NEW ISSUE—FULL-BOOK-ENTRY
See "Book-Entry Only System" under The Bonds

In the opinion of Bond Counsel, under existing law, (i) assuming continuing compliance by the Commonwealth with certain covenants, interest on the Bonds is excluded from gross income for federal income tax purposes; (ii) interest on the Bonds is not an item of tax preference for purposes of the alternative minimum tax imposed on individuals and corporations; and (iii) the Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation. Interest on the Bonds may be subject to certain federal taxes imposed only on certain corporations, including the corporate alternative minimum tax on a portion of that interest. For a more complete discussion of the tax consequences of ownership of the Bonds, see the discussion under "Tax Exemption" herein.

$538,500,000
COMMONWEALTH OF PUERTO RICO
$500,000,000 Public Improvement Bonds of 1998
$38,500,000 Public Improvement Refunding Bonds, Series 1998B
(General Obligation Bonds)

Dated: March 15, 1998 — *Due: July 1, as shown below*

The Bonds are issuable as registered bonds without coupons in denominations of $5,000 and any multiple thereof. Interest on the Bonds will be payable July 1, 1998 (representing 106 days' interest) and each January 1 and July 1 thereafter. Certain of the Bonds are subject to redemption prior to maturity as set forth herein, the earliest possible date of redemption being July 1, 2008.

The Bonds are general obligations of the Commonwealth of Puerto Rico. The good faith, credit and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal of and interest on the Bonds. The Constitution of Puerto Rico provides that public debt of the Commonwealth, including the Bonds, constitutes a first claim on available Commonwealth revenues.

$500,000,000 Public Improvement Bonds of 1998

Amount	Maturity July 1,	Interest Rate	Price or Yield	Amount	Maturity	Interest Rate	Price or Yield
$ 1,625,000	1998	4.50%	3.60%	$12,525,000*	2009	5.75%	4.60%
7,675,000	1999	4.50	3.65	13,245,000*	2010	5.75	4.65
8,020,000	2000	4.50	3.90	14,010,000*	2011	5.75	4.73
8,380,000	2001	4.50	4.10	14,815,000*	2012	5.75	4.82
8,755,000*	2002	4.50	4.10	15,665,000*	2013	6.00	4.85
9,150,000*	2003	5.00	4.20	16,605,000*	2014	6.00	4.90
9,605,000*	2004	5.00	4.30	17,600,000*	2015	6.00	4.93
10,090,000*	2005	5.00	4.40	18,655,000*	2016	6.00	4.96
10,590,000*	2006	5.75	4.45	19,775,000*	2017	5.00	5.15
11,200,000*	2007	5.75	4.50	20,765,000*	2018	5.00	5.17
11,845,000*	2008	5.75	4.52	27,660,000	2024	5.00	95.848

$120,175,000 4.875% Term Bonds due July 1, 2023—Price - 94.430
$ 91,570,000 5.000% Term Bonds due July 1, 2027—Yield - 5.31%

$38,500,000 Public Improvement Refunding Bonds, Series 1998B

Amount	Maturity July 1,	Interest Rate	Price or Yield	Amount	Maturity	Interest Rate	Price or Yield
$3,830,000*	2006	5.75%	4.45%	$ 9,710,000*	2008	5.75%	4.52%
6,090,000*	2007	5.75	4.50	18,870,000*	2009	5.75	4.60

(plus accrued interest)

The Bonds are offered for delivery when, as and if issued and accepted by the Underwriters subject to the approval of legality by Squire, Sanders & Dempsey L.L.P., Bond Counsel and certain other conditions. Certain legal matters will be passed upon for the Underwriters by Pietrantoni Méndez & Alvarez, San Juan, Puerto Rico. It is expected that settlement for the Bonds will occur in New York, New York on or about April 14, 1998.

MORGAN STANLEY DEAN WITTER — **BEAR, STEARNS & CO. INC.** — **GOLDMAN, SACHS & CO.**
MERRILL LYNCH & CO. — **PAINEWEBBER INCORPORATED**

RAYMOND JAMES & ASSOCIATES INC. — **JP MORGAN & CO.** — **PRUDENTIAL SECURITIES INCORPORATED**
SAMUEL A. RAMIREZ & CO., INC. — **SALOMON SMITH BARNEY**

April 2, 1998

*Insured by MBIA Insurance Corporation.

Commonwealth of Puerto Rico

Governor

PEDRO ROSSELLÓ

Members of the Cabinet

ANGEL MOREY
Chief of Staff

NORMA E. BURGOS ANDÚJAR
Secretary of State

VÍCTOR FAJARDO
Secretary of Education

MIGUEL A. MUÑOZ MUÑOZ
Secretary of Agriculture

CARMEN L. RODRÍGUEZ RODRÍGUEZ
Secretary of Family Affairs

JOSÉ A. ALICEA
Secretary of Consumer Affairs

JOSÉ A. FUENTES AGOSTINI
Secretary of Justice

CÉSAR ALMODÓVAR MARCHANY
Secretary of Labor and Human Resources

CARLOS I. PESQUERA MORALES
Secretary of Transportation and Public Works

ANA CARMEN ALEMAÑY
Secretary of Housing

ERIC R. LABRADOR ROSA
Secretary of Sports and Recreation

XENIA VÉLEZ SILVA
Secretary of the Treasury

CARMEN FELICIANO DE MELECIO
Secretary of Health

CARLOS J. VIVONI
Secretary of Economic Development and Commerce

DANIEL PAGÁN ROSA
Secretary of Natural and Environmental Resources

NYDIA COTTO VIVES
Secretary of Corrections and Rehabilitation

PEDRO TOLEDO
Commissioner of Protection and Public Safety

Legislative Officers

CHARLIE RODRÍGUEZ
President, Senate

EDISON MISLA ALDARONDO
Speaker, House of Representatives

Fiscal Officers

JORGE E. APONTE HERNÁNDEZ
Director, Office of Management and Budget

MARCOS RODRÍGUEZ-EMA
President, Government Development Bank for Puerto Rico

Others

NORMA E. BURGOS ANDÚJAR
President, Planning Board

XAVIER ROMEU
Director, Federal Affairs Office

No dealer, broker, sales representative or other person has been authorized by the Commonwealth or the Underwriters to give any information or to make any representations other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by the Commonwealth or any Underwriter. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the Bonds, by any person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale. The information set forth herein has been obtained from the Commonwealth, MBIA Insurance and other official sources that are believed to be reliable, but is not guaranteed as to accuracy or completeness and is not to be construed as a representation by any Underwriter. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Commonwealth since the date hereof.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE BONDS OFFERED HEREBY AND THE COMMONWEALTH'S OUTSTANDING GENERAL OBLIGATION BONDS AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

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$538,500,000

Commonwealth of Puerto Rico

$500,000,000 Public Improvement Bonds of 1998

$38,500,000 Public Improvement Refunding Bonds, Series 1998B

(General Obligation Bonds)

INTRODUCTORY STATEMENT

This Official Statement of the Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico"), which includes the cover page and the appendices, provides certain information in connection with the sale of $500,000,000 Commonwealth of Puerto Rico Public Improvement Bonds of 1998 (the "Public Improvement Bonds"), and $38,500,000 Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 1998B (the "Refunding Bonds", and together with the Public Improvement Bonds, the "Bonds"). The Public Improvement Bonds maturing July 1 of the years 2002 through 2018 and the Refunding Bonds (collectively, the "Insured Bonds") will be respectively insured by separate financial guaranty insurance policies (collectively, the "MBIA Bond Insurance Policies") issued by MBIA Insurance Corporation ("MBIA Insurance").

