Statement of
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before the
Committee on Finance
United States Senate

April 26, 1990

NOTICE

This statement is not available for public release until it is delivered at 10:00 a.m. (EDT), Thursday, April 26, 1990.

Mr. Chairman, I am pleased to appear before the Committee to discuss the Congressional Budget Office's (CBO's) analysis of the possible impact of S. 712 on the Puerto Rican economy and the federal budget. The bill provides for a referendum in which the citizens of Puerto Rico would choose between three options: an enhanced version of commonwealth; statehood; or independence.

The economic impact of the enhanced commonwealth option seems relatively uncontroversial: the enhancements that are contained in S. 712 are likely to benefit the island, but perhaps by only a small amount. The economic effects of the other options--statehood and independence--are likely to be far more significant, but are also complicated, uncertain, and quite controversial.

If Puerto Rico's political status was changed to that of a state or an independent republic, the island could experience significant economic changes. These possible changes could involve the amounts of funds flowing between the island and the federal government; the tax treatment of firms in Puerto Rico; the way Puerto Rico is perceived by outsiders and its own citizens; and seemingly small, but nevertheless consequential, changes in legal provisions governing such matters as trade, shipping, and international tax relations.

In developing quantitative assessments of the likely economic impact of changes in Puerto Rico's status, CBO has been able to estimate only some of these possible effects. CBO's approach has been to quantify those effects that it can, given the state of economics, while noting the unquantifiable possibilities of which it is aware.

My statement today will cover the following topics:

- The role of tax preferences in the Puerto Rican economy;
- The potential economic effects of statehood; and
- The potential economic effects of independence.

THE ROLE OF TAX PREFERENCES IN THE PUERTO RICAN ECONOMY

Much of Puerto Rico's postwar development reflects the complementary roles of federal and Puerto Rican tax preferences. This is especially true of the manufacturing sector. Since 1948, Puerto Rico has largely exempted the profits of all manufacturers from tax. Since 1921, federal tax provisions have, in effect, fully or partially exempted from tax the profits of qualified U.S. corporations operating in U.S. territorial possessions. This provision is known today, in amended form, as Section 936 of the Internal Revenue Code. In

order to qualify for the tax advantage, "Section 936 firms" are usually organized as wholly owned U.S. subsidiaries of mainland parents.

The Puerto Rican economy has undergone a dramatic change under the federal and local tax preferences. The economy has been transformed from one based on agriculture to one based on manufacturing as well as on government, construction, and services. Today, manufacturing concerns employ about 17 percent of Puerto Rico's work force, compared with about 7 percent in 1950. Section 936 firms employ over 10 percent of the work force.

Initially, labor-intensive industries, such as textiles, apparel, and leather goods, dominated the manufacturing sector. But such industries have been leaving the island for countries with lower wages. The pattern of expansion has shifted to such high-technology, capital-intensive industries as pharmaceuticals, electronics, and scientific instruments.

This concentration of industries reflects the incentives of Section 936. As a profit subsidy, Section 936 is more attractive to capital-intensive than to labor-intensive firms. Even more, however, Section 936 offers a unique tax opportunity for corporations that generate income from intangible assets, such as patents or trademarks. To the extent that the tax code allows, firms seek to transfer intangible assets to subsidiaries in low-tax jurisdictions like Puerto Rico. The cost of the intangible appears on the parent's books on the U.S.

mainland, where the tax deduction is valuable; the income of the intangible appears on the subsidiary's books, where the tax rate is low.

Some types of corporations are well suited to take advantage of such opportunities to shield income from tax. These firms usually have developed intangible assets through expenditures for marketing or research and development. These companies produce a product that is easily transported and requires a mass-production stage in light industry. These considerations explain why Section 936 activity in Puerto Rico is dominated by such industries as pharmaceuticals, electronics, and scientific instruments--industries whose firms often have subsidiaries in several foreign locations. Most of their output is exported to the mainland.

