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The Economic Implications of Puerto Rico's Status Options Second Part: Scenarios and Simulations

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editor

In the preceding bulletin (April-June 1997) was published the first combined summaries of the book of essays concerning the economic implications of Puerto Rico's status options, that will be published soon by the Internamerican University. The summaries of the essays try to encompass the Congressional debate, the industrial policies, the contributive incentives and the sensitivity of the 936 type businesses to changes in contributive credit.

In this bulletin are gathered summaries of those essays that contain the scenarios and simulations. A brief summary is presented of the themes of essays that are published on this issue:

- The potential impact of the repeal of Section 936 and the compensatory actions to be taken to confront it (Angel Ruiz and Edwin Meléndez).
- Net transfers (transfer payment less federal taxes) under different status options (Jaime Bofill).
- Income distribution and industrial policy (Jaime del Valle).
- Economic flows between the Puerto Rican and the U.S. economies (Angel Ruiz and Fernando Zalacaín).
- The migration between Puerto Rico and the United States (Carlos Santiago).

Moreover, in the earlier issue was mentioned that a brief description of the more important premises, the scenarios, and some commentary of the methodology would be included in this issue. We start with the premises.

In this number:

The Economic Implications of Puerto Rico's Status Options: Second Part Scenarios and Simulations	1
The Potential Impact of the Repeal of Section 936 on Puerto Rico's Economy: Summary	4
The Impact of Federal Disbursements and Taxes on the Puerto Rican Economy Under Different Status Options	11
Income Distribution and Industrial Policy: An Assessment of the Implications of Political Status Options on Industrial Profitability	16
The Economic Relation of the United States and the Puerto Rican Economies: An Interregional Input-Output Approach	19
Political Status, Minimum Wages, and Puerto Rican Migration	25

The Economic Implications of Puerto Rico's Status Options

assumptions on the proposals presented by the Island's political parties and Congress during the 1981-1991 Congressional hearings regarding Bill S. 712. For example, some of the more important assumptions related to transfer payments and federal taxes under Statehood are:

- At the moment of incorporation as a state all federal taxes and programs apply to Puerto Rico.
- Federal income taxes become effective from January 1, 1994 with the exception provided by Section 936 which will be gradually eliminated over a five year period.
- The U.S. Treasury will transfer to Puerto Rico those funds paid as federal taxes from Puerto Rico during 1994 and 1995.
- Federal excise taxes will begin to be enforced in 1994 and will be returned to Puerto Rico until October 1998.
- Beginning in 1994, all federal programs will extend to Puerto Rico.

In general, the essays partake of some basic parameters in the definitions and design of their scenarios (up to the point where their data and models allow). For this reason it is important for the reader to analyse in detail the premises of each essay and its methodology. For example, in the case of professors Ruiz and Meléndez, they specify the following scenarios to be utilized with an input-output model:

- Base scenario: Continuation of the Commonwealth's trend in growth rate until year 2,000.
- Scenarios 1: Repeal of 936 without compensatory action from government and private sector.
- Scenarios 2: Wage credit without compensatory action.
- Scenarios 3: Repeal of 936 with

compensatory action.

- Scenarios 4: Wage credit with compensatory action.

The result of these scenarios are very valuable and interesting. They offer a new dimension to the role of compensatory action that government and the private sector can play confronted with the repeal of Section 936. However, the situation with Section 936 has changed, hence, when analysing these results or comparing them with other studies, much caution is needed.

The repeal of Section 936 by Congress has increased anxiety concerning the deterioration of the industrial base and the reduction of potential economic growth in Puerto Rico. It ought to be noted that the companies operating in Puerto Rico under Section 936 have been given a ten-year grace period under Section 30A. Even so, an anxious preoccupation persists in the those sectors with new factories or new lines of production that have been excluded from the extension, and the unanswered questions that arise from the unknown economic reality of a post-936 Puerto Rico.

Various basic scenarios can be constructed that describe the overall features of post-936 Puerto Rico. The first among these is the Section 901 scenario. This partakes from the premise that the relevant contributive provisions (repeal of Section 936) will be maintained for a period of time and that Section 901 covered in Puerto Rico during this time.

A wage credit after year 2001 constitute the second scenario of post-936 Puerto Rico. In concrete terms, the scenario consists in the extension of wage credit of 40 or 60 percent after 2001. This is one of the alternatives that possibly will arise in Congress in the coming years. To compare the contributive rates for the two wage credit options (40 or 60 percent), with the credit rates for earnings of 40 percent (which will be relevant in 1998) demonstrate, for many sectors, that the resulting differences in wage and income credit are not as different as perceived. This second scenario is the closest one to the world of 936 that we know before the repeal in August 1996. Section 901 coexists in this scenario of wage credit such as found in the time period of 936 with its wage credit and earnings credit.

Unidad de Investigaciones Económicas

The Implications of Puerto Rico's Status Options

The crucial point of this scenarios is the number and importance of the 936 businesses that decide to relocate their operations or postpone their future investment in the Island, as well as the efficiency of these incentives in attracting new investment. Moreover, the steps taken by the government and the private sectors to compensate for the uncertainty that surrounds the problem of investing in Puerto Rico are very important. The absence of comparative studies of investment yields between our national competitors and Puerto Rico make it difficult to analyze these scenarios, particularly the analysis related to net migration (establishing and shutting down) of type 936 businesses. In the light of these concerns about the repeal of Section 936, it seems that the contrast regarding the scenarios of these essays and those of post-936 Puerto Rico, may be less stark than it seems to appear.

Finally, we can now turn to comment briefly on the methodological issues. Some of the principal methodological issues have been remarked upon by Nazrul Islam (1995) in an interesting piece of work. He proposes an alternative methodology to modeling these issues (a computable general equilibrium model that will allow for the simultaneous interplay of the different issues) that ought to be looked over, particularly by those who are continuing to do research concerning these topics. In sum, the essays presented in this forthcoming book constitutes the best collection of research available on the economic implications of Puerto Rico's status options.

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