The Public Improvement Bonds are being issued under the provisions of Act No. 81 of the Legislature of Puerto Rico, approved August 14, 1997 ("Act No. 81"), and pursuant to a resolution authorizing the issuance of the Public Improvement Bonds (the "Public Improvement Bond Resolution") adopted by the Secretary of the Treasury and approved by the Governor of Puerto Rico on April 2, 1998. The Refunding Bonds are being issued under the provisions of Act No. 2 of the Legislature of Puerto Rico, approved October 10, 1985, and Joint Resolution No. 57 of the Legislature of Puerto Rico, approved July 12, 1993 (collectively, "Act No. 2", and together with Act No. 81, the "Act") and pursuant to a resolution authorizing the issuance of the Refunding Bonds (the "Refunding Bond Resolution", and together with the Public Improvement Bond Resolution, the "Bond Resolution") adopted by the Secretary of the Treasury and approved by the Governor of Puerto Rico on April 2, 1998.

Under the Act, the good faith, credit and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal of and interest on the Bonds. The Constitution of Puerto Rico provides that public debt of the Commonwealth, including the Bonds, constitutes a first claim on available Commonwealth revenues.

This Official Statement includes the cover page, the Appendices and the general purpose financial statements of the Commonwealth for the fiscal year ended June 30, 1997, together with the independent auditor's report thereon, dated December 15, 1997, of Deloitte & Touche LLP, certified public accountants (the "Commonwealth Financial Statements"), which are incorporated herein by reference. The Commonwealth Financial Statements have been filed by the Commonwealth with each nationally recognized municipal securities information repository ("NRMSIR") and with the Municipal Securities Rulemaking Board (the "MSRB") as part of the Comprehensive Annual Financial Report of the Commonwealth for the fiscal year ended June 30, 1997 contained in *Appendix II* to the Official Statement of the Commonwealth, dated January 15, 1998, relating to the sale of $503,963,264.10 Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 1998 (General Obligation Bonds).

Any appendix of an Official Statement of the Commonwealth or of any instrumentality of the Commonwealth filed with each NRMSIR and the MSRB or any other document containing the Commonwealth Financial Statements filed with each NRMSIR after the date hereof and prior to the termination of the offering of the Bonds shall be deemed to be incorporated by reference into this Official Statement and to be part of this Official Statement from the date of filing of such document. Any statement contained herein or in any of the above described documents incorporated herein by reference shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any other subsequently filed document modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

The Commonwealth will provide without charge to any person to whom this Official Statement is delivered, on the written or oral request of such person, a copy of the Commonwealth Financial Statements so incorporated herein by reference. Requests for such document should be directed to Director-New York Office, Government Development Bank for Puerto Rico, 140 Broadway, 38th Floor, New York, N.Y. 10005, telephone number (212) 422-6420, or to Director-General Obligations Division, Government Development Bank for Puerto Rico, P.O. Box 42001, Santurce, PR 00940, telephone number (787) 722-7060.

A copy of the Commonwealth Financial Statements may be obtained by contacting a NRMSIR. The address of each NRMSIR is set forth in *Continuing Disclosure* below.

OVERVIEW

The following is a summary of certain information regarding the Commonwealth contained in *Appendix I* and does not purport to be complete. This summary is qualified in its entirety by reference to more detailed information appearing in *Appendix I*, which should be read in its entirety.

Puerto Rico is located approximately 1,600 miles southeast of New York City. Its population was estimated to be 3,770,000 in fiscal 1997. Puerto Rico's constitutional status is that of an unincorporated territory of the United States and the ultimate source of power over Puerto Rico, pursuant to the territorial clause of the Federal Constitution, is the United States Congress. The Government of Puerto Rico exercises virtually the same control over its internal affairs as do the fifty states, with similar separation of powers among the executive, legislative and judicial branches. The official languages of Puerto Rico are Spanish and English.

Economic Trends

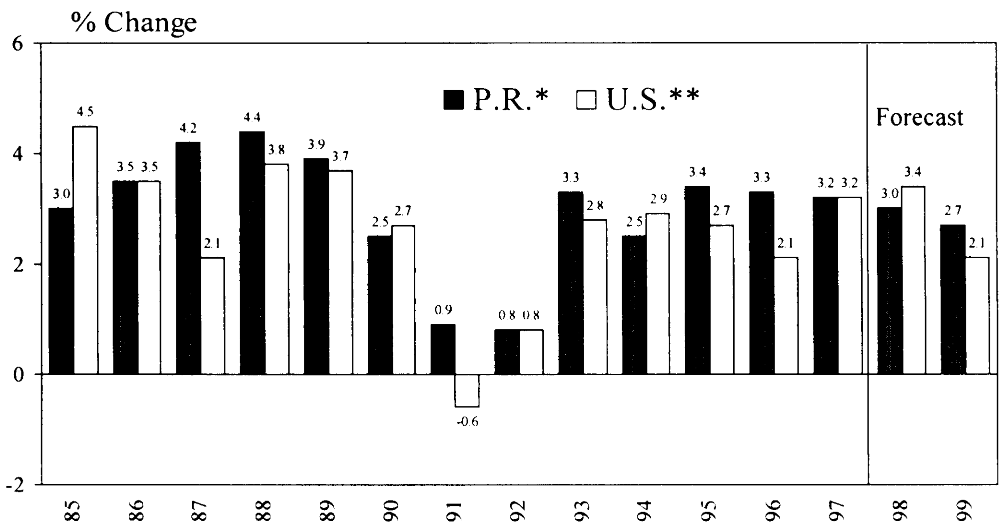
Puerto Rico's more than decade-long economic expansion continued throughout the five-year period from fiscal 1993 through fiscal 1997. Almost every sector of the economy participated and record levels of employment were achieved. Factors behind this expansion included government-sponsored economic development programs, periodic declines in the exchange value of the United States dollar, increases in the level of federal transfers, and the relatively low cost of borrowing.

