Puerto Rican Development in Light of U.S. Colonialism: The Case of the Rum Excise Tax

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The relocation of Diageo's rum production facility from Puerto Rico to the U.S. Virgin Islands in 2010 had larger ramifications than the shifting of jobs from one island to another. Related to this move is the distribution of monies associated with the excise tax placed on each bottle of rum produced in these territories. For close to five decades, Puerto Rico received a large majority of these funds and invested them in economic growth. To secure a larger share of the cover-over money, the U.S. Virgin Islands promised large corporate kickbacks funded by the tax. This article examines which strategy has an effect on economic growth, the cover-over as a supplemental fund or as an enticement to multinational corporations. It concludes that the use of the cover-over as a supplement to island growth is ineffective and that constrained growth on the islands is due to their political status as territories of the United States.

La reubicación de la planta para la producción de ron de Diageo de Puerto Rico a las Islas Vírgenes de los Estados Unidos en 2010 tuvo consecuencias más importantes que el cambio de empleo de una isla a otra. Relacionado a este cambio está la distribución de efectivo asociada con el impuesto aplicado a cada botella de ron producida en estos territorios. Durante casi cinco décadas, Puerto Rico recibía la mayor parte de estos fondos y los invertía en el crecimiento económico. Para asegurar una porción mayor del dinero generado por este impuesto, las Islas Vírgenes de Estados Unidos prometieron grandes ventajas económicas que se pagarían a la corporación con este impuesto. Este artículo examina cuál estrategia tiene un efecto en el crecimiento económico, el impuesto como fondo extra o como un incentivo para las corporaciones multinacionales. Concluye que el uso de este impuesto como un complemento para que las islas crezcan es ineficaz, y que el limitado crecimiento se debe en parte a su estatus político como territorios estadounidenses.

Key words: colonialism, foreign direct investment, Puerto Rico, development

Introduction

In March 2010, a pirate war erupted in the Caribbean. The British-based alcohol producer, Diageo, announced that it was moving production of Captain Morgan's rum from Puerto Rico to the U.S. Virgin Islands (USVI).

Latin American Policy—Volume 5, Number 1—Pages 26–38

Although Diageo had planned on leaving Puerto Rico when its contract ended in 2010, Puerto Rican interest groups (led by the National Puerto Rican Coalition and the Conservation Trust of Puerto Rico) were up in arms, appealing to the U.S. federal government to prohibit the move. While the obvious negative effect of a large manufacturing project leaving the area would be an increase in unemployment, that was not what concerned these groups most.

Instead, the heart of this dispute was the rum cover-over tax subsidy (Allen, 2010). At the beginning of the 20th century, the United States began to return a portion of the excise tax collected through the sale of distilled liquors (most specifically, rum) to Puerto Rico (Maguire & Teefy, 2010). By mid-century, the cover-over was split between Puerto Rico and USVI, with Puerto Rico receiving close to 90% of the tax revenue due to its comparatively high rum production rate. The complaints Puerto Rico filed against the current Diageo move were strategic from their viewpoint. Instead of disagreeing outright with the expected change in the distribution of the cover-over funds, Puerto Rico complained about the USVI using their expectedly increased future share of the monies "inappropriately" to entice Diageo with tax breaks and a new facility rather than funding social programs, similar to how Puerto Rico uses the monies. Although there are no rules about how these funds can be applied, the criticism from Puerto Rico has piqued the interest of various members of Congress concerned with misappropriation, especially those from Florida and New Jersey, where there are large Puerto Rican populations.

The aura of crisis that surrounds the Diageo move leads to a closer evaluation of the Puerto Rican situation and, specifically, the problems underlying its economic dependency on subsidies for its development. In a situation where external trade, wage, and labor laws constrict a political entity, there can be little or no substantial economic growth. Puerto Rico and the USVI are two of the last colonies that remain in the global system today. Many developing countries have dependent relationships on global or regional economic hegemons, but Puerto Rico and the USVI have no other political or economic option in their current situation but to remain dependent.

