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February 24, 2014

The Honorable Gene L. Dodaro
The Comptroller General of the United States
U.S. Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Dodaro:

I write regarding the U.S. Government Accountability Office (GAO) report, GAO-14-31, entitled *Puerto Rico: Information on How Statehood Would Potentially Affect Selected Federal Programs and Revenue Sources*. I thank the GAO for providing me with an opportunity to review and comment on the report in draft form. This report will inform the public policy debate surrounding the increasingly realistic prospect of the U.S. territory of Puerto Rico becoming a U.S. state.

Since the GAO commenced work on this report in April 2011, a series of important events have occurred. First, in a November 6, 2012 referendum held in Puerto Rico pursuant to local law, a majority of voters rejected the current territory status and more voters favored statehood than any other status option. Accordingly, the U.S. citizens of Puerto Rico are being governed without their consent. Second, in response to this historic vote, Congress recently approved—and the President signed into law—legislation that appropriates funding for the first federally-sponsored political status vote in Puerto Rico's history, to be held among one or more options that would "resolve" Puerto Rico's ultimate political status and that are consistent with U.S. law and public policy. See *Consolidated Appropriations Act, 2014* (P.L. 113-76). Finally, virtually identical bills are pending in the U.S. House of Representatives (H.R. 2000) and the U.S. Senate (S. 2020) that provide a blueprint for how the vote conducted pursuant to the recently-enacted appropriations law could—and should—be structured. The bills outline the rights and responsibilities of statehood and provide for a vote in Puerto Rico on the territory's admission as a state. If a majority of voters affirm that they want Puerto Rico to become a state, the bills require the President to transmit legislation to Congress to admit Puerto Rico as a state following a reasonable transition period. The bills also express Congress's commitment to act on that legislation. In light of all of the foregoing, this report is particularly timely.

There are two major takeaways from the GAO report.

First, the report confirms that, as a territory, Puerto Rico is significantly underfunded under key federal spending programs and excluded entirely from other important federal spending programs. The report further confirms that, as a state, Puerto Rico would receive equal treatment under all of these programs. As expected, GAO has estimated that such equality, in the aggregate, would translate into billions of dollars of additional federal funding for Puerto Rico and its residents each year. Disparate treatment under federal programs is the primary reason why territory status is exacting such a terrible toll on Puerto Rico's economic and fiscal condition, and causing residents to relocate to the states in unprecedented numbers.

Second, this report serves to debunk any argument that statehood for Puerto Rico would have an adverse fiscal impact on the U.S. Treasury by resulting in a situation whereby new federal outlays would far outpace new federal revenues. There is a myth propagated in certain quarters that statehood is a zero-sum game, with any gain to one "side" translating into a corresponding loss for the other "side." That notion is categorically false. The reality is that both Puerto Rico and the United States as a whole are harmed by the current territory relationship, economically as well as morally, and both would derive substantial benefits from statehood. The GAO report demonstrates that, if Puerto Rico were a state, the U.S. Treasury would collect more corporate income taxes and, to a lesser extent, individual income taxes from Puerto Rico. However, it is important to bear in mind that individuals of modest means in Puerto Rico would have little or no federal tax liability and many of those individuals would receive refundable tax credits under the Earned Income Tax Credit (EITC) program and the Child Tax Credit (CTC) program that they are currently denied because they reside in a territory. Over time, as Puerto Rico's economy prospers, as it inevitably would under statehood, take-home pay for Puerto Rico workers will rise, business activity will increase, the corporate tax base will grow, and federal tax collections will expand even further. Simultaneously, the Puerto Rico government would almost certainly reduce its (very high) local individual and corporate income tax rates. If Puerto Rico were treated equally under federal programs, the Puerto Rico government would no longer be compelled to fund public services predominately through locally-raised revenue and excessive borrowing to compensate for the shortfall in federal funding.

In sum, to the extent this GAO report was requested as part of an effort to make Puerto Rico statehood appear less attractive to either U.S citizens living in the states or U.S. citizens living in Puerto Rico, the report proves precisely the opposite point. Moreover, as GAO recognizes, statehood would not occur immediately, from one day to the next. Instead, there would be a meaningful and orderly transition period, with equal treatment under both federal spending programs and federal tax law being proportionately phased in, thereby minimizing disruption and maximizing the opportunity for the federal and Puerto Rico governments to undertake appropriate budget planning.

Having offered these broad comments on the report, I now make some more specific points to underscore what the report does, and does not, say.

