

Committee on Resources

Witness Testimony

**Statement of Mr. Ivar A. Pietri,
Private Citizen, before the
Committee on Resources
U.S. House of Representatives
April 19, 1997**

Chairman Young, Members of the Committee on Resources, ladies and gentlemen, my name is Ivar A. Pietri. I appear before you as a private citizen that has been for twenty-five years a close analyst of the economy of Puerto Rico and of its development in the last sixty years. For fifteen years, from 1981 to 1996, I served as an investment banker based in San Juan with a major international firm with headquarters in New York, and I played a leading role in raising over twenty billion dollars in bond issues in the U.S. and European markets for borrowers in Puerto Rico, ranging from the Government of Puerto Rico to major private issuers. I am intimately familiar with how the credit and finances of Puerto Rico are analyzed by nationally recognized credit rating agencies and by global institutional investors. I am now an independent entrepreneur and I am eager to share with the Committee on Resources my insights into the economy of Puerto Rico as it relates to the political status issue. I was born and raised in Puerto Rico, and have lived here but for three years, plus the time spent pursuing my higher education in the U.S. mainland. I am including seven charts in support of this presentation.

I want to preface my comments by stating for the record that I am proud of my United States citizenship and that I believe that the United States of America, *our* country, is the greatest in the history of mankind. I want to insure that U.S. citizenship for myself and for my four children, and their future offspring. I want to achieve the full rights of that citizenship for my family and for all my fellow citizens residing on the Island, and I am most willing to assume all the responsibilities of that citizenship. I believe firmly that the only way to attain that goal is for Puerto Rico to be admitted as the fifty-first state of the union.

Mr. Chairman, for much of the last fifty years, Puerto Rico has been touted as an economic miracle. Our per capita income was hailed as the highest south of the Rio Grande. Our standard of living was compared favorably to that of developing countries. But as an American, I hold that the comparison should be to the fifty states of our great Nation. That comparison leads to an entirely different conclusion. ***Puerto Rico is not and has never been an economic miracle.*** Mr. Chairman, the economy of Puerto Rico has completely stagnated for twenty-five years. Puerto Rico has not cut the enormous gap in standard of living with the rest of the U.S. since 1972. As you can see from examining Chart # 1, between 1950 and 1970 Puerto Rico grew at a pace that allowed it to reduce the economic gap with the rest of the U.S. That has not occurred in more than two decades.

As you can see from Chart # 2, since 1972 Puerto Rico's economy has basically been growing at a similar rate in real terms as that of the entire U.S. economy. ***But we cannot afford to grow at the same pace as that of the largest and most developed economy in the world.*** Chart # 3 shows the growth rates that Puerto Rico must exhibit if we are to catch up with the rest of U.S. You can see, that Puerto Rico must grow at a rate at least three times that of the national economy in order to close the gap in less than thirty years.

Today, in Puerto Rico the population below the Federal poverty level is 59%, per capita income is less than one third (1/3) of the national average and less than half of the lowest state, Mississippi. Our unemployment, even with a labor force participation rate dramatically lower than the U.S. average, had not been below 14% since the early seventies until 1995 when it dipped to an average of 13.8% for the year, and it has been above 20% several times in that period. Our economy stagnated during that period in spite of having the

benefits of Section 936 of the U.S. Internal Revenue Code and no federal taxation. During that time our economic development was based on a failed model that depended strictly on artificial gimmicks that we did not control. Until 1996 we were an economy dependent on corporate welfare at a cost of up to \$3.5 billion yearly to the U.S. taxpayer. Section 936 did contribute to Puerto Rico's economy, but its importance was grossly exaggerated over the years for political purposes by Commonwealth supporters and by the 936 companies themselves. ***For decades, the local administrations led by Commonwealth advocates purposely and irresponsibly pursued a one-dimensional development strategy, neglecting other initiatives and policies in order to foster dependency on Section 936 only to sustain their political goals.***

The changes to Section 936 that were recently enacted in Washington were inevitable when you look at it from the point of view of the Federal Government. Job growth in manufacturing has been marginal for over twenty years. Yet the cost of the program to the federal government grew dramatically every year. In 1985, 936 companies earned \$5.1 billion. In 1989, they earned \$8.1 billion. In 1992, their profits exceeded \$10 billion. By 1996, it is estimated that the profits of 936 companies were above \$14 billion. Clearly, this situation could not go on unchanged for much longer. The cost to the federal government simply grew out of control without a corresponding growth in jobs. This trend could not have been expected to change in the future because of productivity gains in manufacturing. Technology and competition dictate that manufacturing be more efficient every day. The company that does not keep up will lose ground to its competition. Even IBM has had problems of this nature. Digital Equipment did not leave Puerto Rico, costing us 3,000 jobs, because 936 was going to be changed. They left because of competitive pressures. They actually had several of their better plants in the world here.

