

# Issue Six July 2005

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## **PRESIDENT'S MESSAGE**

We had record attendance at the Spring Symposium. I would like to express my thanks to James Mackie and to all of those who helped make this a successful meeting: the program committee, the session organizers, moderators, presenters and discussants, luncheon speaker — and of course the audience. I also want to thank Gary Cornia and the speakers and panel participants for an excellent State and local session.

Plans are well under way for the fall meetings in Miami, November 17-19, chaired by John Diamond. Our Holland Medal recipient this year is Roy Bahl, who will be honored at a special session at the meetings. Our Thursday luncheon speaker is Jim Poterba, who in addition to his role as a well known professor and scholar is also a panel member of the President's tax reform commission. The commission is now expected to issue its report at the end of September, so his remarks will be timely.

For all of those who contributed to the Tax Encyclopedia or who are interested in purchasing the volume, publication was scheduled for July — a little later than we had initially hoped, but still a very quick update. We've had a slight seasonal adjustment to September, which, I am told, is a truly firm date. The second edition of the *Encyclopedia* will retail for \$75.00. NTA members will receive a 20% discount off the retail price by calling the Urban Institute (202) 261-5687; toll-free 1-877-847-7377 and indicating that they are NTA members. The book can also be ordered on line, but the discount will not be available there; you can check on availability at the Urban Institute's website, however: [www.uipress.org](http://www.uipress.org). Or you can mail a check or money order (including \$3.00 for shipping) to: The Urban Institute Press, 2100 M Street N.W., Washington, DC 20037. We'll send another reminder when the volume is published.

I hope you all enjoyed the brief article on Social Security reform in the April newsletter. In this issue we offer an article on the issue of statehood, independence, or commonwealth status for Puerto Rico, written by David Brumbaugh of the Congressional Research Service. It will not surprise you that taxes and government programs — and their relative sizes (the "balance of payments") plays an important role in the decision.

Please let us know what features you like and don't like about the NTA Network. We are open to any suggestions that might make the newsletter more valuable. And please remember to let the NTA office know about any special awards, upcoming tax positions, or any other news we might share with members.

**Jane Gravelle**

## **Puerto Rico and the Other 'Balance of Payments'**

David Brumbaugh\*

Those of us who live or work in Washington D.C. are used to debates that connect taxes and political status — the District's license plates bear the inscription “taxation without representation,” calling attention to D.C.'s lack of full-fledged participation in Congress. For Puerto Rico, the status issue is just as sharp, and involves the very question of nationality. And the matter of Puerto Rico's relationship with the United States is inextricably tied to the question of tax and spending relations between the federal government and Puerto Rico. While the term makes international economists wince, this issue has come to be known as the “balance of payments” question.

Puerto Ricans have long debated the merits of three alternative status options: full U.S. statehood; independence; or continuation of the current hybrid “commonwealth” status. Over the past 40 years, Puerto Rico has conducted three plebiscites and one referendum on the matter, and status is a continual focus of political debate both on the island and in the U.S. Congress. Non-tax issues in the debate are numerous and complex, and include topics such as self-determination, language and culture, and likely congressional representation, to name only a few. But a change in Puerto Rico's status would change the applicability of federal tax and spending programs. As a result, a persistently prominent element of the debate is how a change in status would change the balance between federal outlays on the island and Puerto Rico's own federal tax payments.

Puerto Rico is a U.S. territory, but since 1952 it has had its own constitution and a measure of autonomy as a “commonwealth.” Puerto Ricans are U.S. citizens, but cannot vote in Presidential elections; Puerto Rico has a non-voting representative in Congress. In the area of taxes, Puerto Rico has considerable autonomy in tax matters, and applies its own tax system. Under federal tax law, residents of Puerto Rico generally do not pay federal income taxes, although social security taxes do apply. On the business side, corporations chartered in Puerto Rico are considered “foreign” under the federal tax code and can use the same “deferral” tax benefit available to U.S. firms investing in foreign countries. (An alternative, more generous federal tax benefit—the possessions tax credit, or Puerto Rican economic activity credit—is available through the end of 2005, but will then expire under terms of federal legislation enacted in 1996. For decades, the economic merits of the credit, was a key part of the status debate, because the credit would not apply under statehood. While the credit's scheduled expiration may not make fiscal relations a less important part of the debate, they at least make them less complicated.)

Like taxes, federal spending programs are not fully applicable in Puerto Rico. For example, the federal food stamp program and supplemental security income (SSI) programs do not apply, while TANF and Medicaid are capped. With the full applicability of federal programs under statehood, outlays would expand. The “balance of payments” question, then, is this: If Puerto Rico were to become a state, would the increase in federal spending outstrip the increase (if any) in federal tax payments?

Compared to the 50 states, Puerto Rico is poor; median income is only 46% that of Mississippi, the poorest U.S. state. The island's relative poverty and the progressive nature of the federal tax system and spending programs makes the answer to the balance of payments question clear: the increase in spending under statehood would outstrip new federal tax payments; there would be in all likelihood an increase in the net flow of federal funds to the island.