<u>In General</u>

- As GAO indicates, the report seeks only to estimate the fiscal impact that Puerto Rico statehood would have on the federal government—that is, on federal outlays and revenues. The conclusions in the report serve as a compelling *economic* argument for statehood, whether viewed from the perspective of Puerto Rico or the U.S. as a whole.

What this report does not do—and, indeed, what no report can adequately do—is address the profound *moral* argument for statehood. Puerto Rico's territory status cannot be reconciled with the principles our nation strives to uphold at home and promotes abroad. Puerto Rico has more U.S. citizens—3.6 million—than 21 states. Its sons and daughters have served in the Armed Forces in large numbers, from World War I to Afghanistan. Still, Puerto Rico's residents cannot vote for President and Vice-President, and are not represented in the U.S. Senate. They send one nonvoting delegate to the U.S. House of Representatives, known as the Resident Commissioner, a position I have held since 2009. Statehood, unlike territory status, would provide Puerto Rico with democracy at the national (federal) level. Equality, democracy, and justice are principles that cannot be measured in dollars and cents, like items on a balance sheet.

- As GAO acknowledges, the report's estimate of the fiscal impact of statehood on the federal government is limited in scope because it is—by necessity—static rather than dynamic. GAO notes how much federal funding Puerto Rico actually received in a particular fiscal year in the past (usually 2010 or 2011) under a specific federal program (or how much Puerto Rico paid in federal individual or corporate income taxes in a particular fiscal year), and then estimates how much Puerto Rico would have received (or paid) in that fiscal year if it had been a state, providing a "low end" estimate and a "high end" estimate. This "snapshot in time" approach has some utility, to be sure, but it also has inherent limitations. It cannot tell the full story of the fiscal impact that statehood is likely to have on the federal government. As noted above, if the experience of other territories that became states is a guide, Puerto Rico's economy would grow substantially under statehood. As individuals and corporations earn more, they will pay more in taxes to the federal government. Likewise, federal outlays for means-tested programs like Medicaid, Supplemental Security Income (SSI), and the Supplemental Nutrition Assistance Program (SNAP) will decline as fewer individuals depend upon those programs. As GAO acknowledges, its methodology does not capture this dynamic, positive change.

- The GAO report examines 29 large federal spending programs, finding that Puerto Rico's treatment under roughly half of those programs would change for the better if the territory were to become a state. However, GAO does not examine scores of "smaller" but nevertheless very significant federal spending programs under which Puerto Rico is treated unequally as a territory. If Puerto Rico were a state, it would receive equal treatment under these programs as well—a fact the report does not attempt to quantify.

- The GAO report observes that, in recent years, the level of migration from Puerto Rico to the states has been extraordinarily high, but does not attempt to measure the fiscal impact such migration has had on the federal government. That impact is real and substantial, since individuals who move from Puerto Rico to the states qualify for equal treatment under all federal programs, which has a cost for the federal government in the form of additional spending. In short, the report does not attempt to calculate the major adverse impact that Puerto Rico's *current* status is having on the U.S. Treasury.

- As GAO expressly acknowledges, many of the major federal benefits provided under the 2010 *Affordable Care Act* (ACA)—including subsidies to help lower-income individuals purchase insurance through a health care exchange—are not available to residents of the U.S. *territory* of Puerto Rico, but would be available to residents of the U.S. *state* of Puerto Rico. Nevertheless, this fact is not reflected in all of the report's estimates of federal spending under statehood. It is critical to underscore these omissions, because equal treatment under the ACA would mean billions of additional federal dollars for Puerto Rico.