Puerto Rico (along with the USVI) is also in a unique position in that its development strategies are supported and somewhat constrained by U.S. federal law, including the application of U.S. minimum wage and various tax laws, such as Section 936. Section 936 of the U.S. Revenue Code encourages U.S. corporations to move to U.S. territorial possessions through the use of tax incentives. The ultimate goal of Section 936 is to bring jobs to these entities, but critics have deemed it a failure (Jenkins & Hexner, 1994).

Although it enjoys relative economic stability that is not found in other developing areas in Latin America, Puerto Rico has a hard time attracting non-U.S. businesses to invest and bring jobs to the island (Castillo-Freeman & Freeman, 1992; Krueger, 1995). U.S.-based businesses receive tax breaks, whereas foreign multinational corporations (MNCs) do not enjoy such incentives associated with such investment projects. This article seeks to explore the effects of external constraints on a political entity's economic development by using as a case study the unique position of Puerto Rico in the midst of the fight for the rum cover-over monies.

Economic Dependency and Development Strategies

Similar to other Latin American political entities, Puerto Rico has been dependent on the United States for trade and growth. Because of Puerto Rico's status as a U.S. colony, this dependence is even more entrenched. Dependency theory originated in the 1950s and 1960s as an effort to explain why states in the developing world were unable to engage the global economy with the result of positive growth. There were many constraints on these developing economies, including policy prescriptions from international organizations such as the International Monetary Fund and the World Bank, and declining terms of trade, where the main exports of raw goods from developing nations were devalued, and the main exports of finished goods from developed nations were constantly increasing (best known as the Prebisch–Singer hypothesis). One of the main policy prescriptions that led Latin American countries into this dependent relationship with the United States was the idea that open trade would lead to development. Instead, trade liberalization continues to leave dependent economies vulnerable to global competition, not only for goods but also for the strength and cost of their workforces (Valenzuela & Valenzuela, 1978).

Dependent development has been an issue in the developing world throughout the 20th century, but many countries have begun to move away from this strategy. Many states, specifically in Asia, began to entice investment from MNCs. Usually the developing states were willing to provide incentives for the MNCs, such as a skilled workforce with low or no minimum wage laws, relaxed environmental and safety regulations, and tax and tariff breaks. Over time, as these states developed and their workforce became more educated, the goods that they manufactured progressed from raw materials to cheap goods to more technologically advanced goods (Alfaro, Chanda, Kalemli-Ozcan, & Sayek, 2004; Hermes & Lensink, 2003; Herzer, Klasen, & Nowak-Lehmann, 2008; Moran, 2008; Zhang, 2001).

Although scholars have disagreed about the influence of foreign direct investment (FDI) on economic development, FDI is seen as the most efficient way to break the dependency cycle. FDI contributes to development by "the augmentation of domestic capital and enhancement of efficiency through the transfer of new technology, marketing, and managerial skills, innovation and best practices" (Adams, 2009, p. 178). The reinvestment of the technology and knowledge that FDI brings to the developing world allows for growth to occur (Lucas, 1988; Romer, 1994).

Because Puerto Rico is a U.S. territory, U.S. laws and regulations constrain its ability to attract FDI. The federal government in Washington, DC defined much of Puerto Rico's development throughout the 20th century. Elites in San Juan are unable to control attracting FDI to spur development, which leaves Puerto Rico in limbo in its status as the highest per capita income Caribbean nation while it lags substantially behind even the poorest of the U.S. states.

Rum Production and Its Effects on Puerto Rican Development

In this article, the economic effect of the Diageo move will be examined from two different perspectives. Because the focus of the Diageo move is closely related to the rum cover-over tax, the effects of this fund on economic growth will be investigated. Many Puerto Rican interest groups have criticized USVI for enticing Diageo with incentives based on future cover-over revenue, citing that Puerto Rico had given only 10% of annual revenue to the rum industries and used the rest for social programs (Kocieniewski, 2010). But MNCs are rational actors; they are looking for the most beneficial situation. Especially in this day and age, MNCs are able to engage in rent-seeking behavior because developing states are competing for FDI (Guisinger, 1985; Moran, 1999; Oman, 2000; Stopford & Strange, 1991; Thomas, 2000). In the USVI, they found an educated workforce and a stable government that was willing to bolster their industry with tax incentives. Puerto Rico was unwilling to do the same, due to its interpretation of how the rum cover-over funds should be used. The move was inevitable.