Potential Effects of Losing Section 936 Tax Benefits

CBO concluded that Puerto Rico would grow more slowly under statehood because statehood would imply the loss of Section 936 tax benefits. CBO assumed that Section 936 benefits would continue under commonwealth status. Losing that tax advantage would leave Puerto Rico at a cost disadvantage relative to other locations. The after-tax rate of return on existing investments on the island would fall. Firms that found themselves earning less than a normal after-tax rate of return would be likely to curtail investment there or relocate their production.

CBO's calculations suggest that, under statehood, the reported after-tax rate of return would fall by about nine percentage points for the average Section 936 manufacturer. It would fall by about eleven percentage points for firms in the chemicals, electronics, and instruments industries, that together represent about three-quarters of all Section 936 capital. These are substantial reductions; they are close to the overall operating rates of return that corporations earn on the United States mainland.

For many firms, location in a low-tax foreign location could offer a significant tax advantage over Puerto Rico under statehood. By some estimates, over half the tax loss that statehood would imply might be recouped by relocating in a low-tax foreign jurisdiction. This possibility arises because deferral of U.S. tax on foreign-source profits reduces the effective tax rate on such profits. In principle, deferral applies only to tangible income, but U.S. firms operating abroad generally can use legal and accounting arrangements to shield significant amounts of intangible income from current U.S. tax.

CBO expects that Section 936 firms would be sensitive to loss of tax benefits. Section 936 firms must file commitments with the Puerto Rican government to create jobs in order to qualify their investment projects for exemption from Puerto Rican taxes. In the past, such job commitments have fallen sharply when news of possible changes in Section 936 provisions has been announced. These declines have occurred even when commitments by

local firms have changed little. Section 936 commitments have once again fallen sharply during the current discussion of changing Puerto Rico's status. An actual change in status would probably reduce commitments and investment even further. In addition, Section 936 firms have demonstrated their sensitivity to tax and cost conditions by their initial decision to locate in Puerto Rico, by their many overseas operations, and by their tendency to leave Puerto Rico when costs become unfavorable.

Firms are more likely to reduce investment than to relocate. Moving existing assets and production to a new location involves costs that do not apply when considering possible locations for expanded production. Beyond their investment in fixed capital, going concerns in Puerto Rico have already trained their staff, organized their supply and distribution networks, and developed relations with local unions and government organizations. The costs of such efforts would have to be incurred again if a firm moved to a new location.

Arguments Suggesting that Investment Would Remain Strong Under Statehood. Several arguments have been advanced that Section 936 firms might not reduce their investment significantly if Puerto Rico were to become a state. But CBO did not incorporate these arguments into its analysis. In some cases CBO was unconvinced by the logic or evidence; in other cases, CBO did not have the time or resources to undertake the required analysis.

The first argument states that Section 936 corporations would remain profitable even after additional tax was imposed because they have such high before-tax profit margins. But these high reported profits are more apparent than real because they reflect the incentives provided by Section 936 firms to make their costs appear on the U.S. parent's books and their income (especially intangible income) appear on the Puerto Rican subsidiary's books. These returns to intangibles would accrue wherever production takes place, so they would not affect the decision on location in the absence of tax considerations.

The second argument states that new job commitments do not appear to have slowed when rules about the reporting of intangible income were tightened in 1982 and 1986. But the tightened rules merely reduced, and did not eliminate, the unique tax advantage provided by Section 936. They left Puerto Rico with a significant tax advantage over alternative locations. Moreover, it is difficult to separate the effect of these rules changes from the effect of the general business cycle.

The third argument states that Puerto Rico might still offer cost advantages under statehood compared with other locations. For some--but not all--firms and operations, this would be true. But a full comparison of the costs of each firm calculated for each feasible location is well beyond CBO's capabilities.

Proponents of statehood argue that the dominant effects would be positive. Admission to the Union would bring with it greater visibility and reduced uncertainty over Puerto Rico's status. As a result, outsiders would be more aware of the opportunities the island offers for tourism, investment, and trade with the remainder of Latin America. Proponents also argue that the increase in federal transfer payments (less new taxes) that the island would receive under statehood would stimulate its economy. At the same time, all observers acknowledge that statehood would bring with it serious economic impediments, such as loss of federal tax benefits for investment on the island, imposition of federal taxes on Puerto Ricans, and potentially restrictive fiscal policies by the Puerto Rican government.