Finally, Congress took the anticipated corrective action in repealing 936. That repeal, combined with the North American Free Trade Agreement (NAFTA), obliterated the economic rationale for Commonwealth status. Commonwealth advocates have justified this status on four so called "pillars": common citizenship, common currency, common market and common defense. These four "pillars" were backed up by the myth of "permanent" union with separate sovereignty, under the guise of "autonomy", and by no Federal taxation. NAFTA and its proposed expansion to Chile and beyond eliminated the exclusive nature of one of the so-called pillars of Commonwealth. This development and the repeal of 936 did away with the basis for the economic justification by Commonwealth advocates for that status as a viable option.

The elimination of Section 936, does not mean that the jobs that have been created with its help will be lost, it does not mean that the "936 companies" will leave Puerto Rico. Not only do the companies make huge profits in Puerto Rico, profits which grow significantly every year, but there have been other changes to the Internal Revenue Code that preclude the transfer from Puerto Rico of the intangible assets (which are responsible for most of the revenues from the products of 936 companies) to foreign countries in search of tax deferrals. Section 482 regulates intercompany pricing and section 367 regulates the transfer of the intangible assets including the imposition of a super royalty in the U.S. on the revenues from intangibles transferred outside the U.S. The result of these measures is that relocation to other countries in search of a tax haven is not an option, leaving the companies with no tax incentive to relocate their extremely productive complexes from Puerto Rico.

As we all know, there are many conflicting views about the economic impact of statehood: section 936 and U.S. taxes have been the center of the economic arguments against statehood. There have been several studies that supposedly analyze the economic viability of statehood for Puerto Rico. However, they all share the same critical flaw: they are *static* analyses that superimpose the U.S. tax system on our economy and remove section 936, and assume that nothing else changes. That is not statehood. That is Commonwealth with U.S. taxes and without 936. Obviously, that would be negative. But these studies completely ignore ***the most important benefits of statehood: full integration into the U.S. economy, stability, credibility, permanence, political power, dignity and broad comprehension around the world of its political concept.*** Keep in mind that most of the studies were prepared with one purpose: to preserve the 936 program for those paying for the studies.

The benefits of statehood are definitely tangible and concrete, and they will most definitely have an extremely positive economic impact. Historically, territories, before becoming states, have been characterized by a lower level of economic development than that of the states. Upon admission into the Union and full integration into the U.S. economy, they experienced an accelerated rate of economic growth that allowed them to converge with the national economy. ***Mr. Chairman, statehood is a pre-condition to Puerto Rico's economic growth, not vice versa. The opponents of statehood have used the notion that pre-development must come before Puerto Rico is ready for statehood to distort the historical fact that statehood leads to dramatic growth.*** The benefits of statehood are difficult to quantify in a simple and neat way. It is easy to quantify what would happen if we simply superimpose U.S. taxes on our present system and eliminate section 936. Therefore, it is easy to use *faulty analysis to pretend* that you can *prove* that statehood would ruin our economy and would be more costly to the U.S. than the other two alternatives. In reality it is Commonwealth that would continue to be a fiscal sinkhole to the U.S. Treasury.

To believe such flawed analysis of the economic impact of statehood is to turn a blind eye to certain key facts:

Puerto Rico has a per capita income that is less than one third of the national average, and about 50% of the poorest state, Mississippi. This gap has not been reduced in twenty-five years and, in fact, has begun to widen in recent years. This situation destroys the notion that a territory should "get ready" for statehood. This is simply not applicable. The fifty states are running away from us economically.