The second part of this story is the dependence of Puerto Rico on the United States for its ability to attract the FDI and capital necessary for its development. The development successes of the last 30 years (mainly in Asia) illustrate how important it is to be able to fund development independently. Because Puerto Rico and the USVI are colonies, they are unable to follow this recipe for success as they are constrained by laws and codes made in Washington that affect their path to development. Puerto Rico was left dependent on the cover-over tax to fund its expenditures, and what was once a major source of income for the island's government has become a source of income for a multinational corporation. Puerto Rico sees this rum war as a necessity. It is truly reflective of a dependent government that is scrounging to save a key source of its annual income.

Development in Puerto Rico

Until the 1970s, Puerto Rico was seen as a successful case of development in the Caribbean. After World War II, the U.S. federal government enacted "Operation Bootstrap," where U.S. businesses were given funds to invest on the island and bring industrial jobs and capital. Puerto Rico has a unique political situation as a U.S. territory; it is not a U.S. state, and although it has its own governor and legislature that makes laws on the island, U.S. federal law is paramount. The postwar development strategy was to bring jobs from the mainland to the island, creating a "laboratory" for third-world economic and political development (Lapp, 1995). This occurred by building on the Jones Act and Section 931 of the Internal Revenue Code, which exempts individuals and corporations from federal income and corporate taxes on what they earn in Puerto Rico. The Industrial Incentives Act, which the Puerto Rican legislature passed in May 1947, "exempted qualifying firms from property, excise, and municipal taxes and license fees . . . and provided complete exemption from insular income taxes until 1959 and partial exemption until 1962" (Dietz, 1986, pp. 209–210).

The problem with Operation Bootstrap was that, although it brought jobs to Puerto Rico, it did little to encourage the growth of the domestic economic landscape. Mainland investors were eager to return their profits to the United States rather than invest in local Puerto Rican businesses. This semi-foreign investment hurt local entrepreneurs; there was not much available local capital because it was returned to the U.S. mainland rather than reinvested in Puerto Rico. The island was a unique economic environment. U.S. investors were able to take advantage of a virtually tax-free existence while employing the comparatively high-skilled Puerto Rican labor force (Dietz, 2003, p. 15). It also failed to create the technological foundation necessary for Puerto Rico to benefit from this unique form of FDI in such a way that it would spur greater localized growth.

While the island economy is clearly lagging, one thing that has helped to keep it afloat for so long is a federal excise tax on rum sales in the mainland United States. The rum excise tax originated in the Jones Act of 1917, which established that Puerto Rico was a U.S. territory and that its residents were U.S. citizens. The Jones Act of 1917 (1917) stated that, "all taxes collected under the internal revenue laws of the United States on articles produced in Porto Rico [sic] and transported to the United States, or consumed in the island shall be covered over into the treasury of Porto Rico [sic]." The Jones Act included all Puerto Rican goods sold on the mainland, and rum sales made up the most significant portion of this revenue. This "cover-over" was extended to the USVI under the Revised Organic Act of 1954, which slightly reduced the amount that Puerto Rico received.

Throughout the 1970s, Puerto Rican growth slowed down, which is reflective of the recession that occurred on the mainland as well. Twenty years prior to that, the island was on a path to convergence with the mainland states (Baumol & Wolff, 1996). Puerto Rico's slowdown occurred while many other developing countries were welcoming foreign investment to bring jobs. Other developing areas are able to relax laws and provide tax incentives, but Puerto Rico is unable to offer competitive enticements to foreign investors because U.S. trade and labor laws are paramount, especially the U.S. minimum wage laws (Collins, Bosworth, & Soto-Class, 2006). Also, because of the structure of Operation Bootstrap, Puerto Rican development was geared toward opening itself up to U.S. corporations rather than attempting to attract FDI from other countries. The incentives it is able to offer foreign investors are limited due to federal constraints and a general lack of funds.

