



## PUERTO RICO FORWARD

### Episode 18: Effects of Statehood

#### Transcript

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In the most recent episode of *The PRF Review* I talked about Representative Darren Soto's *Puerto Rico Admission Act*<sup>1</sup>, which seeks to have Puerto Rico (hereinafter PR) become the fifty-first state of the United States of America (hereinafter USA) within 90 days of its enactment<sup>2</sup>. This bill, together with the growing importance of the PR issue for the upcoming presidential race, have served as the perfect platform for the archipelago's status question to finally be addressed. As I've mentioned before, PR's colonial condition can only be eliminated by changing its legal status from a COLONY OF THE US to a status that allows it to regain a degree of sovereignty that would allow it to control the most basic elements of its economic and legal system.

Now, I am on record stating that statehood and independence are in fact valid status options that, from a legal standpoint, would allow PR to move out of its colonial condition. I have discussed that through statehood, PR would be recognized the same degree of sovereignty that all states of the federal union have. Of course, it goes without saying that independence would endow PR with a full degree of sovereign powers as any other independent country would. But of the two, lately, the one that has occupied all the headlines on this issue is statehood. This really isn't all that surprising given the fact that, at least from an economic and legal point of view, PR's current colonial status is far more similar to statehood than it is to independence. As I'll discuss later on, statehood would actually change few, albeit fundamental legal aspects of the current status quo. Understandably, this serves as a powerful basis to form a pro-statehood opinion in regards to PR's status issue. However, the intellectual seduction offered by statehood's apparent simplicity harbors some very real risks for the people of PR. These risks lie in the transition process that would dictate the necessary steps out of colonialism and into the statehood status.

Unfortunately, few studies have been done that tackle the question of PR's existence as a state. That isn't to say that not much has been written from an opinion-based or anecdotal point of view. Like independence, statehood has many passionate and aggressive supporters

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<sup>1</sup> Puerto Rico Admission Act, H.R. 1965, 116<sup>th</sup> Cong. (2019)

<sup>2</sup> *Id.* at Sec. 5(a)

that do all they can to highlight the virtues of their preferred status option. However, opinions only go so far; and when it comes to PR's status issue, they are not enough. This is one of the reasons why the status issue needs to be discussed within a fact-based environment and why empirically guided studies are so important. Although investigations of said nature aren't as available as their opinion based counterparts, in March of 2014 the United States Government Accountability Office issued a report titled *Puerto Rico: Information on How Statehood Would Potentially Affect Selected Federal Programs and Revenue Sources*.<sup>3</sup> The report is actually quite limited in its scope and only provides a view into how statehood would affect certain federal programs. The report itself affirms this: "The objectives of this report are to evaluate (1) potential changes to selected federal programs and related changes in federal spending, and (2) potential changes to selected sources of federal revenue, should Puerto Rico become a state."<sup>4</sup> That said, it is in fact a useful resource when it comes to illustrating how nuanced and thorough the status debate must to be.

The report starts off by affirming a very simple, and yet often overlooked, fact:

**In some ways, Puerto Rico—the largest and most populous territory of the United States—has a fiscal relationship with the federal government similar to that with the states.** For example, Puerto Rico's residents have access to many federal programs and are subject to certain federal tax laws. However, for some federal programs, Puerto Rico or its residents are subject to different requirements or funding rules than are the states or their residents. Likewise, some federal tax laws apply differently to Puerto Rico residents and corporations than to residents of the states and corporations in the states.<sup>5</sup> (*emphasis added*)

Clearly, the report starts off by stating that, despite some exceptions, the fiscal relationship that exists between PR and the federal government is already mostly similar to that which exists between a state and the federal government. This point deserves a lot more attention than it gets due to the fact that it can be used both to favor and to oppose statehood. On one hand you could say that statehood is the natural choice or solving PR's status problem since it already has much in common with the states. However, one could also oppose statehood by pointing out PR's current fiscal failure has occurred despite it being so similar to a state. Taking that into consideration, why should we believe statehood would prove beneficial to the archipelago's ultimate development? As I have mentioned before, it is my belief that these questions must be pondered within the context of a **constitutional status convention** so that

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<sup>3</sup> U.S. Gov't Accountability Office, GAO-14-31, PUERTO RICO: INFORMATION ON HOW STATEHOOD WOULD POTENTIALLY AFFECT SELECTED FEDERAL PROGRAMS AND REVENUE SOURCES (2014). [HEREINAFTER *REPORT*]

<sup>4</sup> *Id.* at 2

<sup>5</sup> *Id.* at 1

each status option could be developed into a coherent and well formed status proposition. But I digress.