Gross product in fiscal 1993 was $25.1 billion ($24.5 billion in 1992 prices) and gross product in fiscal 1997 was $32.1 billion ($27.7 billion in 1992 prices). This represents an increase in gross product of 27.7% from fiscal 1993 to 1997 (13.0% in 1992 prices). Since fiscal 1985, personal income, both aggregate and per capita, has increased consistently each fiscal year. In fiscal 1997, aggregate personal income was $32.1 billion ($30.0 billion in 1992 prices) and personal income per capita was $8,509 ($7,957 in 1992 prices).

Average monthly employment increased from 999,000 in fiscal 1993, to 1,092,300 in fiscal 1996 and 1,128,300 in fiscal 1997. Average monthly unemployment decreased from 16.8% in fiscal 1993, to 13.1% in fiscal 1997. According to the Labor Department's Household Employment Survey, during fiscal 1997 total average monthly employment increased 3.3% over fiscal 1996. During the first eight months of fiscal 1998, total average monthly employment increased 0.4% over the same period in fiscal 1997. Total average monthly employment was 1,129,000 during the first eight months of fiscal 1998, compared to 1,124,500 in the same period of fiscal 1997. The seasonally adjusted unemployment rate for February 1998 was 14.1%.

According to the Planning Board's preliminary data released in February, 1998, the growth rate of real gross product for fiscal 1997 was 3.2%. The Planning Board's forecast for real gross product for fiscal 1998 projects an increase of 3.0% over fiscal 1997.

Real Rates of Growth of GNP



* 98 and 99 represents base line forecast.

** DRI Forecast 3/98.

Puerto Rico has a diversified economy with the manufacturing and service sectors comprising the principal sectors. Manufacturing is the largest sector in terms of gross domestic product. According to the Planning Board's preliminary figures, in fiscal 1997 manufacturing generated $19.8 billion, or 41.2% of gross domestic product and accounted for 14.4% of total employment; as compared with fiscal 1996, when it generated $19.0 billion, or 41.8%, of gross domestic product and accounted for 15.3% of total employment. See "Economic Performance by Sector" under *The Economy* in *Appendix I.* Manufacturing in Puerto Rico is now more diversified than during the earlier phases of Puerto Rico's industrial development. In the last two decades, industrial development has tended to be more capital intensive and more dependent on skilled labor. This gradual shift in emphasis is best exemplified by the heavy investment in the pharmaceutical, scientific instruments, computer, microprocessor, medical product and electrical product industries over the last decade. One of the factors assisting the development of the manufacturing sector has been the tax incentives offered by the federal and Puerto Rico governments. Federal legislation enacted in August 1996, however, amended Internal Revenue Code Section 936 to phase out the federal tax incentives during a ten-year period. See "Tax Incentives—Sections 30A and 936 of the Code" under *The Economy* in *Appendix I.*

The services sector, which includes hotel and related services and which, during fiscal 1997, accounted for approximately 48.8% of total employment, accounted for $18.4 billion, or 38.2%, of Puerto Rico's gross domestic product in fiscal 1997, as compared with $17.5 billion, or 38.3%, of gross domestic product in fiscal 1996. The services sector, particularly wholesale and retail trade and finance, insurance and real estate, has experienced significant growth partly in response to the expansion of the manufacturing sector.

Growth in construction and tourism has also contributed to increased economic activity in fiscal 1997. The growth in the construction industry has been evidenced by a nominal increase of 14.7 % in construction investment for fiscal 1997 over fiscal 1996. Tourism has grown in each fiscal year since fiscal 1985. More than 4.3 million visitors spent over $2.0 billion in Puerto Rico in fiscal 1997. San Juan has become the largest home port for cruise ships in the Caribbean and the second largest home port for cruise ships in the world. Twenty-four U.S. and international airlines offer scheduled service to and from San Juan, and a major U.S. airline uses San Juan as a hub for its intra-Caribbean operations. This reflects the importance of Puerto Rico as a tourist destination and as a transportation hub in the Caribbean.

Fiscal Management

Fiscal responsibility for the Commonwealth is shared among the Department of the Treasury, the Office of Management and Budget and Government Development Bank for Puerto Rico ("Government Development Bank"). The Department of the Treasury is responsible for collecting most of the Commonwealth's revenues, overseeing preparation of its financial statements and contributing to the preparation of the budget. The Office of Management and Budget prepares the Commonwealth's budget and has the responsibility for monitoring expenditures. Government Development Bank is the fiscal agent and financial advisor to the Commonwealth and its agencies, public corporations and municipalities and coordinates the management of public finances.

Section 7 of Article VI of the Constitution of Puerto Rico provides that "The appropriations made for any fiscal year shall not exceed the total revenues, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided by law."

Since fiscal 1990 the complete financial statements of the Commonwealth have been audited. The financial statements for the Commonwealth for fiscal 1997 have been audited by Deloitte & Touche LLP. Such statements have been incorporated herein by reference. For a summary of the Commonwealth's significant accounting policies, see Note 1 to the Commonwealth Financial Statements. Preparation of the audited financial statements of the Commonwealth involves the collection and combination of audited financial statements from 48 separate reporting entities.

Debt Management

The Constitution of Puerto Rico provides a limitation on the amount of general obligation debt that can be issued. The Commonwealth's policy has been and continues to be to maintain the level of such debt within a prudent range below the constitutional limitation. See "Debt Limitation" under *The Bonds*.

Historically, the Commonwealth has maintained a fiscal policy which provides for a prudent relationship between the growth of public sector debt and the growth of the economic base required to service that debt. In that respect, during the period from fiscal 1992 to 1996, public sector debt and nominal gross product increased 27.5% and 27.7%, respectively. The Commonwealth also has sought opportunities to realize debt service savings by refunding outstanding debt with obligations bearing lower interest rates.

During the period from fiscal 1993 to 1997, however, public sector debt increased 37.0% while nominal gross product increased 27.7%. This higher level of growth of public sector debt over that of nominal gross product is due to the increase during fiscal 1996 and 1997 in the amount of debt incurred to finance certain key infrastructure projects which are important to the development of the economy and are expected to produce long term economic benefits. For fiscal 1996 and 1997, public sector debt increased 10.2% and 10.7%, while nominal gross product increased 6.6% and 5.8%, respectively. This trend of higher levels of public sector debt relative to the growth in nominal gross product is expected to continue during the next few fiscal years as the level of public sector capital investment remains high. See "Trends of Public Sector Debt" under *Debt* and "Economic Performance by Sector - Construction" under *The Economy* in *Appendix I.*

Short-term debt outstanding relative to total debt was 10.6% as of January 31, 1998. Short-term debt consists of debt obligations, other than bonds, issued with an original maturity of three years or less and lines of credit with a remaining maturity of three years or less. Short-term debt outstanding includes $600,000,000 in tax and revenue anticipation notes issued on December 3, 1997 and maturing on July 30, 1998. Excluding said tax and revenue anticipation notes, short term debt outstanding relative to total debt outstanding as of January 31, 1998 was 7.9%.