To keep U.S. companies interested in Puerto Rico during the recession, a number of revisions to the U.S. tax code were enacted, specifically the 1976 addition of Section 936 of the U.S. Internal Revenue Code. This revision "allowed subsidiaries of U.S. companies located on the island to repatriate income generated from their investments in Puerto Rico to their parent companies on the mainland free of federal taxes, but only if these funds were deposited in Puerto Rico for at least six months before repatriation" (Rivera-Batiz & Santiago, 1996, p. 11). This strategy was successful (a large portion of investment and jobs are due to Section 936), but the close connection to U.S. businesses placed the island economy in a hypersensitive context (Melendez & Blum, 1994). The recession of the late 1980s compounded its economic problems because close to 90% of all manufacturing jobs on the island came from U.S. businesses (Bosworth & Collins, 2006). As the mainland economy contracted, economic opportunities in Puerto Rico shrank faster and harder than in the 50 states. The island's meager revenue was further supplemented in 1983, when the Caribbean Basin Economic Recovery Act included excise tax earned from all rum imported into the United States (not just that produced in Puerto Rico or the USVI) in the cover-over revenue. Prior to the Diageo move, Puerto Rico received between 80% and 90% of the annual cover-over. This was mainly because the island housed the production facilities of the Bacardi and Captain Morgan brands, while the USVI controlled manufacturing only for the Cruzan brand (Maguire & Teefy, 2010).

Puerto Rico has never really recovered from the bust of the 1980s. Much of the island's economic story can be told through the jobs that were lost and the persistence of high unemployment (Padin, 2003). Many scholars find that the island's job problems are twofold. First, there is clearly a lack of jobs because many manufacturers left the island in the past 20 years as the benefits from Section 936 began to phase out between 1995 and 2005. The manufacturing sector provides almost half of Puerto Rico's gross domestic product (GDP), but it employs only 9.2% of the island's population with work (Government Development Bank for Puerto Rico, 2011). Second, highly educated residents are not finding jobs that compliment their skills; 53.6% of the island's total employment is in the service trade or government service (Government Development Bank for Puerto Rico, 2011). Puerto Rico has a highly educated workforce when compared with most developing countries, but those that do not find appropriate work go elsewhere, specifically to major U.S. cities (Ladd & Rivera-Batiz, 2006). This "exporting unemployment" solution contributes to Puerto Rico's consistent underdevelopment, as many of its citizens that leave for the mainland are highly educated compared with the average Puerto Rican (Fernandez, 1996).

In addition to the lack of employment, other scholars cite the increase in the number of residents that receive income from a variety of U.S. social security programs, whether it is disability benefits through the Social Security Insurance or Temporary Assistance for Needy Families. Puerto Ricans do not pay federal income taxes, but they pay into the Social Security fund and are eligible for such benefits. This creates a moral hazard, in that many of the island's residents settle on a living made from these benefits rather than being economically motivated because of a lack of opportunities (Burtless & Sotomayor, 2006).

Puerto Rico continues to find itself in an economic quagmire. The island's government has instilled a number of local tax incentives to bring in more jobs from the mainland, but it is difficult to be competitive in the Latin American context because U.S. trade and labor laws govern Puerto Rico. Diageo's decision to take its production to the USVI compounded Puerto Rico's dependency problems.

The Cover-Over Dispute of 2010

The U.S. federal government never specified how the cover-over revenue was to be used once it was returned to the treasuries of Puerto Rico and the USVI, but the Revised Organic Act (1954) pushed the two island territories to use the funds to garner greater economic independence from the federal government's "periodic appropriations." Puerto Rico, which received the overwhelming majority of cover-over funds, heavily supplemented the island's overextended operating budget from these monies. The Puerto Rican government had become dependent on the cover-over, and the distribution had favored them since the 1954 Revised Organic Act.

By late 2009, the manufacturing contract with Diageo was ending and the MNC began to look elsewhere (Kocieniewski, 2010). It initially considered relocating to another Latin American country (Costa Rica and Honduras were mentioned as possibilities) to reap the benefits of FDI, cheaper labor than what was found in Puerto Rico, and better tax exemptions. To remain competitive, the USVI acted strategically and devised a plan in which Diageo and their government could mutually benefit if the Captain Morgan plant was moved there. The USVI acted like an independent state instead of a political entity of the United States in that it manipulated the subsidy it expected to receive rather than use it as a supplement to the annual operating budget. Many underdeveloped countries have to offer tax incentives to attract FDI (Broadway & Shah, 1995; Moran, 1999; Oman, 2000; Thomas, 2000; Zee, Stotsky, & Ley, 2002). In the end, Diageo ended up profiting more from the move than the USVI because the cover-over monies went mainly to the MNC rather than being used to supplement the USVI budget.