Why have the other 50 states been so successful, especially Alaska and Hawaii, the most recent admissions into the Union? Hawaii completely transformed its economy after it became a state, from one that relied on defense expenditures by the Federal Government to one based on its tourism industry. And why can't Puerto Rico also enjoy such success as part of the greatest and most prosperous nation on Earth? *After all, let us not forget that at the turn of the century the U.S. had five great off shore territories with the potential to become states. Alaska and Hawaii became states and have prospered. Cuba and the Philippines chose independence and we all know how much they have prospered. Puerto Rico is still a territory, and has mucked along this entire century, showing a potential that will never be fulfilled until we become a state.*

To believe that we cannot achieve more progress as a full partner in the nation than as a territory is to have a very myopic and cynical view of what it means to be part of this great nation. It also takes a dim view of our capabilities as Puerto Ricans to compete in the global economy and to contribute to our Nation's economy. This is the same view that holds that the People of Puerto Rico are welfare basket cases and would all migrate to the mainland to go on welfare if the Congress made changes to section 936. The same people make those statements: the enemies of the only status that can give us the tools to close the economic gap with the rest of the Nation. The enemies of statehood put our own people down to confuse us, the Congress and the Nation about the potential of Puerto Rico under statehood. ***Well, I will say unequivocally to this Committee, to Congress and to the entire Nation, if the People of Puerto Rico were welfare hounds, we would have moved to the mainland already.*** Those of us that moved in the fifties and sixties did so looking for better opportunities for their families. Many succeeded in spite of being ill-equipped educationally, and more and more of the new generation of mainland Puerto Ricans are succeeding every day. Those of us that are moving to the mainland in the nineties, are successful professionals and entrepreneurs that contribute significantly wherever they settle. You only have to look as far as the Puerto Rican community in the Orlando, Florida area. ***Mr. Chairman, the People of Puerto Rico are industrious, dedicated, hard working and devoted to family. Those that rely on welfare do so only because the present political status has not provided them with the opportunities they aspire to.***

Puerto Rico has many *competitive advantages: a strategic geographic location, a democratic tradition, we are under the U.S. flag, we have a dollar based economy, an infrastructure that needs improvement but is the best in Latin America, world class communications and transportation, a bilingual and bi-cultural business environment and, most important of all, a large, loyal, well educated, trainable and highly*

productive labor force. Only as a state can the potential of these advantages be maximized for both Puerto Rico and the Nation. We have to use our cultural affinity with the rest of Latin America, now that the world is so well on its way toward free trade and regional trading blocks, to position ourselves as the ***Economic Crossroads of the Americas.*** We have to become the trade and services *bridge* between the rest of the U.S., Europe and Latin America. Our tourism industry has as much potential as that of Hawaii or as that of any other part of the world. Governor Rosselló is trying very hard to make that potential become a reality. But his efforts are doomed to be limited in results until we resolve the political status issue.

Statehood will give the impetus needed to the above efforts. It is the only political status that can do it. The State of Puerto Rico will achieve the economic growth rate that we need to close the gap with the rest of the Nation.

Before I close, Mr. Chairman, I would like to urge the Committee not to listen to the siren calls of those who insist on a level playing field between the alternative forms of status to be presented before the People of Puerto Rico. ***The playing field can never be level. Each status alternative is inherently different. What the advocates of the level playing field want is to confuse the people of Puerto Rico into believing that the benefits of statehood are available under the other status options. Mr. Chairman, as we all know, this is not the case.*** There is no substitute for statehood. The opponents of statehood have used the level playing field concept to confuse our People as they have continually done for over forty-five years. To have the benefits of statehood without the responsibilities would not only be unfair to all the other citizens of the Nation, but in some aspects may be unconstitutional. No matter how many of those benefits Congress would concede them, no one could ever provide them with the most important ones of all: full integration into the U.S. economy, stability, permanence and the political power of statehood. ***I urge the Committee not to accept definition changes to the status alternatives that could lead to re-creating the fiasco of the 1993 plebiscite.***

I join my voice to that of most witnesses before this Committee in asking that Congress assume its historical responsibility to the 3.8 million U.S. citizens residing in Puerto Rico. Our ancestors suffered four hundred years of exploitation as a Spanish colony. Although the United States has been a benevolent and rather generous ruler, after almost one hundred years of under U.S. sovereignty, almost a full century of political disenfranchisement under the U.S. flag, it is time that Congress recognize the contributions that these 3.8 million citizens can make to the Nation, and that we be granted the opportunity to enjoy our full and unalienable political rights under the Constitution of these great United States of America. I strongly urge Congress to pass H.R. 856. Thank you very much.

###