PLAN OF FINANCING

The Public Improvement Bonds

The net proceeds of the Public Improvement Bonds will be deposited in the 1998 Public Improvement Fund established under Act No. 81 to carry out the capital improvement programs authorized by the Legislature, including but not limited to highways and transportation facilities, aqueduct and sewer facilities, schools, health facilities, corrections facilities, agricultural facilities, park and other recreation facilities, flood control and solid waste facilities and other governmental purposes, and for certain extraordinary maintenance requirements of existing public improvements of the Commonwealth.

The Refunding Bonds

The Refunding Bonds will be issued under the provisions of Act No. 2 for the purpose of refunding the following Commonwealth of Puerto Rico Public Improvement Bonds and Public Improvement Refunding Bonds (collectively, the "Refunded Bonds"), such Refunded Bonds being redeemed on the dates, and at the prices, set forth below:

Refunded Bonds	Amount to be Refunded	Interest Rate	Maturity Date July 1,	Redemption Date July 1,	Redemption Price (% of Par)
Public Improvement Refunding Bonds, Series 1988	$ 3,930,000	8.00%	2006	1998	102.00%
Public Improvement Refunding Bonds, Series 1988	6,285,000	8.00	2007	1998	102.00
Public Improvement Refunding Bonds, Series 1988	1,400,000	8.00	2008	1998	102.00
Public Improvement Bonds of 1993	10,110,000	5.85	2009	2002	101.50
Public Improvement Bonds of 1994	8,660,000	6.25	2008	2004	101.50
Public Improvement Bonds of 1994	9,205,000	6.30	2009	2004	101.50
Total	$39,590,000				

The refunding will permit the Commonwealth to realize savings on the aggregate debt service requirements on its general obligation bonds. The Secretary of the Treasury will deposit the net proceeds of the Refunding Bonds and certain other available moneys with State Street Bank and Trust Company, N.A., as Escrow Agent. A portion of the net proceeds and such other available moneys will be invested in noncallable direct obligations of the United States, the principal of and interest on which, with any remaining net proceeds not so invested, will be sufficient to pay the principal of and premium on the Refunded Bonds on the respective redemption dates set forth above, and to pay interest accrued thereon to such dates. None of such dates will be changed by the Secretary of the Treasury. The sufficiency of the amount so deposited, with the investment earnings thereon, to accomplish the refunding of the Refunded Bonds will be verified by Deloitte & Touche LLP, the verification agent. Upon the deposit with the Escrow Agent referred to above, the Refunded Bonds will cease to be outstanding under the terms of their respective authorizing resolutions. Under Act No. 2, once the above deposit of cash and noncallable direct obligations of the United States has been made, all the Refunded Bonds will be deemed not to be outstanding for the purpose of applying the debt limitation under Section 2 of Article VI of the Commonwealth's Constitution.

Sources and Uses of Funds

Sources:	
Principal amount of the Bonds	$538,500,000.00
Accrued Interest	2,274,746.41
Net original issue premium	9,375,996.40
Other available moneys	660,450.00
Total sources	$550,811,192.81
Uses:	
Payment into the 1998 Public Improvement Fund	$499,394,857.57
Deposit to Escrow Fund	42,359,254.00
Deposit to Redemption Fund (as described below)	2,274,746.41
Underwriting discount, municipal bond insurance premium, and legal, printing, and other financing expenses	6,782,334.83
Total uses	$550,811,192.81

THE BONDS

General

The Bonds will be dated, will bear interest at such rates, payable at such times, and will mature on the dates and in the principal amounts set forth on the cover page of this Official Statement. The Refunding Bonds are not subject to redemption prior to maturity. The Public Improvement Bonds are subject to redemption at the times and at the prices set forth below in "Redemption."

Book-Entry Only System

The following information concerning The Depository Trust Company ("DTC"), New York, New York and DTC's book-entry system has been obtained from DTC. Neither the Commonwealth nor the Underwriters take any responsibility for the accuracy thereof.

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully registered Bonds registered in the name of Cede & Co. (DTC's partnership nominee). One fully registered Bond will be issued for each maturity of the Public Improvement Bonds and of the Refunding Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds securities that its participants (the "Participants") deposit with DTC. DTC also facilitates the settlement among Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in Participants' accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations (the "Direct Participants"). DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc. and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as securities brokers and dealers, banks and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (the "Indirect Participants"). The Rules applicable to DTC and its Participants are on file with the Securities and Exchange Commission.

Purchases of the Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of a Bond (a "Beneficial Owner") will in turn be recorded in the Direct or Indirect Participants' records. Beneficial Owners will not receive written confirmations from DTC of their purchases, but Beneficial Owners are expected to receive written confirmation providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds will be accomplished by entries made on the books of Participants acting on behalf of the Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Bonds except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers all Bonds deposited by Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. The deposit of Bonds with DTC and their registration in the name of Cede & Co. effect no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices will be sent to Cede & Co. If less than all of the Bonds within a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in the Bonds to be redeemed.

Neither DTC nor Cede & Co. will consent or vote with respect to the Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to the Commonwealth as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal, redemption premium, if any, and interest payments on the Bonds will be made to DTC. DTC's practice is to credit Direct Participants' accounts on the payable date in accordance with their respective holdings shown on DTC's records unless DTC has reason to believe that it will not receive payment on the payable date. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participant and not of DTC, the Commonwealth, or Banco Popular de Puerto Rico as paying agent and registrar (the "Registrar"), subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, redemption premium, if any, and interest to DTC is the responsibility of the Commonwealth or the Registrar, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the Commonwealth or the Registrar. Under such circumstances, in the event that a successor securities depository is not obtained, definitive Bonds are required to be printed and delivered.

The Commonwealth may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, definitive Bonds will also be printed and delivered.

Payments and Transfers

No assurance can be given by the Commonwealth that DTC will make prompt transfer of payments to the Participants or that Participants will make prompt transfer of payments to Beneficial Owners. The Commonwealth is not responsible or liable for payment by DTC or Participants or for sending transaction statements or for maintaining, supervising or reviewing records maintained by DTC or Participants.

For every transfer and exchange of the Bonds, the Beneficial Owners may be charged a sum sufficient to cover any tax, fee or other charge that may be imposed in relation thereto.