In anticipation of the increase they would receive in light of Diageo's move, the USVI offered the company a portion of the expectedly enlarged share of the cover-over return. This incentive was not framed in a monetary light. Instead, using their portion of the annual rum cover-over, the USVI built a new production facility and gave Diageo an "exemption from all property and gross receipt taxes for the length of the deal [thirty years], a 90% reduction in corporate taxes, plus marketing support and production incentives" (Kocieniewski, 2010). Diageo was eager to accept this deal, and planned to move into the new facility in 2011.

Puerto Rican politicians and interest groups were up in arms, appealing to Washington to stop this deal. The main complaint was that the USVI was misusing the cover-over funds to provide "corporate welfare" to Diageo (Bauman, 2010), which was something that the U.S. public and Congress has attempted to avoid since the economic crisis of 2008. MNCs are usually attracted to host countries with a stable political and economic foundation (Janeba, 2002; Porcano & Price, 1996; Rolfe & White, 1992; Rondinelli & Brupitt, 2000; Single, 1999). Theoretically, Diageo would have chosen to stay in Puerto Rico had the USVI not offered up a share of the rum cover-over. In fact, all 50 states offer tax incentives to promote FDI within their borders (Davis, 2004; Thomas & Wishaadle, 2009) despite evidence that tax incentives have little to no effect on attracting FDI (Bobonis & Shatz, 2007). Puerto Rico and Congress were unhappy with the use of the cover-over funds in the USVI, but any future federal decision regarding the inability to use the cover-over as an FDI incentive would not impede the Diageo–USVI deal.

The Diageo move proved detrimental to the Puerto Rican economy. Manufacturing jobs had already begun to leave the island in the wake of the end of Section 936 in 2005. By losing the Diageo deal, Puerto Rico is also losing much-needed government revenue from the cover-over. Maguire and Teefy (2010, p. 3) claim that, "if rum production shifts between the two possessions [the USVI and Puerto Rico], the 'losing' possession would lose all of the revenue generated by the relocated rum production. Thus, the possession losing the rum producer would be better off if the rum producer relocated outside of Puerto Rico, the USVI, or the US." Puerto Rico admitted that the annual budget would be hurt by the lack of funds, and more programs and jobs would be affected. The USVI acted entrepreneurially, but Puerto Rico was unwilling to offer Diageo a similar incentive because the cover-over funds were used for decades to supplement various public programs. Because the Puerto Rican FDI strategy is still geared toward the U.S. mainland, there is a situation of economic stagnation, with Puerto Rico unable to move forward and be competitive in the global market.

Table 1. The Puerto Rican Cover-Over Fund as a Portion of Gross National Product, Annual Expenditures, and Annual Revenue, 1990–2009, in U.S. $

Year	Cover-over return ($)	% of GNP	% of expenditures	% of revenue
1990	232,021,783	1.07	3.83	3.59
1991	217,305,578	0.95	3.30	3.23
1992	209,772,484	0.89	3.06	2.95
1993	196,367,789	0.78	3.08	2.83
1994	199,934,385	0.75	3.33	2.77
1995	204,920,853	0.72	2.80	2.54
1996	220,732,872	0.73	2.80	2.62
1997	204,458,332	0.63	2.18	2.20
1998	229,323,065	0.65	2.45	2.33
1999	234,672,672	0.61	2.58	2.27
2000	296,312,893	0.72	2.94	2.73
2001	332,902,707	0.76	3.21	2.97
2002	304,361,856	0.76	1.99	2.61
2003	356,144,489	0.75	2.39	2.92
2004	335,292,969	0.66	2.21	2.77
2005	459,278,752	0.78	3.36	2.36
2006	358.663,728	0.63	2.26	2.53
2007	459,278,752	0.78	2.68	3.06
2008	371,005,447	0.61	2.03	2.73
2009	470,207,940	0.75	2.58	3.20

Sources: Maguire and Teefy (2010); Commonwealth of Puerto Rico (1990–2009).

