and Sewer Authority	991.3	332.8	658.5	88.7
Telephone Authority	782.6	751.0	31.6	212.0
Public Buildings Authority	512.0	430.1	81.9	60.3
Industrial Development Company	395.6	134.2	261.4	27.5
University of Puerto Rico	383.4	329.7	53.7	207.0
Sugar Corporation (See note a)	353.2	415.6	(62.4)	80.1
Urban Renewal & Housing Corporation	330.4	455.8	(125.4)	65.5
Ports Authority	254.3	124.8	129.5	37.5
Maritime Shipping Authority	179.9	211.9	(32.0)	232.4
Land Administration	143.8	31.1	112.7	5.8
Housing Bank & Finance Agency	120.7	95.0	25.7	9.9
Communications Authority	72.7	59.7	13.0	17.9
Municipal Finance Agency	47.7	47.3	0.4	3.1
Totals	<u>\$9,292.0</u>	<u>\$7,018.1</u>	<u>\$2,273.9</u>	<u>\$1,962.7</u>

a/Fiscal year 1978 data.

MUNICIPAL GOVERNMENTS

Municipalities are Puerto Rico's only local political sub-division. Each of the island's 78 municipalities has a mayor and a municipal assembly. Located in both urban and rural areas, the average population for the municipalities is about 25,000 and only 5 have populations exceeding 100,000. Metropolitan San Juan has a population of about one million persons.

Although the Commonwealth government provides most government services, the municipalities are responsible for local administration of services, such as street cleaning, garbage collection, and some public works. To a limited extent, the municipalities share responsibility for education and health by providing various services such as drivers for school buses and ambulances. Moreover, seven municipalities augment the Commonwealth police with their own local police forces, and two municipalities provide their own electric power because they are too remote from facilities of the Electric Power Authority.

The municipalities carry out their responsibilities primarily with Commonwealth and Federal governments' funds, as well as some self-generated revenues. Further, the Commonwealth legislature exercises certain supervisory responsibilities over

the municipalities' budgeting and fiscal affairs. For fiscal year 1980, the estimated budget for the municipalities amounted to \$540 million, with \$274 million coming from Commonwealth and local sources, and the remaining \$266 million coming from the Federal Government, primarily for the Comprehensive Employment and Training program, Community Development, and local public works. The largest combined municipal budget was San Juan's, which totalled \$165 million--\$88 million from island sources and \$77 million from the Federal Government.

Most municipalities had budgets ranging between \$1 and \$2 million, exclusive of Federal funds. The more significant sources of local revenue were the municipal subsidies from the Commonwealth; the property taxes levied by the municipalities and collected by the Commonwealth; and the municipal shares of the Puerto Rican lottery receipts, cigarette taxes, and Electric Power Authority rebates. Municipalities also raised limited revenues from business licenses and from renting municipal facilities to the Commonwealth government.

PUERTO RICO'S PUBLIC DEBT

The island's public debt was about \$7 billion as of June 30, 1980. The public debt grew significantly during the early and mid-1970s, due primarily to financing the development of the island's infrastructure. The Commonwealth government has adopted a policy to restrict the public debt's rate of growth. Both investment services and investors have expressed confidence in Puerto Rico's bonds as evidenced by their high ratings and ready marketability.

Puerto Rico's public debt more than tripled--increasing from \$2.1 to almost \$7 billion--during the 10-year period ending June 30, 1980. Public corporations' bonds account for the great majority of the public debt, as shown in the following chart.

<u>Fiscal year</u>	<u>Commonwealth</u>	<u>Municipalities</u>	<u>Public corporations</u> (See note a)	<u>Total</u>
	------(millions)-----			
1980 (Preliminary)	\$1,599.7	\$187.3	\$5,210.7	\$6,997.7
1971	<u>591.8</u>	<u>138.1</u>	<u>1,335.1</u>	<u>2,065.0</u>
Increase	<u>\$1,007.9</u>	<u>\$ 49.2</u>	<u>\$3,875.6</u>	<u>\$4,932.7</u>

a/The bonds and notes of the Government Development Bank and the Municipal Finance Agency are not included in the debt of the public corporations because they are used to purchase obligations of the Commonwealth, its agencies, and municipalities.

Puerto Rico's agencies, authorities, and public corporations provide significantly more services and financing arrangements than State and local governments on the mainland. This is, in

part, due to the need to rapidly develop its infrastructure when the island changed from an agricultural to an industrial economy. As a result, most public corporation debt was incurred for infrastructure development, including highways, ports, industrial facilities, power, communications, shipping, and housing.

In 1977 the Commonwealth adopted a number of fiscal policies designed to improve Puerto Rico's debt picture. The policies included (1) limiting the growth rate of public debt to less than the growth of the island's gross product, (2) reducing the ratio of debt to gross product, (3) reducing the percent of short-term debt, and (4) making greater efforts to finance capital improvements with internally generated funds.

During the past 4 fiscal years, Puerto Rico's debt picture has improved noticeably compared to the 4 prior years. The following chart summarizes these improvements.

Puerto Rico Public Debt

<u>Fiscal year</u>	<u>Percent of total debt</u>		<u>Total debt</u> (millions)	<u>Percent of increase in total debt</u>	<u>Total debt as a percent of gross product</u>	<u>Percent of increase in gross product</u>
	<u>Short term</u>	<u>Long term</u>				
1973	14	86	\$2,991	21.5	47.7	9.5
1974	17	83	3,731	24.6	54.9	8.4
1975	26	74	5,095	36.6	71.4	5.0
1976	30	70	5,587	9.7	74.4	5.2
1977	27	73	5,962	6.7	73.7	7.8
1978	25	75	6,082	2.0	68.1	10.3
1979	19	81	6,452	6.1	64.5	12.0
1980 _a /	18	82	6,998	8.5	62.8	11.5

a/The 1980 figures are preliminary.

Government Development Bank officials have stated they intend to continue policies designed to improve the debt picture. Their goal is to bring the ratio of public debt to gross product into a more fiscally acceptable range of 50 percent as quickly as possible. Because of the success of these policies, a number of prominent investment analysts have indicated that although the island's debt is large, it is manageable.

Government Development Bank officials also have stated that despite the island's large debt, Puerto Rico's bonds have been marketable at favorable interest rates. They attribute this to a number of factors including:

--Puerto Rico has never defaulted on the interest or principal of any of its bonds.

--The island's constitution requires that the Commonwealth's annual debt service not exceed 15 percent of the average

annual recurring general revenues of the preceding 2 years.

--Puerto Rican bonds are highly rated by the two leading investment services.

--Interest earned on Puerto Rican bonds is fully exempt from Federal, State, and local income taxes in all 50 States.

The officials also pointed to the May 1980 issue of general obligation Commonwealth bonds as further evidence of the confidence investors have in Puerto Rican bonds. This issue was originally scheduled as a \$200 million offering. Because investor demand was so heavy, it was increased to \$300 million, equaling the largest previous single Commonwealth issue. Despite the issue's increase, it was oversubscribed by \$100 million.

AN EQUAL OPPORTUNITY EMPLOYER

**UNITED STATES
GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548**

**OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE, \$300**

**POSTAGE AND FEES PAID
U. S. GENERAL ACCOUNTING OFFICE**



**SPECIAL FOURTH CLASS RATE
BOOK**