Discontinuance of the Book-Entry Only System

In the event that such book-entry only system is discontinued, the following provisions will apply: principal of and redemption premium, if any, on the Bonds shall be payable in lawful money of the United States of America at the principal office of the Registrar in San Juan, Puerto Rico. Interest on the Bonds will be payable by check mailed to the respective addresses of the registered owners determined as of the applicable record date thereof provided in the Bond Resolution as shown on the registration books of the Commonwealth maintained by the Registrar. The Bonds will be issued only as registered Bonds without coupons in denominations of $5,000 and any multiple thereof. The transfer of the Bonds will be registrable and they may be exchanged at the corporate trust office of the Registrar in San Juan, Puerto Rico, upon the payment of any taxes or other governmental charges required to be paid with respect to such transfer or exchange.

Authorization

Section 2 of Article VI of the Constitution of the Commonwealth provides that the power of the Commonwealth to contract and to authorize the contracting of debts shall be exercised as determined by the Legislature. Pursuant to this power, the Legislature enacted the Act, which authorizes the issuance of the Bonds.

Redemption

The Refunding Bonds are not subject to redemption.

Optional Redemption of Public Improvement Bonds. At the option of the Secretary of the Treasury and upon at least 30 days' notice, the Public Improvement Bonds maturing on or after July 1, 2017 are subject to redemption, from any moneys that may be available for that purpose (other than from moneys set aside in respect of an amortization requirement), prior to maturity, on or after July 1, 2008, either in whole or in part, on any date, as directed by the Secretary of the Treasury, at the redemption prices (expressed as a percentage of principal amount) set forth in the table below, together with accrued interest to the date fixed for redemption:

Period During Which Redeemed	Redemption Price
July 1, 2008 through June 30, 2009	101 %
July 1, 2009 through June 30, 2010	100½
July 1, 2010 and thereafter	100

The Public Improvement Bonds maturing prior to July 1, 2017 are not subject to redemption prior to maturity.

Mandatory Redemption. The term Public Improvement Bonds maturing July 1, 2023 and July 1, 2027 are subject to redemption to the extent of the respective amortization requirements therefor set forth below (less the amount applied to the purchase of any such Bonds and otherwise subject to adjustment as described below), upon at least 30 days' notice, on July 1, 2019 and on July 1, 2025, respectively, and on July 1 in each year thereafter at a redemption price of par plus accrued interest to the dates fixed for redemption:

July 1	Amortization Requirements for Bonds due July 1	
	2023	2027
2019	$21,805,000	
2020	22,865,000	
2021	23,980,000	
2022	25,150,000	
2023	26,375,000 *	
2024		
2025		$29,045,000
2026		30,500,000
2027		32,025,000 *
Average life (years)	23.309	28.246

*Maturity.

If the amount of the term Public Improvement Bonds purchased or redeemed pursuant to an amortization requirement during any fiscal year exceeds the amount of the amortization requirement for such Bonds for such fiscal year, the amortization requirement for such Public Improvement Bonds may be decreased for such subsequent fiscal years and in such amounts aggregating the amount of such excess as the Secretary of the Treasury shall determine.

Notice and Effect of Redemption of Public Improvement Bonds

Any redemption of the Public Improvement Bonds, either in whole or in part, shall be made upon at least thirty (30) days' prior notice by mail to DTC or, if the book-entry only system as described above has been discontinued, by first class mail, postage prepaid, to all registered owners in the manner and under the terms and conditions provided in the Public Improvement Bond Resolution. On the date designated for redemption, notice having been given as provided in the Public Improvement Bond Resolution and moneys for payment of the principal of and redemption premium, if any, and accrued interest on the Public Improvement Bonds or portions thereof so called for redemption being held by the Registrar, interest on the Public Improvement Bonds or portions thereof so called for redemption shall cease to accrue. Subject to certain provisions of the Public Improvement Bond Resolution, Public Improvement Bonds and portions of Public Improvement Bonds which have been duly called for redemption under the provisions of the Public Improvement Bond Resolution, or with respect to which irrevocable instructions to call for redemption or to pay at maturity have been given, and for the payment of the principal of and redemption premium, if any, and the accrued interest on which sufficient moneys or investments permitted by law shall be held in separate trust for the owners of the Public Improvement Bonds or portions thereof to be paid or redeemed, shall not be deemed to be outstanding under the Public Improvement Bond Resolution, and the registered owners thereof shall have no rights in respect thereof except to receive payment of the principal thereof and the redemption premium, if any, and the accrued interest thereon from said separate trust.

Each notice of redemption shall contain, among other things, the CUSIP identification number of the Public Improvement Bonds (or portion thereof) being called for redemption, the redemption date and price and the address at which such Public Improvement Bonds are to be surrendered for payment of the redemption price. Any defect in such notice or the failure so to mail any such notice to DTC in respect of, or the registered owner of, any Public Improvement Bond will not affect the validity of the proceedings for the redemption of any other Public Improvement Bond.

If less than all the Public Improvement Bonds of any maturity are called for redemption, the particular Public Improvement Bonds so called for redemption shall be selected by the Registrar by such method as it deems fair and appropriate, except that so long as the book-entry only system shall remain in effect, in the event of any such partial redemption, DTC shall reduce the credit balances of the applicable DTC Participants in respect of the Public Improvement Bonds and such DTC Participants shall in turn select those Beneficial Owners whose ownership interests are to be extinguished by such partial redemption each by such method as DTC or such DTC Participant, as the case may be, in its sole discretion, deems fair and appropriate.

Security

Provision for Payment of Public Debt

The Act provides that the good faith, credit and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal of and interest on the Bonds issued under the provisions of the Act. The Secretary of the Treasury is authorized and directed under the Act to pay the principal of and interest on the Bonds as the same become due and payable from any funds available for such purpose with the Department of the Treasury in the fiscal year in which such payment is due. The provisions contained in the Act regarding the payment of the principal of and interest on the Bonds are considered to be a continuous appropriation for the Secretary of the Treasury to make such payments, even though no specific appropriations are made for such purposes. Such payments are required to be made pursuant to the provisions of the laws of the Commonwealth that regulate the disbursement of public funds.

The Constitution of Puerto Rico provides that public debt of the Commonwealth will constitute a first claim on available Commonwealth revenues. Public debt includes general obligation bonds and notes of the Commonwealth and any payments required to be made by the Commonwealth under its guarantees of bonds and notes issued by its public instrumentalities.

The Commonwealth has allocated certain motor vehicle fuel taxes, crude oil and derivative products excise taxes and license fees to Puerto Rico Highway and Transportation Authority (the "Highway Authority"). The amounts so allocated, however, are subject to first being applied to payment of the principal of and interest on the Commonwealth public debt, but only if and to the extent that all other available revenues of the Commonwealth are insufficient for that purpose. The Commonwealth has never applied such amounts to the payment of its public debt.