With all the resistance against the distributive shift favoring the USVI, it begs the question of which is the more successful strategy, using the cover-over to fund public programs or to entice FDI? Currently, Puerto Rico is the only case where an assessment can be done because of the extremely recent shift in cover-over distribution. The endogenous growth theory explains that the infusion of money into an economy is useful only if that money is invested in technological development and growth. This is not how the Puerto Rican government used the money; they admit that they used it to prop up their island's operating budget rather than for reinvestment in attracting jobs to the island or supporting home-grown ventures. Historically, Puerto Rico supplemented its government budget with close to 90% of its annual share of the cover-over revenue, with only 10% being given to rum companies (Kocieniewski, 2010). Table 1 shows that the cover-over was less than 1% of Puerto Rico's total GDP, but it was close to 3% of Puerto Rico's annual revenue and expenditure figures. Puerto Rico has stated repeatedly that it supplements its annual operating budget with this money, and it is clear that the loss of this money would have a significant effect on its spending.

In examining the effects on the workforce, it also does not seem as though there is much benefit to luring a large MNC to the islands past the shift in cover-over distribution. Diageo employed approximately 350 people at its Puerto

Rico plant and will only employ approximately 40 people at its USVI plant (Bauman, 2010). The argument can hardly be made that using the cover-over to attract foreign investment brings new jobs. Also, because an overwhelming portion of the USVI's future cover-over monies will be given to Diageo via their 30-year agreement, it is hardly likely that the cover-over funds will be used to attract other foreign investors. Like many other incentive programs, the Diageo deal is excessive when compared with the potential benefits to the USVI (Buettner & Ruf, 2007; Head, Ries, & Swenson, 1999).

The USVI and its supporters defend its strategy by claiming that an increase in cover-over share will "fund economic development and public needs, upgrading infrastructure and building schools" (O'Neale, 2010), which is similar to how Puerto Rico used its money. This is an interesting statement for two reasons. First, the USVI will be receiving approximately 80% of the total rum cover-over subsidy. As part of their agreement, the USVI has promised Diageo 80% of that share. The portion that is not given to the rum MNC and is left to the discretionary use of the USVI government will not be much larger than the pre-Diageo cover-over share. Second, although Puerto Rico invested an overwhelming amount of its cover-over monies into public programs, its growth has been stagnant for almost three decades. Considering the average 4% cut to the island's budget due to the relocation of the cover-over monies, it is difficult to discount this fund's importance to Puerto Rico's economic stability.

Discussion

It is clear that Puerto Rico and the USVI are highly dependent up the United States for their development (Dietz, 1979; Villamil, 1979). Both entities are fighting over a relatively small amount of revenue generated by the excise tax, with no guarantee of future growth of this fund. Over the course of the past century, the Puerto Rican government became dependent on the cover-over to sustain its annual operating costs and provide basic social services to its population. By refusing to change its tactics to keep Diageo and the excise tax monies, Puerto Rico signaled what was most important to it, using this money to help the people of the island rather than pay a company to stay and continue generating the revenue.

This strategy could be one of principle, in that Puerto Rico recognizes that it needs assistance (budgetary, development, and more). By committing to using that money for public programs rather than as an investment incentive, the island government hoped that Congress (which ultimately continues to retain legislative control over the excise tax code) would recognize that this money was originally developed as a means toward some sort of dependent development and would possibly be willing to legislate how this money could be used, but the U.S. Congress is currently occupied with the economic downturn that is affecting the mainland United States and not necessarily with the stunted development of its Caribbean colonies.

The USVI's entrepreneurial approach to the excise tax monies also illustrates the constrained behavior of a political entity not in control of its own development. Instead of making general incentives to MNCs possibly interested in investing in the USVI, the islands enticed Diageo by promising money that the

USVI would not receive unless the move actually happened. Considering the small amount of new employees that Diageo will hire and the fact that the USVI has basically given its newly increased share of the cover-over to the company, this shift will not have much effect on the islands' development. While the USVI is not a winner, Puerto Rico is a clear loser in this situation.