While many economic consequences of statehood could be significant, CBO has quantified only two: the change in net federal transfers; and the reduction in investment by Section 936 corporations. Other effects discussed earlier may be significant, but there is little basis for estimating their magnitude.

The features of statehood that CBO can quantify suggest, on balance, reduced growth prospects for the rest of the century. Overall, from 1992 to 2000, average annual growth in Puerto Rico's real (inflation-adjusted) gross national product (GNP) might be slower by about one to two percentage

points than under current status. This translates into real GNP that would be 10 percent to 15 percent lower by 2000 than it might otherwise have been. The decline in real GNP would reduce federal tax revenues and increase federal spending in Puerto Rico. CBO does not have an estimate of the response of federal tax revenues to lower GNP. The Joint Committee on Taxation is responsible for estimating the revenue effects of S. 712. As discussed later, federal spending in Puerto Rico would increase by an estimated $0.3 billion to $0.6 billion in 2000 as a result of the economic changes. This is in addition to the estimated $3.6 billion increase in 2000 that statehood would imply in the absence of economic changes. A good deal of uncertainty surrounds all these estimates, suggesting that they should be regarded only as rough guides to the magnitudes involved.

Changes in Net Federal Transfers to Puerto Rico

Under statehood, net federal transfers to Puerto Rico would increase. Individuals would become eligible for most federal entitlements on the date of Puerto Rico's admission to the Union--assumed to be October 1, 1992--and would become eligible for full federal entitlements by 1995. Puerto Rican individuals and corporations would become liable for federal taxes beginning in 1994, but these taxes would be remitted to the Puerto Rican Treasury in 1994 and 1995. All federal excise taxes would be imposed, but the taxes collected would be remitted to Puerto Rico through 1998. After 1998, the U.S. Treasury would not remit any tax collections to Puerto Rico.

In the absence of economic effects, these changes would increase net federal flows to the island by about $18 billion over the 1992-2000 period (see Table 1). Other things being equal, tax collections from Section 936 firms would also increase, but they are not included in this estimate. Those taxes reduce the income of mainlanders, rather than islanders. Therefore, they do not affect Puerto Rican aggregate demand.

These changes might have two types of effect. First, the net increase in federal flows would increase aggregate demand on the island and stimulate the Puerto Rican economy. Second, they might affect the supply of labor on the island and migration between the island and the mainland. CBO is unable to quantify the second effect, but believes that its inclusion would not significantly alter the results.

Reduced Investment by Section 936 Firms

Section 936 benefits would be phased out under statehood. In 1994, a Section 936 firm would receive only 80 percent of the credit it would otherwise receive, 60 percent in 1995, 40 percent in 1996, 20 percent in 1997, and no credit thereafter.

TABLE 1. ASSUMED STATIC CHANGES IN FEDERAL EXPENDITURES AND REVENUES FROM LOCAL SOURCES AS A RESULT OF STATEHOOD (In millions of dollars, by United States fiscal year)

Change	1992	1993	1994	1995	1996	1997	1998	1999	2000	Total 1992-2000
Change in Total Spending	1,666	1,810	2,550	2,950	3,068	3,191	3,318	3,451	3,589	25,593
Change in Revenues from Local Sources[a]										
New excise taxes	0	0	0	0	0	0	0	395	414	809
Customs duties	0	0	0	0	0	0	0	163	171	334
Rum excise tax	0	0	0	0	0	0	0	265	268	533
Personal tax	0	0	163	10	539	739	773	809	846	3,879
Tax on local corporations	0	0	0	0	274	471	495	519	545	2,304
Total Change in Local Source Revenues[a]	0	0	163	10	813	1,210	1,268	2,151	2,244	7,859
Change in Net Transfers to Puerto Rico[a]	1,666	1,810	2,387	2,940	2,255	1,981	2,050	1,300	1,345	17,734

SOURCES: Congressional Budget Office; Department of the Treasury.