Since fiscal 1989, the Commonwealth has pledged to Puerto Rico Infrastructure Financing Authority certain federal excise taxes imposed on alcoholic beverages and tobacco products produced in Puerto Rico and sold in the United States, which taxes are returned to the Commonwealth. The amounts so pledged, however, are subject to first being applied to payment of the principal of and interest on the Commonwealth public debt, but only if and to the extent that all other available revenues of the Commonwealth are insufficient for that purpose. The Commonwealth has never applied such amounts to the payment of its public debt.

The Constitution expressly empowers a holder of bonds and notes evidencing public debt to bring suit against the Secretary of the Treasury to require application of available revenues, including surplus, to the payment of principal of and interest on public debt when due.

Special Fund for General Obligation Debt Service

Act No. 83, approved August 30, 1991, as amended, provides for the levy of an annual special tax of 1.03% of the assessed value of all real and personal property not exempt from taxation. The proceeds of said tax are credited to the Special Fund for the Amortization and Redemption of General Obligations Evidenced by Bonds and Promissory Notes (the "Redemption Fund"), for application to the payment of general obligation bonds and notes of the Commonwealth.

Act No. 39, approved May 13, 1976, as amended ("Act No. 39"), requires the Secretary of the Treasury to transfer each month from available funds of the Commonwealth to the Redemption Fund such amounts which together with certain funds otherwise deposited therein will be equal to the sum of one-sixth of the interest to be paid in the next six months and one-twelfth of the principal to be paid or required to be amortized within the next twelve months on all bonds and notes of the Commonwealth for which its good faith and credit are pledged as the same become due and for which the guaranty of the Commonwealth has been exercised. Moneys in the Redemption Fund are held in trust by Government Development Bank. Act No. 39 provides that the obligation of the Secretary of the Treasury to make the above transfers is cumulative, and the amount of any deficiency in any month shall be added to the amount of transfers required in future months until such deficiency has been fully paid. On March 15, 1998, the amount on deposit in the Redemption Fund was $150,089,355, which was the required amount.

Act No. 39 expressly relates to direct obligations of the Commonwealth. It may also apply to the payment of Commonwealth guaranteed obligations of public corporations outstanding prior to the date of its adoption but not to the payment of bonds and other obligations of such public corporations guaranteed by the Commonwealth issued after the date of its adoption.

The MBIA Insurance Corporation Insurance Policies

The following information has been furnished by MBIA Insurance for use in this Official Statement. Reference is made to *Appendix III* for a specimen of the MBIA Bond Insurance Policies.

The MBIA Bond Insurance Policies unconditionally and irrevocably guarantee the full and complete payment required to be made by or on behalf of the Commonwealth to the Registrar or its successor of an amount equal to (i) the principal of (either at the stated maturity or by an advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Insured Bonds as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed by the MBIA Bond Insurance Policies shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner of the Insured Bonds pursuant to a final judgement by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law (a "Preference").

The MBIA Bond Insurance Policies do not insure against loss of any prepayment premium which may at any time be payable with respect to any Insured Bond. The MBIA Bond Insurance Policies do not, under any circumstance, insure against loss relating to: (i) optional or mandatory redemptions (other than mandatory sinking fund redemptions); (ii) any payments to be made on an accelerated basis; (iii) payments of the purchase price of Insured Bonds upon tender by an owner thereof; or (iv) any Preference relating to (i) through (iii) above. The MBIA Bond Insurance Policies also do not insure against nonpayment of principal of or interest on the Insured Bonds resulting from the insolvency, negligence or any other act or omission of the Registrar or any other paying agent for the Insured Bonds.

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by MBIA Insurance from the Registrar or any owner of an Insured Bond the payment of an insured amount for which is then due, that such required payment has not been made, MBIA Insurance on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with State Street Bank and Trust Company, N.A., in New York, New York, or its successor, sufficient for the payment of any such insured amounts which are then due. Upon presentment and surrender of such Insured Bonds or presentment of such other proof of ownership of the Insured Bonds, together with any appropriate instruments of assignment to evidence the assignment of the insured amounts due on the Insured Bonds as are paid by MBIA Insurance, and appropriate instruments to effect the appointment of MBIA Insurance as agent for such owners of the Insured Bonds in any legal proceeding related to payment of insured amounts on the Insured Bonds, such instruments being in a form satisfactory to State Street Bank and Trust Company, N.A., State Street Bank and Trust Company, N.A. shall disburse to such owners or the Registrar payment of the insured amounts due on such Insured Bonds, less any amount held by the Registrar for the payment of such insured amounts and legally available therefor.

MBIA Insurance is the principal operating subsidiary of MBIA Inc., a New York Stock Exchange listed company (the "Company"). MBIA Inc. is not obligated to pay the debts of or claims against MBIA Insurance. MBIA Insurance is domiciled in the State of New York and licensed to do business in, and subject to regulation under the laws of, all 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, the Virgin Islands of the United States and the Territory of Guam. MBIA Insurance has two European branches, one in the Republic of France and the other in the Kingdom of Spain. New York has laws prescribing minimum capital requirements, limiting classes and concentrations of investments and requiring the approval of policy rates and forms. State laws also regulate the amount of both the aggregate and individual risks that may be insured, the payment of dividends by MBIA Insurance, changes in control and transactions among affiliates. Additionally, MBIA Insurance is required to maintain contingency reserves on its liabilities in certain amounts and for certain periods of time.

Effective February 17, 1998, the Company acquired all of the outstanding stock of Capital Markets Assurance Corporation ("CMAC"), a New York domiciled financial guarantee insurance company, through a merger with its parent CapMAC Holdings Inc. Pursuant to a reinsurance agreement, CMAC has ceded all of its net insured risks, as well as its unearned premiums and contingency reserves, to MBIA Insurance and MBIA Insurance has reinsured CMAC's net outstanding exposure. The Company is not obligated to pay the debts of or claims against CMAC.

As of December 31, 1996, MBIA Insurance had admitted assets of $4.4 billion (audited), total liabilities of $3.0 billion (audited), and total capital and surplus of $1.4 billion (audited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of September 30, 1997, MBIA Insurance had admitted assets of $5.1 billion (unaudited), total liabilities of $3.4 billion (unaudited), and total capital and surplus of $1.7 billion (unaudited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

Copies of the MBIA Insurance's year end financial statements prepared in accordance with statutory accounting practices are available without charge from MBIA Insurance. A copy of the Annual Report on Form 10K of MBIA Inc. is available from MBIA Insurance or the Securities and Exchange Commission. The address of MBIA Insurance is 113 King Street, Armonk, New York 10504. The telephone number of MBIA Insurance is (914) 273-4545.

Moody's Investors Service ("Moody's") rates the claims paying ability of MBIA Insurance and CMAC "Aaa".

Standard & Poor's Rating Services, a division of The McGraw Hill Companies, Inc. ("Standard & Poor's") rates the claims paying ability of MBIA Insurance and CMAC "AAA".