In the past 30 years, it has become obvious that a country needs to be able to attract FDI to develop in this globalized economy. Puerto Rico and the USVI are constrained in being able to compete in this type of developing economy. Puerto Rico has had a minimum wage since the 1938 Fair Labor Standards Act, although it was not the same minimum wage as on the mainland. Congress had provided a lower minimum wage for the island that would allow it to remain competitive in the Latin American market. Finally, in 1983, Puerto Rico's minimum wage was brought into alignment with the mainland to lower Puerto Rico's "unfair competitive advantage over mainland competitors" (U.S. Department of Commerce, 1979, pp. 633–642). Congress should not be concerned about Puerto Rico or the USVI having an excessive advantage over the 50 states. Puerto Rico lags behind the poorest state in the union (Mississippi); its annual GDP is only one-third of that state's GDP. While Puerto Rico seems to be rich in the Latin American context, it continually lags behind the United States (Baumol & Wolff, 1996; Castillo-Freeman & Freeman, 1992).

The problem is that Puerto Rico and the USVI do not have autonomous control over their development strategies. Instead, they are dependent on a legislative body in which they have no vote to be mindful of their political and economic situation. These colonial entities are forced to fight over the scraps of an excise tax and manipulate it in such a way to attract a small bit of investment that will, in turn, bring more of the tax money to their islands, which will then be returned to the MNC. If the United States is interested in assisting development in Puerto Rico and the USVI, it should commit to real strategies, such as repealing the minimum wage laws to make the colonies more competitive in the global market, investing more in education, and bringing permanent jobs to the islands to keep the educated population at home. Becoming embroiled in this rum war by siding with Puerto Rico or the USVI will not help to solve the crux of the problem, which is chronic dependent underdevelopment. On the other hand, others insist that changing U.S. law will not solve these developmental issues. Instead, these critics support the solution of full independence for Puerto Rico.

Conclusion

In the dispute in the Caribbean in early 2010, Puerto Rico was not fighting to keep Diageo and its Captain Morgan's rum production facility on the island to protect jobs, but to maintain the 80% plus share of the annual rum cover-over tax subsidy that was returned to the island from the U.S. federal government. By signing a 30-year deal with Diageo, the USVI did not create new jobs for their population, but instead guaranteed the favored share of the cover-over funds for themselves. While both commonwealths place the utmost importance on the cover-over as their path to greater independence from the U.S. mainland and eventual development, the Puerto Rican case does not support the cover-over's supposed contribution to its development.

By divvying up the money into smaller projects, Puerto Rico was able to keep various social and infrastructural programs afloat. The cover-over provides some intermediary effects that create the illusion that Puerto Rico is doing well and is economically stable. The Puerto Rican government was quick to note that when the shift in distribution occurs, their tenuous economic situation will be very apparent. The same can be anticipated for the USVI. They will be receiving the bulk of the cover-over monies until 2040, but a good portion of that will be given to Diageo as part of their agreement. The USVI will be left with a much smaller increase over their pre-2011 allotment. Since the USVI government insists that it will be investing this money in infrastructure and social programs, the Puerto Rican case is a good predictor of how the cover-over will affect growth.

The focus of this case study is how external constraints on Puerto Rico's trade, wage, and labor laws affect its growth. Other developing states are able to entice foreign investment by offering cheaper labor and tax breaks, but Puerto Rico and the USVI have to enforce U.S. minimum wage laws and can offer tax breaks only to investors from the U.S. mainland. In a bill introduced in the U.S. Senate in early 2010, the federal government sought to restrict how much of the cover-over money could be used to reward foreign investors. This bill died in committee and has not been reintroduced as the focus in Congress has turned toward other issues on the mainland. In the meantime, the USVI's initiative paid off. Diageo has shifted its production there because of incentives based on future cover-over monies. Many Puerto Rican interest groups claim that the loss of the cover-over, along with a host of other economic issues, led to 54% of Puerto Rican voters supporting future statehood in a November 2012 referendum, which may be challenged strongly in Congress (BBC News, 2012). In the meantime, Puerto Rico is left to deal with the economic consequences of its dependence on U.S investment and the loss of the cover-over tax monies.

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