NOTE: Revenue figures are expressed as net of remission of federal collections to the Puerto Rican Treasury. The earned income tax credit is netted from personal tax, rather than appearing separately in expenditures. Beyond 1995, expenditure figures were assumed to grow at 4 percent a year. For more detail, see Congressional Budget Office, "Background Materials on the Costs of the Puerto Rico Status Referendum Act" (November 5, 1989, processed); and Testimony of Kenneth Gideon, Assistant Secretary of the Treasury, before the Senate Committee on Finance, November 14, 1989.

a. Excluding increased tax collections from Section 936 corporations.

As I have already suggested, firms would probably reduce their investment in Puerto Rico substantially in response to losing Section 936 benefits. The reduced investment would directly reduce aggregate demand on the island and would ultimately reduce the island's capacity to produce.

CBO can make only a crude estimate of the extent to which Section 936 firms would reduce their scale of operations under statehood. As was noted earlier, loss of Section 936 benefits is more likely to discourage new investment than it is to lead firms to leave outright. But some firms would leave Puerto Rico even under current commonwealth status. Such attrition is normally more than offset by expansion of existing firms and entrance of new firms. CBO assumed that attrition would continue at its historical rate, but that the remaining firms would invest only enough to maintain their real stock of capital. This allows the possibility that more firms might exit while others entered or expanded, but supposes that the effects would balance.

The investment path described would reduce the capital and output of Section 936 firms. By the year 2000, their capital would fall below baseline levels by 37 percent to 47 percent (see Table 2). Investment would fall

TABLE 2. ASSUMED CHANGES IN SECTION 936 GROSS INVESTMENT, CAPITAL, AND EXPORTS (In percentages of baseline levels, by Puerto Rican fiscal year)

Item Changed	1991	1992	1993	1994	1995	2000
			High-Growth Baseline			
Section 936 Gross Investment	0	-26	-30	-56	-59	-73
Section 936 Capital	0	-4	-8	-15	-21	-47
Section 936 Exports	0	0	-4	-8	-15	-43
			Low-Growth Baseline			
Section 936 Gross Investment	0	-26	-30	-47	-49	-62
Section 936 Capital	0	-3	-7	-12	-17	-37
Section 936 Exports	0	0	-3	-7	-12	-33

SOURCE: Congressional Budget Office.

NOTE: Puerto Rican fiscal years start on July 1 of the preceding calendar years.

below the baseline by even more. CBO assumed that the output and exports of Section 936 firms would fall below baseline in proportion to the previous year's fall in capital.

Estimating the Overall Economic Implications of these Changes

CBO's analysis of the quantifiable effects of statehood consisted of two steps:

- o Developing high- and low-growth baseline projections assuming Puerto Rico's current commonwealth status; and
- o Estimating the net effects of the increase in net federal transfers and the decrease in investment by Section 936 firms relative to these baseline projections by using an economic model of Puerto Rico.

The Baseline Projections. CBO developed two baseline economic projections for Puerto Rico. These are not forecasts; CBO does not have the expertise to develop forecasts of the Puerto Rican economy. Instead, the projections are mechanical extrapolations based on historical performance. They maintain consistent relationships among economic variables--such as income,

output, investment and exports--and serve as benchmarks against which alternative status options can be measured.

The baselines represent the best and worst growth possibilities that can be considered likely based strictly on historical experience. Real gross domestic product (GDP) grows at 4.4 percent a year on the high-growth path and 2.4 percent a year on the low-growth path. In each case, output of the Section 936 sector grows 1.2 percentage points faster than the economy as a whole.

Estimating the Net Effects Using an Economic Model. CBO developed a model of the Puerto Rican economy that it used to determine the net effects of changed federal flows and reduced investment by Section 936 firms. This model makes it possible to take into account many of the important indirect economic effects of the change in federal transfers, as well as the loss in Section 936 investment. For example, the model implicitly takes account of any change in investment by local Puerto Rican firms that supply goods to Section 936 firms. The model also makes it possible to estimate the amount by which Puerto Rican consumers would increase their spending in response to increased federal transfers, and how much this increase would be offset by the losses in income that they would experience when Section 936 corporations and others reduced their employment on the island.