Fitch IBCA, Inc. (formerly known as Fitch Investors Service, L.P.) ("Fitch"), rates the claims paying ability of MBIA Insurance "AAA" (CMAC has not requested a rating from Fitch).

Each rating of MBIA Insurance should be evaluated independently. The ratings reflect the respective rating agency's current assessment of the creditworthiness of MBIA Insurance and its ability to pay claims on its policies of insurance. Any further explanation as to the significance of the above ratings may be obtained only from the applicable rating agency.

The above ratings are not recommendations to buy, sell or hold the Insured Bonds, and such ratings may be subject to revisions or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market prices of the Insured Bonds. MBIA Insurance does not guaranty the market prices of the Insured Bonds nor does it guaranty that the ratings on the Insured Bonds will not be revised or withdrawn.

Payment Record

The Commonwealth has never defaulted on the payment of principal of or interest on any of its debt.

Debt Limitation

Section 2 of Article VI of the Constitution of Puerto Rico provides that direct obligations of the Commonwealth evidenced by full faith and credit bonds or notes shall not be issued if the amount of the principal of and interest on such bonds and notes and on all such bonds and notes theretofore issued which is payable in any fiscal year, together with any amount paid by the Commonwealth in the preceding fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceeds 15% of the average annual revenues raised under the provisions of Commonwealth legislation and covered into the Treasury of Puerto Rico (hereinafter "internal revenues") in the two fiscal years preceding the then current fiscal year. Section 2 of Article VI does not limit the amount of debt that the Commonwealth may guarantee so long as the 15% limitation is not exceeded. Internal revenues consist principally of income taxes, property taxes and excise taxes. Certain revenues, such as federal excise taxes on offshore shipments of alcoholic beverages and tobacco products and customs duties, which are collected by the United States Government and returned to the Treasury of Puerto Rico, and motor vehicle fuel taxes and license fees, which are allocated to the Highway Authority, are not included as internal revenues for the purpose of calculating the debt limit, although they may be available for the payment of debt service.

On December 21, 1995, Aqueduct and Sewer Authority issued $400,340,000 Puerto Rico Aqueduct and Sewer Authority Refunding Bonds, guaranteed by the Commonwealth of Puerto Rico (the "PRASA Guaranteed Bonds"). On January 1, 1997, the Commonwealth began to make payments of debt service on the PRASA Guaranteed Bonds under the full faith and credit guarantee of the Commonwealth. The amount paid by the

Commonwealth is taken into account as an additional amount of debt service on the Commonwealth's general obligation debt for purposes of computing the above described 15% constitutional debt limitation.

After giving effect to the issuance of the Bonds and the refunding of the Refunded Bonds, future maximum annual debt service for the Commonwealth's outstanding general obligation debt will be $467,765,000 in the fiscal year ending June 30, 2000. See "Debt Service Requirements for Commonwealth General Obligation Bonds and Certain Guaranteed Debt," under *Public Sector Debt of the Commonwealth,* below. Debt service for the PRASA Guaranteed Bonds paid during fiscal 1997 (including for this purpose debt service payments due July 1, 1997) was $20,794,919. The sum of those amounts ($488,559,919) is equal to 9.477% of $5,155,398,500, which is the average of the adjusted internal revenues for the prior two fiscal years ended June 30, 1997.

Maturity Limitation

The Constitution provides that no bonds or notes of the Commonwealth shall mature later than 30 years from their date of issue, except bonds or notes for housing facilities, which shall mature in no more than 40 years.

PUBLIC SECTOR DEBT OF THE COMMONWEALTH

Pro Forma Public Sector Debt

The following table presents a summary of the public sector debt of the Commonwealth as of January 31, 1998 and as adjusted for the issuance of the Bonds and the refunding of the Refunded Bonds. The table should be read in conjunction with the information set forth in *Debt* in *Appendix I*.

Puerto Rico

Public Sector Debt*
(in thousands)

	January 31, 1998	As Adjusted
Puerto Rico direct debt	$ 4,919,668	$ 5,418,578
Municipal debt	880,904	880,904
Public corporations debt		
Puerto Rico guaranteed debt	446,420	446,420
Debt supported by Puerto Rico appropriations or taxes	8,216,736[1]	8,216,736
Other non-guaranteed debt	6,128,558[2]	6,128,558
Total public corporations debt	14,791,714	14,791,714
Total public sector debt	$20,592,286	$21,091,196

* For a complete recital of all notes to this table, see "Public Sector Debt" under *Debt* in *Appendix I*.

(1) On March 19, 1998, Puerto Rico Highway and Transportation Authority issued its $1,129,643,740 Transportation Revenue Bonds (Series A), a portion of which was used to repay a Government Development Bank line of credit and to refund outstanding bonds of the Authority. Also, Puerto Rico Infrastructure Financing Authority issued on April 2, 1998 its $134,660,000 Special Tax Revenue Refunding Bonds, Series 1998 A. After adjusting for such bond issues, the repayment of such line of credit and such refundings, the amount appearing in the table under "Debt supported by Puerto Rico appropriations or taxes" would be $9,058,012,000.

(2) The Puerto Rico Electric Power Authority is expected to issue, on or about April 7, 1998, its $508,555,000 Power Revenue Bonds, Series DD, and $380,515,000 Power Revenue Refunding Bonds, Series EE, a portion of which will be used to repay a Government Development Bank line of credit and to refund outstanding bonds of the Authority. After adjusting for such bond issue, the repayment of such line of credit and such refunding, the amount appearing in the table under "Other non-guaranteed debt" would be $6,604,068,000.

Source: Government Development Bank.

Debt Service Requirements for Commonwealth General Obligation Bonds and Certain Guaranteed Debt

The following table presents debt service requirements for: (i) general obligation bonds of the Commonwealth outstanding on March 15, 1998, excluding the Refunded Bonds; (ii) the Bonds; (iii) all general obligation bonds of the Commonwealth, adjusted to include the issuance of the Bonds and the refunding of the Refunded Bonds; and (iv) the PRASA Guaranteed Bonds. See "Commonwealth Guaranteed Debt" in *Appendix I.* With respect to other debt of Aqueduct and Sewer Authority, see *Public Corporations* in *Appendix I.* Debt service requirements for each fiscal year, as shown in the following table, include principal and interest due on July 1 immediately following the close of such fiscal year.