Rough calculations based on 2003 data suggest that if federal spending in Puerto Rico were to increase to the rate of outlays in Mississippi, they would be about twice the level of federal outlays under commonwealth status — around \$14 billion. Taxes likely would not begin to offset this amount; if individual income taxes in Puerto Rico were paid at the Mississippi rate they would be slightly over \$2 billion. Given provisions such as the earned income credit, the actual tax figure would likely be much lower. The revenue pick-up from federal business taxes would be unlikely to make up the difference, especially with the scheduled expiration of the possessions tax credit.

Federal tax and spending policies are complex, and add yet another dimension to the already-complicated question of Puerto Rico's status. Yet in the case of fiscal relations, the direction of statehood's effect seems clear.

\*David Brumbaugh is an economist with the Congressional Research Service.

### **Tax Policy and the Economy**

The National Bureau of Economic Research and the NTA is offering, as a courtesy to the NTA's membership, the 2005 volume (no. 19) of *Tax Policy and the Economy* from MIT Press. This publication is being distributed exclusively to NTA members and will be mailed at the end of August.

### **Allied Social Science Association**

The NTA will again sponsor a session at the Allied Social Science Association Program in association with the AEA meetings which will be held in Boston next year (January 6-8). Bob Bohm of the University of Tennessee has again organized the NTA session.

Title: Issues in Interstate Competition and Policy (H710)

Presiding: Jonathan C. Rork, Vassar College

"How Do States Formulate Medicaid Policy?" Reagan Baughman, University of New Hampshire and Jeffery Milyo, University of Missouri-Columbia

"Cross-Border Shopping and the Sales Tax: A Reexamination of Food Purchases in West Virginia." Mehmet Tosun, West Virginia University and Mark Skidmore, University of Wisconsin-Whitewater

"Dynamic Scoring of State Reform Proposals," Paul Coomes, University of Louisville and William Hoyt, University of Kentucky

Discussants:

Brian Hill, University of Tennessee-Knoxville

Claudio Agostini, Universidad Alberto Hurtado

Robert Rebelein, Vassar College

### **Research News**

**Julia Coronado**, senior research analyst and **Sylvester J. Schieber**, research director at Watson Wyatt Worldwide wrote an article about the Bush administration's proposal to encourage employers to fully fund their pension plans. The study, *Saving Private Pension Insurance: An Evaluation of Current Proposals to shore up PBGC*, was published in the *Journal of Compensation and Benefits*. A full text of the article is available by calling the NTA's office.

### **Welcome New Members Summer 2005**

*Annette Alstadsaeter*, Statistics Norway, Oslo, Norway

*Mary J. Balmer*, Best Software, Herndon, VA

*Helena Blazic*, University of Rijeka, Rijeka, Croatia

*Gregory S. Burge*, Florida State University

*Thomas Carton*, Ohio Department of Development, Columbus

*Philip DeCicca*, University of Michigan, Ann Arbor

*Robert J. Eger III*, Georgia State University, Atlanta

*Patterson C. Ekeocha*, University of Nigeria, Nsukka, Nigeria

*Pamela Hannigan*, New York University, New York, NY

*Andy Hultquist*, Ohio State University, Columbus

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*Steven R. Kelley*, Ohio Department of Development, Columbus

*Xin Li*, University of Michigan, Ann Arbor

*Kung-Cheng Lin*, Feng Chia University, Taichung, Taiwan

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*Doreen Rae*, University of Texas, Arlington  
*Laura Rooney*, Arizona State University, Tuscon  
*Benjamin Russo*, University of North Carolina, Charlotte  
*Kent Smetters*, Wharton School, University of Pennsylvania  
*Robert Stempfer*, Ohio Department of Development, Columbus  
*John A. Swain*, James E. Rogers College of Law, University of Arizona, Tuscon  
*Laura Ullrich*, University of Tennessee, Knoxville  
*Marcia Van Wagner*, Office of the Comptroller, New York, NY  
*Laura Wheeler*, Andrew Young School of Policy Studies, Georgia State University, Atlanta

#### **Members on the Move**

*Dan R. Bucks*, Montana Department of Revenue  
*John Deskins*, Creighton University, Omaha, Nebraska  
*LeAnn Luna*, University of Tennessee  
*George Plesko*, University of Connecticut

**Please send information about your recent promotions, organization changes, etc., to [natlta@aol.com](mailto:natlta@aol.com)**

#### **Happy Birthday John Due**

John F. Due, a noted expert on the sales tax and the 2000 Holland Medal winner, is celebrating his 90<sup>th</sup> birthday in July. He is a long-time NTA member and an emeritus professor at the University of Illinois at Urbana-Champaign.

#### **POSITION AVAILABLE**

#### **SPECIALIST IN PUBLIC SECTOR ECONOMICS (Vacancy #050074)**

Economist-Confidential Madison (Area 13) JOB ANNOUNCEMENT CODE: 05-01484

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