Federal Spending

- **Medicare**: GAO uses Fiscal Year 2010 as the relevant year. The report estimates that actual federal spending on Medicare in Puerto Rico in FY 2010 was **$4.5 billion**. The report estimates that, if Puerto Rico had been a state in FY 2010, the federal government would have spent between **$4.5 billion (low end)** and **$6.0 billion (high end)**. The high-end estimate—a $1.5 billion increase under statehood—makes intuitive sense, since GAO explains that, as a territory, Puerto Rico is treated unequally under Medicare in various respects. But the low-end estimate is difficult to understand, begging the question: How could it be possible that Puerto Rico, as a state, would receive the same level of federal funding under Medicare as it did as a territory? GAO provides two responses to that query. First, GAO assumes that Puerto Rico would be treated equally under *Medicaid* as well, which means that, for certain individuals, Medicaid rather than Medicare will become the primary payer of their health care. For those individuals, reduced federal payments under Medicare would be offset by increased payments under Medicaid. Second, the ACA reduces payments to Medicare Advantage (MA) plans, which currently cover over 70 percent of the Medicare population in Puerto Rico. Thus, total federal funding for Medicare in Puerto Rico is on a downward trend, irrespective of Puerto Rico's political status. Nevertheless, GAO does not take the downward trend into consideration when calculating the actual FY 2010 number, but does take it into account when calculating the estimate of what Puerto Rico would have received if it had been a state in 2010. In a sense, this analysis is a bit like comparing apples to oranges. The upshot is that, going forward, federal spending on Medicare in Puerto Rico under statehood would be significantly higher than it would be if territory status were to continue.

- **Medicaid**: GAO uses Fiscal Year 2011 as the relevant year. This is not necessarily an ideal year to use because, in 2011, the increased Medicaid funding that Puerto Rico became eligible to receive under the ACA had only partially taken effect. Regardless, the report estimates that actual federal spending on Medicaid in Puerto Rico in FY 2011 was **$685 million**. The report estimates that, if Puerto Rico had been a state in FY 2011, the federal government would have spent between **$1.1 billion (low end)** and **$2.1 billion (high end)**. The report further estimates that Puerto Rico's FMAP (the federal contribution to total Medicaid spending) would increase from 55 percent to 83 percent, reducing the *Puerto Rico government's* annual contribution by **$152 million (low end)** to **$358 million (high end)**, thereby easing the fiscal pressure placed on the local government. As GAO notes, the estimate of federal Medicaid spending under statehood does not include an estimate of Long-Term Care (LTC), an important service that the Puerto Rico government currently cannot afford to provide to its Medicaid beneficiaries as a result of the territory's Medicaid cap, but which the Puerto Rico government would provide under statehood. If the LTC cost were taken into account, federal Medicaid spending under statehood is likely to be substantially more than the high-end estimate of $2.1 billion.

- **Supplemental Security Income (SSI):** GAO uses Fiscal Year 2011 as the relevant year. The report estimates that actual federal spending in Puerto Rico—through an alternative SSI program that applies in the territory known as Aid to the Aged, Blind, and Disabled (AABD)—was **$24 million** in FY 2011. The report estimates that, if Puerto Rico had been a state in FY 2011, the federal government would have spent between **$1.5 billion (low end)** and **$1.8 billion (high end)** in monthly SSI cash payments to blind, disabled or elderly individuals who have limited or no income. Of all the disparities that Puerto Rico faces because of its territory status, perhaps none is as harmful or unprincipled as its exclusion from SSI. While SSI beneficiaries in the states receive between $400 and $600 per month directly from the federal government, AABD beneficiaries in Puerto Rico receive an average of just $70 a month from the government of Puerto Rico.

- **Nutrition Assistance**: GAO uses Fiscal Year 2011 as the relevant year. The report estimates that actual federal spending on nutrition assistance in Puerto Rico in FY 2011 was **$1.9 billion**. The report estimates that, if Puerto Rico had been a state in FY 2011, the federal government would have spent between **$1.7 billion (low end)** and **$2.6 billion (high end)** under the Supplemental Nutrition Assistance Program (SNAP) in lieu of the federally-capped block grant known locally as PAN. The high-end estimate, which would mean an additional $700 million a year, is roughly on par with the estimate provided by the U.S. Department of Agriculture when it examined this issue in a 2010 report. That report concluded that inclusion in SNAP would increase federal funding to Puerto Rico by $457 million a year and would enable 220,000 additional individuals to receive assistance. It is important to clarify the GAO's low-end estimate of $1.7 billion. GAO takes into consideration the fact that, under statehood, Puerto Rico residents would become eligible for SSI payments and that such payments, by increasing an individual's income, could reduce their monthly SNAP benefits. The overarching point is this: under statehood, low-income residents of Puerto Rico would receive far more federal support under the combination of the various social safety-net programs. In addition, as GAO indicates, application of SNAP to Puerto Rico would enable the Puerto Rico government to receive additional federal funding to support employment and training, outreach, and educational programs for SNAP participants and extra help for residents in the event of a federally-declared disaster—benefits that Puerto Rico is presently denied under territory status.