In regards to the process of selecting the federal programs that would be studied, the report states the following:

To evaluate potential changes to selected federal programs under Puerto Rico statehood, we used data from fiscal years 2010 and 2011 to identify programs that generally provide funds directly to states and territories, or residents and institutions in the states and territories. Among those programs, we identified those that had total federal net outlays of at least \$5 billion and/or programs for which federal spending in Puerto Rico differed by at least \$100 million from spending in a set of comparable states. **Based on these criteria, we selected 29 programs to review, which accounted for about 86 percent of spending in fiscal year 2010 on programs that generally provide funds directly to states and territories, or residents and institutions in the states and territories.** For each selected program, we reviewed relevant laws and regulations and interviewed federal (and in some cases Puerto Rico) agency officials to determine if and how spending would change under Puerto Rico statehood.<sup>6</sup> (*emphasis added*)

As we can see, the report focused on 29 programs that represented 86 of the money spent on programs that provide funding for states, territories or their residents and institutions directly. Of course, a more complete and detailed report is in fact desirable, but for now this report presents a well enough picture to at least understand some implications of statehood.

The report also took into account the possible changes brought by PR's statehood status change in the spending for various federal programs.

To evaluate potential changes in federal spending that could result from potential changes to federal programs, we developed estimates of federal spending under statehood for some programs. **The programs for which we developed estimates accounted for about 94 percent of fiscal year 2010 spending on programs that would likely change under statehood.** For these programs, we developed a range of estimated spending for a single year in the past, as if Puerto Rico had been treated like the other states in that year.<sup>7</sup> (*emphasis added*)

Perhaps most importantly, the report studied the effects PR's statehood would have on the most important sources of the federal government's revenue.

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<sup>6</sup> *Id.* at 2-3

<sup>7</sup> *Id.* at 3-4

To evaluate potential changes to selected federal revenue sources under Puerto Rico statehood, we reviewed federal laws and regulations related to the main sources of federal revenue in fiscal year 2012—individual income tax (which accounted for 46.2 percent of federal revenue in fiscal year 2012), employment tax (34.5 percent), corporate income tax (9.9 percent), excise tax (3.2 percent), customs duties (1.2 percent), and estate and gift taxes (0.6 percent).<sup>8</sup>

At this point, some might notice that, as the report's title implies, everything discussed will be related to money. Of course, PR's status issue is far more than numbers on a balance-sheet. It's about people, and different cultures, and a consideration of all the things given up by choosing one status option over the other. We know this, I know this. However, PR's status question is not exempt from the cost-benefit analysis that has permeated all policy considerations, and that would not be a problem if it weren't for the profit centered definition we have made of the concept of "benefit". In other words, under this rational, PR's future must be considered on the basis of one simple yet destructive question: does the cost (for the US) out-weigh the **benefit** (for the US)? Keep that in mind as we continue on.

One of the first points the report makes is to recognize that the archipelago's precarious economic condition was a well known fact in the Beltway.

Historically, trends in Puerto Rico's economy have tended to follow those in the rest of United States. However, Puerto Rico's latest economic downturn has been longer and more extreme than the mainland U.S. downturn. Specifically, the U.S. economy entered into a recession in December 2007, which ended in June 2009, according to the Business Cycle Dating Committee of the National Bureau of Economic Research. In contrast, Puerto Rico's recession began in the fourth quarter of 2006, and the economy contracted every fiscal year from 2007 to 2011.<sup>9</sup>

As we can see, the report paints a very grim picture in regards to PR's economic health. And mind you, this shouldn't have surprised anyone since the archipelago's recession outlasted and persisted for far more time than the US's. Placing aside the obvious obstacles this poses for PR's ultimate development, what impact could this have in regards the probability of Congress welcoming it as a state? After all, it seems completely reasonable to expect some level of resistance to the idea of a territory with such a dark economic reality to become the 51<sup>st</sup> state of the federal union.