On balance, statehood would reduce average Puerto Rican growth over the rest of the decade, given the quantifiable assumptions considered here. The economy would probably enjoy a temporary surge in response to increased net transfers, but this would eventually be offset by the loss of Section 936 activity. CBO's assumptions imply that the average annual growth rate would fall by one to two percentage points through 2000 (see Table 3). This growth shortfall translates into ten to fifteen percentage points lower real GNP than would otherwise have occurred by 2000 (see Figure 1). Employment growth would fall by one-half to one percentage point, which translates into 50,000 to 100,000 fewer jobs by 2000. In the absence of changes in labor supply or migration, these figures would roughly translate into an unemployment rate four to seven percentage points higher than otherwise by 2000.

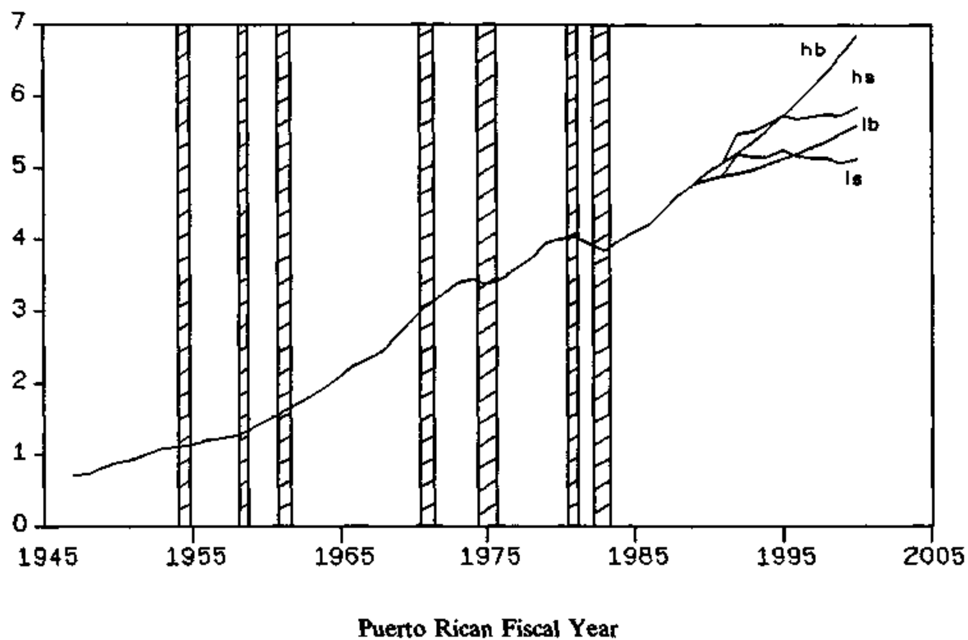
The simulations do not take account of some other economic effects that might occur. First, Puerto Rico might have to reduce public spending to keep its budget balanced if tax collections fell either with slower growth or with

TABLE 3. ILLUSTRATIVE EFFECTS OF STATEHOOD ON THE PUERTO RICAN ECONOMY (Difference from baseline of average annual growth rate, in percentage points)

	1992-1995	1996-2000	1992-2000
	High-Growth Baseline		
Real GNP	0.1	-3.3	-1.8
Real GDP	-0.4	-3.0	-1.9
Employment	0.1	-1.9	-1.0
Real Exports	-2.4	-4.5	-3.6
	Low-Growth Baseline		
Real GNP	0.7	-2.3	-1.0
Real GDP	0.1	-2.2	-1.2
Employment	0.5	-1.4	-0.6
Real Exports	-1.8	-3.0	-2.5

SOURCE: Congressional Budget Office.

FIGURE 1. ESTIMATED LEVELS OF REAL GNP UNDER STATEHOOD COMPARED WITH ALTERNATIVE BASELINE ASSUMPTIONS UNDER COMMONWEALTH STATUS (In billions of 1954 dollars)



Puerto Rican Fiscal Year

SOURCE: Congressional Budget Office.