- **Federal Highway Funding**: GAO uses a combination of Fiscal Year 2013 (for the federal spending portion of the equation) and Fiscal Year 2011 (for the federal tax portion of the equation) to make estimates regarding federal highway funding. In FY 2013, the Puerto Rico government was authorized to receive **$149.7 million** in federal highway funding, although it was actually allocated only **$129.3 million** as a result of the imposition of certain federal penalties. GAO, using estimates provided by the U.S. Department of Transportation, concludes that, if Puerto Rico had been a state in FY 2013, it would have been apportioned **$265 million** in federal funds to improve roads, highways, bridges, and other important transportation infrastructure, an increase of over $115 million annually. The GAO also correctly notes that, if Puerto Rico were a state, motor fuel sold on the island would become subject to the federal gas tax. However, the Puerto Rico government currently assesses a local tax on motor fuel, which would almost certainly be reduced if Puerto Rico were to become a state, thereby resulting in minimal or no change in the total amount of government taxes assessed on motor fuel in Puerto Rico under statehood.

Federal Revenue

- **Corporate Income Taxes**: GAO uses Fiscal Year 2009 as the relevant year. The report estimates that actual corporate income tax receipts in FY 2009 were **$4.3 billion**. The report estimates that, if Puerto Rico had been a state in FY 2009, the federal government would have collected between **$5.0 billion (low end)** and **$9.3 billion (high end)** in corporate income taxes, which is $700 million to $5.0 billion more than the actual figure. The fact that this range is so large illustrates the difficulty of making a precise estimate in this area. As GAO notes, an important but unquantifiable benefit of statehood is that it would foster a business climate characterized by certainty and stability. Under the current status, corporations already investing or considering investing in Puerto Rico do not know whether and how the federal government might change current corporate tax laws in the territory. Under statehood, corporations will be placed on a surer footing. It is worth noting that corporate investment in Alaska and Hawaii (both domestic and foreign) dramatically increased after those territories became states.

- **Individual Income Taxes**: GAO uses Fiscal Year 2010 as the relevant year. The report states that actual individual income tax receipts in FY 2010 was **$0.02 billion**. The report estimates that, if Puerto Rico had been a state in FY 2010, the federal government would have collected between **$2.2 billion (low end)** and **$2.3 billion (high end)** in individual income taxes. It must be noted that these estimates are significantly higher than previous GAO estimates. See, e.g., GAO/GGD-96-127, *Analysis of Certain Potential Effects of Extending Federal Income Taxation to Puerto Rico* (April 1996) (finding that, if Puerto Rico were a state in 1995, its residents would have an aggregate federal tax liability of $623 million, minus $574 million in tax credits under the Earned Income Tax Credit (EITC), for a total of $49 million in aggregate net federal income tax liability). The difference between the estimates provided in this GAO report and the previous GAO report reflect the inherent challenges associated with modeling federal tax tables based on local tax receipt data. Moreover, the Puerto Rico government currently assesses local income taxes that are far higher than that of any state. If Puerto Rico were to become a state, the Puerto Rico government would almost certainly reduce its local rates. For many residents of Puerto Rico, the result would be a total tax liability (federal and state taxes) that is not meaningfully different than what they pay now. And, as noted, individuals of modest means in Puerto Rico would have little or no federal tax liability and many of those individuals would receive refundable tax credits under the EITC and the Child Tax Credit (CTC) programs that they are currently denied because they reside in a territory. Indeed, the GAO estimates that, under statehood, $473 million would be paid to Puerto Rico's taxpayers through the EITC and $108 million in additional funding would be paid through the CTC. These tax credits would help lower-income individuals meet their needs and inject money into the local economy.

In closing, I want to thank GAO for its efforts in preparing this report. The report serves to underscore the numerous ways in which territory status harms Puerto Rico's economy and undermines the quality of life of its residents. The report also confirms that, under statehood, Puerto Rico would receive equal treatment under all federal programs, resulting in billions of dollars in additional federal funding each year. Finally, the report serves to lay to rest any argument that statehood would impose unreasonable or unmanageable fiscal demands on the U.S. Treasury. To the contrary, the report concludes that the federal government would likely benefit from additional revenues under statehood, which would help counter-balance the additional outlays. Over time, under statehood, Puerto Rico's economy will prosper, and that in turn will benefit the United States as a whole.

Sincerely,

Pedro R. Pierluisi
Member of Congress

cc: Mr. Stanley J. Czerwinski, Director of Intergovernmental Relations,
U.S. Government Accountability Office