Even if we place aside the fact that the archipelago's economy has been in a recession since 2006, certain structural problems still persist. The report highlights these:

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<sup>8</sup> *Id.* at 4

<sup>9</sup> *Id.* at 8-9

In 2011, the percentage of the population living below the federal poverty threshold was greater in Puerto Rico than in any state. More broadly, household income in Puerto Rico in 2011 was lower than that in the states—median household income was \$18,660, compared to median household income of \$50,502 in the states, and was lower than that in any state. Likewise, for 2011, Puerto Rico had a higher unemployment rate and lower labor force participation rate than any single state.<sup>10</sup>

Now, to the report's credit, it does point out one of the central weaknesses of the colonial condition: dependency. Of course, it doesn't do it directly, but rather it supports it through the facts presented.

Another salient feature of Puerto Rico's economy is that a substantial share of production is carried out by U.S. multinational corporations, in part because of federal corporate income tax benefits that have been available to firms that located in Puerto Rico. [...] In 1996, the credit was repealed, although corporations that were existing credit claimants were eligible to claim credits through 2005. Following the termination of the possessions tax credit, many U.S. corporations operating in Puerto Rico chose to reorganize by establishing Puerto Rico subsidiaries. Under U.S. tax law, Puerto Rico corporations are considered foreign corporations, which generally are not required to pay federal income taxes. U.S. parent corporations with foreign subsidiaries can defer tax on foreign income—including income earned in Puerto Rico—until they repatriate it to the United States, unless anti-deferral rules apply. Depending on their ownership, these Puerto Rico subsidiaries may be considered controlled foreign corporations (CFCs) under U.S. tax law, in which case deferral by the U.S. parent would not be available on certain types of income.

That a large share of production in Puerto Rico is carried out by multinational corporations is evident in the data on Puerto Rico's economic activity. For example, in 2010, Puerto Rico's nominal gross domestic product (GDP)—which measures the income earned by both residents and nonresidents within a country—was roughly \$95 billion. Nominal gross national product (GNP)—which measures just the income earned by residents of a country—was roughly \$65 billion. The relative gap between GDP and GNP in Puerto Rico is higher than the gaps in similarly sized economies with a high presence of foreign multinational corporations, such as those of Ireland, Panama, and Singapore.<sup>11</sup>

Through this data, we can fully appreciate that PR is being economically exploited by large US corporations that employ the archipelago as a tax-haven bastion; all the while remaining

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<sup>10</sup> *Id.* at 10

<sup>11</sup> *Id.* at 11-12

under the US's legal system. Not only does this make PR a very useful tool in the ventures of economic exploitation, but it also allows for a certain degree of security in the event that the territory's economy go belly-up. For proof of this, look no further than the *Puerto Rico Oversight, Management, and Economic Stability Act*<sup>12</sup>, or PROMESA for short. Through this bill, the Financial Oversight and Management Board was created, placing it above the local elected government when it comes to fiscal matters. Said board is charged with the task of providing for a way for PR to regain "...access to the capital markets."<sup>13</sup> As a result, credit rating agencies must be appeased in order for PR's debt emissions to gain a favorable rating in order for them to be attractive to buyers in the market.

For now I won't go further into detail on this matter since here at PRF we prepared a four-part series exclusively dedicated to PROMESA and its consequences. So if you want to know more, please listen to episodes fourteen through seventeen.

Moving along, the report affirms the following:

Of the 29 selected federal programs we reviewed, statehood would likely affect 11 programs. For 3 other programs, while the programs themselves would likely not change under statehood, eligibility determinations for these programs could be affected indirectly by changes that could occur to benefits in other programs. Statehood would not likely affect the 15 remaining programs.<sup>14</sup>

In case it wasn't clear already, the GAO is warning us about that fact that **the majority of the selected federal programs would not be affected by PR becoming a state**. This however, is not the most important fact highlighted by the report, but rather the sentence that follows: "Ultimately, changes to programs under statehood would depend on decisions by Congress and, to some extent, on decisions by federal agencies. For example, **Congress could enact legislation that creates or maintains certain exceptions for Puerto Rico.**"<sup>15</sup> (*emphasis added*)

So, for all the formalities and legal structures in place assuring equal treatment among states and their residents, the GAO acknowledges the possibility of PR being singled out and treated differently, even under a statehood process. With that firmly in mind, we now turn to the different federal programs that would be affected by the acceptance of PR as a state.