NOTES: Shaded areas represent recessions in the United States.
Puerto Rican fiscal years start on July 1 of the preceding calendar years.

hs = statehood with high growth.
ls = statehood with low growth.
hb = baseline with high growth.
lb = baseline with low growth.

action to reduce a high combined federal and state income tax rate. These reductions in spending would further act to slow growth. Second, local firms, like Section 936 firms, would face higher taxes and might reduce their investment or go out of business. Third, Puerto Rico's financial sector would contract because tax incentives that now induce Section 936 firms to make financial investments on the island would no longer apply.

Impact on Federal Spending of Slower Economic Growth in Puerto Rico

Lower economic growth and higher unemployment in Puerto Rico would work to increase federal spending. Spending for unemployment insurance, food stamps, Aid for Families with Dependent Children (AFDC), and Medicaid would all increase as additional people and families became eligible for benefits. All of the additional benefit payments in unemployment insurance and food stamps would affect the federal budget, and an estimated 83 percent of additional AFDC and Medicaid costs would fall on the federal budget.

It is difficult to estimate accurately the size of these spending increases, since only one of these programs--unemployment insurance--is currently an open-ended entitlement program in Puerto Rico, while all would be so under statehood. CBO made its estimates on the basis of the Puerto Rican data for unemployment insurance, supplemented with U.S. experience for food stamps, AFDC, and Medicaid. Using these data, CBO estimates that the economic

changes implied by statehood, coupled with the static impacts described in Table 1, might increase federal spending by between $3.9 billion and $4.2 billion in 2000. This contrasts with the $3.6 billion federal spending change in 2000 that would result from statehood alone, without any induced economic changes.

POTENTIAL ECONOMIC EFFECTS OF INDEPENDENCE

As I suggested earlier, Puerto Rico's economic prospects under independence are even more speculative than under statehood. Independence could help the island if it expanded investment and if Puerto Ricans responded with renewed energies. In addition, it would reduce what some observers view as an excessive economic dependence on the mainland United States. However, independence could be harmful if the progressive loss in federal transfers that would occur under S. 712 proved too burdensome, and if obtaining capital from abroad proved as difficult as it has for many developing countries.

CBO has focused on three of the many issues that are relevant to independence: net federal transfers to Puerto Rico; capacity to attract direct investment from abroad; and capacity to finance Puerto Rico's balance of payments.

Changes in Net Federal Transfers to Puerto Rico

Under independence, federal transfers to Puerto Rico would fall and federal revenues from local sources would rise. An annual block grant would replace current entitlement programs, such as Food Stamps and Aid for Families with Dependent Children. This grant would equal the 1993 level of spending on such programs and would extend through the year 2000, when it would expire. It would not provide the same funds as the entitlement programs would have, because it would not allow for inflation or for the increased participation that would have occurred. The U.S. Treasury would no longer remit collections from the excise tax on rum as it does now. The overall result would be a decline in net fiscal flows from the United States to Puerto Rico. As Table 4 shows, this would amount to about $7 billion from 1992 through 2000 in the absence of any economic effects. (As in the case of statehood, these estimates exclude increased tax collections from U.S. corporations operating in Puerto Rico.)

The decline in net fiscal flows from the United States would have two

TABLE 4. ASSUMED STATIC CHANGES IN FEDERAL EXPENDITURES AND REVENUES FROM LOCAL SOURCES AS A RESULT OF INDEPENDENCE (In millions of dollars, by U.S. fiscal year)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	Total 1992-2000
Change in Total Spending	0	0	-100	-300	-500	-600	-800	-1,000	-1,200	4,500
Change in Revenues from Local Sources (Rum excise tax)[a]	0	188	252	255	257	260	262	265	268	2,007
Change in Net Transfers to Puerto Rico	0	188	-352	-555	-757	-860	-1,062	-1,265	-1,468	6,507

SOURCES: Congressional Budget Office; Department of the Treasury.

NOTE: Independence is assumed to occur on January 1, 1993. For more detail, see Congressional Budget Office, "Background Materials on the Costs of the Puerto Rico Status Referendum Act" (November 5, 1989, processed); and Testimony of Kenneth Gideon, Assistant Secretary of the Treasury, before the Senate Committee on Finance, November 14, 1989.

a. Excluding increased tax collections from U.S. corporations operating in Puerto Rico.

effects. First, Puerto Rican aggregate demand would fall. Second, Puerto Rico would have more difficulty in financing its balance of payments.

CBO has estimated the economic effects of the reduction in net federal transfers using its model of the Puerto Rican economy. The exercise isolates the effect of such transfers by assuming that no other outside change affects the economy. Compared with the same high- and low-growth baselines used in analyzing statehood, average growth in real GNP would fall by 0.2 to 0.3 percentage point per year between 1992 and 2000.

Capacity to Attract Direct Investment from Abroad

Several issues arise in assessing an independent Puerto Rico's potential to attract direct investment. Under S. 712, U.S. corporations in Puerto Rico would lose all benefits of Section 936 upon the proclamation of independence. Puerto Rico might, however, offer several tax-related advantages. First, by maintaining its current tax treatment, the republic could serve as a low-tax foreign jurisdiction for U.S. firms. Second, the republic could negotiate treaties with third countries that would make their investment in Puerto Rico more attractive than it is now. Third, the republic could institute

a tax-subsidy policy as described by independence advocates that would be designed, in effect, to replace the benefits of Section 936.

The net effect of the possible outcomes cannot be quantified. Therefore, CBO provides no estimate of the extent to which an independent Puerto Rico might, on balance, gain or lose investment from abroad.

Capacity to Finance Puerto Rico's Balance of Payments

An independent Puerto Rico might have severe difficulty financing its balance of payments. The problem arises because outsiders (mostly section 936 firms) provide substantial funds for investment in Puerto Rico. The profits they repatriate represent an outflow in the balance of payments accounts. In the past, this outflow has apparently been financed by three principal sources: net transfers from the federal government; Puerto Rican government borrowing in the United States, generally through the tax-exempt municipal bond market; and direct investment by Section 936 firms.

At least two of these sources would become more restricted under independence, and possibly all three would. U.S. government transfers would decline under independence from the levels that CBO projects under

continued commonwealth status. Puerto Rico would lose access to U.S. tax-exempt bond markets. It would have to pay interest rates on new bonds at least two percentage points higher than now. In fact, like many Latin American countries, it might have difficulty borrowing abroad at any reasonable rate. Finally, direct investment from abroad might either rise or fall from levels that would occur under commonwealth status.

Any decline in funds from outside sources would cause the Puerto Rican economy to contract. Either the government would have to reduce its borrowing to balance the shortfall, or real interest rates would rise in Puerto Rico. Either case would lead to reduced output, employment, and income in the short run. Flexible wages and prices would mitigate the contraction, but, if the minimum wage was retained, it would largely forestall their operation.

Other Issues Under Independence

Other factors would also affect Puerto Rico's development as a republic. First, Puerto Rican exports to the United States would no longer automatically be duty-free. Although S. 712 states the desire of the United States to enter a free-trade association with an independent Puerto Rico, it makes no actual commitment to reduce or eliminate its tariffs. At a minimum, Puerto

Rico would qualify for most-favored-nation status. Favorable U.S. tariff provisions would provide a significant cost advantage to Puerto Rico relative to other foreign locations. Second, an independent Puerto Rico would enjoy a cost advantage relative to U.S. locations for firms that make intracoastal shipments. Shipments from an independent Puerto Rico to the mainland would no longer have to be carried on U.S. vessels with U.S. crews. Finally, the greatest imponderable might be the response of Puerto Ricans themselves. They might respond positively by increasing work and saving in Puerto Rico, or they might respond negatively by emigrating or sending their savings abroad.

CONCLUSION

The effects of a change in Puerto Rico's status are extremely uncertain. CBO cannot quantify all these effects, and those that it can quantify cannot be stated with much precision. Therefore, while CBO's analysis may advance the debate, it cannot be regarded as definitive. Furthermore, as with any major political event, a change in Puerto Rico's status would require consideration of many factors beyond the limited realm of economics.