First up we have the *Social Security- Old Age and Survivor's Benefits* program. The objective of this federal program is to "...partially replace lost earnings due to retirement or worker's death."<sup>16</sup> In discussing this program, the report states something that for many in the US is

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<sup>12</sup> Puerto Rico Oversight, Management, and Economic Stability Act, 48 U.S.C. §§ 2101–2241 (2016) [hereinafter *PROMESA*]

<sup>13</sup> *Id.* at §101(a)

<sup>14</sup> REPORT at 14

<sup>15</sup> *Id.*

<sup>16</sup> REPORT at 15

still, to this day, a surprising fact: **PR residents pay Social Security taxes and can receive full benefits if qualified.** As a result, the archipelago's condition as a state would not alter this at all.

On the other hand we have Medicare, which

Provides hospital insurance, medical insurance protection for covered services, and prescription drug plans to individuals age 65 and older, the disabled and individuals with end-stage renal disease. Hospitals and medical insurance benefits can be obtained through the original Medicare free-for-service (Medicare FFS) program of private plan alternatives, called Medicare Advantage (MA). Prescription drug benefits are obtained from private plans, including through MA.

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If PR were to become a state, in the specific case of Medicare free-for-service, "Puerto Rico hospitals would likely receive larger payments per hospital stay; residents' medical insurance enrollment process generally would be the same as in the states."<sup>18</sup> As for Medicare Advantage, "regardless of whether Puerto Rico becomes a state, plans will receive lower payments because of provisions in the Patient Protection and Affordable Care Act."<sup>19</sup> On the other hand, in regards to prescription drugs, "the subsidy for qualified low-income beneficiaries would be available."<sup>20</sup>

Moving along we arrive to Medicaid, which "[p]rovides states with financial assistance for health care coverage to certain categories of low-income individuals."<sup>21</sup> This program in particular has served as a prime example of the unequal treatment suffered by PR under its colonial condition due to the fact that "Puerto Rico's federal funding is capped and its federal matching rate is limited. [...] Puerto Rico is not eligible for certain program components, such as Disproportionate Share Hospital (DSH) payments."<sup>22</sup> If PR were to become a state, "[f]ederal funding would not be subject to a cap, and would be based on a higher matching rate. Puerto Rico would be required to extend eligibility to additional low-income individuals. It potentially would qualify for DSH payments."

The report moves on to highlight that in the case of *Social Security- Disability Insurance* and *Unemployment Insurance*, the residents of PR and employers in PR pay taxes to fund both programs. As a result, the archipelago's residents receive full benefits under *Social Security-*

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<sup>17</sup> *Id.*  
<sup>18</sup> *Id.*  
<sup>19</sup> *Id.*  
<sup>20</sup> *Id.*  
<sup>21</sup> *Id.*  
<sup>22</sup> *Id.*

*Disability Insurance* and employees also receive the full benefits of *Unemployment Insurance*. As a result, neither program would be affected by PR becoming a state.<sup>23</sup>

However, this is not the case when it comes to the *Supplemental Nutrition Assistance Program (SNAP)*. Said program “[s]eeks to improve nutrition levels of low-income households by ensuring access to nutritious, healthful diets through monthly nutrition assistance (food purchase) benefits.”<sup>24</sup> As is to be expected in the PR issue, the territory’s colonial condition allows for its mistreatment: “Although Puerto Rico previously received nutrition assistance through the Food Stamp Program (the precursor to SNAP), in 1982 Congress replaced the program in Puerto Rico with a block grant, which Puerto Rico uses to fund the Nutrition Assistance Program (NAP).”<sup>25</sup> If PR were to become a state, [b]enefits would be available to eligible Puerto Rico residents; funding for NAP would cease.”<sup>26</sup>

The report continues its analysis with the *Supplemental Security Income (SSI)* program, which “[a]ssures a minimum level of income for people who are age 65 or over, or who are blind or disabled and who do not have sufficient income and resources to maintain a standard of living at the established federal minimum income level.”<sup>27</sup> According to the report, this “...program does not extend to Puerto Rico. Instead, the Aid to the Aged, Blind, and Disabled Program (AABD) provides funding to eligible Puerto Rico residents for a similar program.”<sup>28</sup> If PR were to become a state, SSI benefits “...would become available to eligible Puerto Rico residents; funding for AABD would cease.”<sup>29</sup>

Moving along, the report states that three other federal programs would not be altered by PR becoming a state: the *Veterans Disability Compensation* program, the *Deposit Insurance* program and the *National Institutes of Health Extramural Research* program.<sup>30</sup>

However, this is not the case for the *Federal-Aid Highways* program. Said program “[a]ssists state transportation agencies in planning and developing an integrated, interconnected transportation system by providing funds for constructing and rehabilitating the National Highway System, including interstates [and] provides funds for other purposes.”<sup>31</sup> Under PR’s current colonial status, “Puerto Rico highway users do not contribute to the Highway Trust Fund, which finances federal highway programs. Puerto Rico receives funding in a different manner than the states.”<sup>32</sup> If the territory were to become a state, “Puerto Rico highway users

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23 REPORT at 16

24 *Id.*

25 *Id.*

26 *Id.*

27 *Id.*

28 *Id.*

29 *Id.*

30 REPORT at 17

31 *Id.*

32 *Id.*



would be required to contribute to the Highway Trust Fund; Puerto Rico would receive funding in the same manner as the states.”<sup>33</sup>

One of the other federal programs the report looked at was the *Pell Grants* program. Its purpose is to “[provide] grant assistance to help meet educational expenses for eligible undergraduate postsecondary [sic] students who have demonstrated financial need.”<sup>34</sup>

Currently,

...Puerto Rico residents are eligible for the grants. However, the formula component used to determine an applicant’s grant amount is based on taxable income in his or her state of residence. Puerto Rico is not subject to the analysis used to determine grant-related state tax/allowances. Rather, a nominal amount is included in the formula for Puerto Rico residents.<sup>35</sup>

If PR were to become a state, “Puerto Rico would be included in the analysis to determine state tax allowances, which could affect eligibility for grants.”<sup>36</sup>

Of all the federal programs affected by PR becoming a state, perhaps the most talked about is the *Temporary Assistance for Needy Families (TANF)* program. This program was created

[t]o provide grants to states, territories, the District of Columbia, and federally-recognized Indian tribes to assist needy families with children so that children can be cared for in their own homes; to reduce dependency by promoting job preparation, work, and marriage; to reduce and prevent out-of-wedlock pregnancies; and to encourage the formation and maintenance of two parent families.<sup>37</sup>

Currently as a colony, “Puerto Rico’s funding is set in statute. In addition, total funding for a group of programs that includes TANF is statutorily capped. Puerto Rico is not eligible for the TANF Contingency Fund, which provides states meeting certain criteria additional TANF funds.”<sup>38</sup> In the event that PR were to become a state, “Puerto Rico’s funding would continue to be set in statute. Funding for the group of programs the includes TANF would not be capped. Puerto Rico would be eligible to receive assistance from the TANF Contingency Fund.”<sup>39</sup>

Another well known federal program is the *Section 8 Housing Assistance Payments Program (Tenant-Based)*. Said program “[p]rovides rental assistance to very low-income individuals

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33 *Id.*

34 REPORT at 18

35 *Id.*

36 *Id.*

37 *Id.*

38 *Id.*

39 *Id.*

and families to enable them to live in affordable, decent, safe, and sanitary housing.”<sup>40</sup> Although PR statehood would not have a **direct** effect on the program, “...changes to [Supplemental Security Income] and TANF under statehood could affect eligibility determinations.”<sup>41</sup> The same result applies to the *Section 8 Housing Assistance Payments Program (Project Based)* and the *Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)*; this last one also being affected by changes in Medicaid under statehood.<sup>42</sup>

In addition, the report reviews the potential effects of PR statehood on one of the most important federal programs of all: *Title I Grants to Local Educational Agencies*. The importance stems from the fact that this program “[p]rovides instruction and instructional support to assist disadvantaged children (pre-kindergarten through grade 12) in mastering curricula and meeting state academic achievement standards.”<sup>43</sup> PR’s current status allows for “...some types of grants [to] contain exceptions and limits for Puerto Rico.”<sup>44</sup> If PR were to become a state, “[t]he formula exceptions and limits for some types of grants would not apply or would change.”<sup>45</sup>

The report then goes on to identify five more federal programs that would not be affected by the archipelago’s transformation into a state: *Special Education Grants to States*, *Social Insurance for Railroad Workers*, the *Mutual Mortgage Insurance Program*, the *Head Start Program*, and the *National School Lunch Program*.<sup>46</sup> However, this is not the case for another important and well known federal program: the *Children’s Health Insurance Program (CHIP)*. The program’s purpose is to “[provide] funds to states for maintenance and expansion of child health assistance to uninsured, low-income children.”<sup>47</sup> In the event that PR were to become the 51<sup>st</sup> state, it “...would qualify for funding at a higher federal matching rate. [Also,] [e]ligibility rules would be affected by changes in eligibility for Medicaid.”<sup>48</sup>

Moving on we have the *Post-9/11 GI Bill*. This program “[s]eeks to help military service persons adjust to civilian life after separation, assists in recruitment and retention of highly qualified personnel in active and reserve components by providing educational benefits, and provides educational opportunities to dependents of certain service members and veterans.”<sup>49</sup> Currently, “[v]eterans attending education programs in Puerto Rico receive a monthly housing

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40 *Id.*

41 *Id.*

42 REPORT at 20

43 REPORT at 18

44 *Id.*

45 *Id.*

46 REPORT at 19-20

47 REPORT at 19

48 *Id.*

49 REPORT at 20

allowance based on the Overseas Housing Allowance.”<sup>50</sup> If PR were to become a state, “[t]he Basic Allowance for Housing would apply.”<sup>51</sup>

Towards the end of the report the GAO mentions another four federal government programs that would suffer no change in the face of PR statehood: the *Public Housing Operation Fund* program, the *Disaster Relief Public Assistance Grants for Presidentially Declared Disasters*, the *Public Housing Capital Fund*, and the *Central Liquidity Facility* program.<sup>52</sup> However, the same cannot be said about the *Federal Direct Student Loan Program*. This program “[p]rovides loan capital directly from the federal government (rather than through private lenders) to vocational, undergraduate, and graduate post secondary school students and their parents.”<sup>53</sup> Although residents of the archipelago are eligible for the loans, “Puerto Rico is not subject to the [same] analysis done to determine state tax allowances [but] [r]ather, a nominal amount is included in the formula, which likely decreases loan eligibility for Puerto Rico residents.”<sup>54</sup> If PR were to become the 51<sup>st</sup> state of the US, it “...would be included in the analysis to determine state tax allowances, which could affect eligibility for loans.”<sup>55</sup>

As you could imagine, the report goes further into detail about the possible changes to the above mentioned federal programs that would ensue if PR were to be accepted as the 51<sup>st</sup> state of the union. Today I’ve only provided a general review of the affected programs, so of course I do invite everyone to read the report in order to receive the full benefits of the data. However, for all its dense legal and economic jargon, the report only provides a limited view into only certain affected federal programs. Although this is better than nothing, it would be foolish and even negligent to base such an important decision on such a limited view of the possible implications of PR transforming into a state.

Having the ability to choose your own destiny is only as useful as the information we have at hand. This reasoning holds true even at the personal level. Even a process as simple as ordering a meal off a menu requires some pondering: If you have an idea of what you like, you may compare it to other options offered; you might even seek the expert counsel of the waiter! So, if a task as simple as ordering lunch requires deliberation, why expect any less from solving PR’s status issue?

Given the importance of such an impactful step for PR’s future, it is necessary to take a mindful and informed approach. Taking this issue seriously implies deep research and a conscious pursuit of the most complete and realistic analysis possible of what each status option would look like, entail and require. Thinking you can responsibly solve a grave injustice

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50 *Id.*

51 *Id.*

52 REPORT at 21

53 *Id.*

54 *Id.*

55 *Id.*

that has persisted **even** under the control of two colonial invaders for over half a millennia **in 90 days** is not only irrational, but insulting as well.