Puerto Rico
Debt Service Requirements*
(in thousands)

Fiscal Year Ending June 30	Total Debt Service Prior to Issuance of Bonds(1)	Debt Service on Bonds(2)	Adjusted Debt Service(3)			Aqueduct and Sewer Authority Bonds Debt Service	Grand Total
			Principal	Interest	Total		
1998 . . .	$ 399,878	$ 9,940	$ 179,000	$ 230,818	$ 409,818	$ 33,473	$ 443,291
1999 . . .	418,671	35,840	207,951	246,560	454,511	33,530	488,041
2000 . . .	431,925	35,840	235,875	231,890	467,765	33,509	501,273
2001 . . .	425,732	35,839	242,261	219,310	461,571	33,473	495,044
2002 . . .	416,154	35,837	243,619	208,372	451,991	33,542	485,533
2003 . . .	416,271	35,838	177,339	274,770	452,109	32,745	484,854
2004 . . .	380,913	35,835	148,850	267,899	416,749	30,125	446,874
2005 . . .	377,347	35,840	224,492	188,695	413,187	30,127	443,314
2006 . . .	348,502	39,666	186,518	201,649	388,168	30,121	418,288
2007 . . .	326,204	41,706	161,059	206,852	367,910	30,126	398,037
2008 . . .	261,177	44,977	135,373	170,782	306,154	30,131	336,285
2009 . . .	234,320	53,578	145,050	142,848	287,897	30,123	318,021
2010 . . .	254,345	33,623	155,770	132,198	287,967	29,984	317,952
2011 . . .	253,852	33,626	163,832	123,646	287,478	29,928	317,407
2012 . . .	246,805	33,625	173,010	107,421	280,431	30,127	310,558
2013 . . .	229,137	33,624	164,405	98,355	262,760	30,128	292,888
2014 . . .	208,472	33,624	133,673	108,423	242,096	30,125	272,221
2015 . . .	208,656	33,622	139,555	102,724	242,278	30,126	272,404
2016 . . .	208,587	33,621	144,990	97,218	242,208	30,121	272,329
2017 . . .	208,760	33,622	152,287	90,096	242,382	30,122	272,504
2018 . . .	208,664	33,623	158,635	83,653	242,287	30,126	272,413
2019 . . .	187,738	33,625	170,005	51,358	221,363	30,125	251,488
2020 . . .	188,874	33,622	179,690	42,806	222,496	0	222,496
2021 . . .	145,622	33,622	145,740	33,504	179,244	0	179,244
2022 . . .	123,579	33,623	130,970	26,233	157,203	0	157,203
2023 . . .	100,297	33,622	114,220	19,699	133,919	0	133,919
2024 . . .	76,796	33,622	96,610	13,807	110,417	0	110,417
2025 . . .	53,538	33,624	78,530	8,631	87,161	0	87,161
2026 . . .	29,148	33,626	58,260	4,514	62,774	0	62,774
2027 . . .	0	33,626	32,025	1,601	33,626	0	33,626
Total	$7,369,965	$1,045,957	$4,679,591	$3,736,331	$8,415,922	$681,937	$9,097,859

* Totals may not add due to rounding.

(1) Debt service requirements on all general obligation bonds outstanding on March 15, 1998, excluding the Refunded Bonds.

(2) Debt service requirements on the Public Improvement Bonds and the Refunding Bonds.

(3) Debt service requirements on all general obligation bonds outstanding, adjusted to include the issuance of the Bonds and the refunding of the Refunded Bonds.

Sources: Government Development Bank and Department of the Treasury.

TAX EXEMPTION

In the opinion of Bond Counsel, under existing law, (i) interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103(a) of the Internal Revenue Code of 1986, as amended (the "Code"); (ii) interest on the Bonds is not an item of tax preference under Section 57 of the Code for purposes of the alternative minimum tax imposed on individuals and corporations; and (iii) the Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation. Bond Counsel will express no opinion as to any other tax consequences regarding the Bonds.

The opinion on federal tax matters will be based on and will assume the accuracy of certain representations and certifications and compliance with certain covenants of the Commonwealth to be contained in the transcript of proceedings and which are intended to evidence and assure the foregoing, including that the Bonds are and will remain obligations the interest on which is excluded from gross income for federal income tax purposes. Bond Counsel will not independently verify the accuracy of the certifications and representations made by the Commonwealth.

The Code prescribes a number of qualifications and conditions for the interest on obligations such as the Bonds to be and to remain excluded from gross income for federal income tax purposes, some of which, including provisions for potential payments by the Commonwealth to the federal government, require future or continued compliance after issuance in order for the interest to be and continue to be so excluded from the date of issuance. Noncompliance with these requirements by the Commonwealth could cause the interest on the Bonds to be included in gross income for federal income tax purposes and thus to be subject to federal income tax retroactively to the date of their issuance. The Commonwealth will covenant, to the extent permitted by the Constitution and the laws of the Commonwealth, to take actions required of it for the interest on the Bonds to be and to remain excluded from gross income for federal income tax purposes, and not to take any actions that would adversely affect that exclusion. Bond Counsel is not aware of any provision of the Constitution or laws of the Commonwealth which would prevent the Commonwealth from complying with the requirements of the Code.

Under Code provisions applicable only to certain corporations (as defined for federal income tax purposes), a portion of the excess of adjusted current earnings (which includes interest on all tax-exempt obligations, including the Bonds) over other alternative minimum taxable income is included in alternative minimum taxable income which may be subject to a corporate alternative minimum tax. In addition, interest on the Bonds may be subject to a branch profits tax imposed on certain foreign corporations doing business in the United States and to a tax imposed on excess net passive income of certain S corporations.

Under the Code, the exclusion of interest from gross income for federal income tax purposes can have certain adverse federal income tax consequences on items of income, deduction or credit for certain taxpayers, including among them financial institutions, certain insurance companies, FASITs (financial asset securitization investment trusts), recipients of Social Security and Railroad Retirement benefits, those that are deemed to incur or continue indebtedness to acquire or carry tax-exempt obligations and individuals otherwise eligible for the earned income tax credit. The applicability and extent of these or other tax consequences will depend upon the particular tax status or other tax items of the owner of the Bonds. Bond Counsel will express no opinion regarding such consequences.

Ownership of tax-exempt obligations, including the Bonds, may also result in collateral income tax consequences under Puerto Rico law to financial institutions doing business in Puerto Rico.

From time to time, there are legislative proposals in Congress which, if enacted, could alter or amend one or more of the federal income tax matters referred to herein or adversely affect the market value of the Bonds. It cannot be predicted whether or in what form any such proposal might be enacted or whether, if enacted, it would apply to obligations (such as the Bonds) issued prior to enactment.

The discussion of tax matters in this Official Statement applies only in the case of purchasers of the Bonds at their original issuance and at the respective prices or yields indicated on the cover. It does not address any other tax consequences such as, among others, the consequence of the existence of any market discount or premium to subsequent purchasers of the Bonds.

Discount Bonds

The Public Improvement Bonds maturing in July 1 of the years 2017, 2018, 2023, 2024 and 2027 (collectively, the "Discount Bonds"), have been offered and sold to the public at an original issue discount ("OID"). OID is the excess of the stated redemption price at maturity (original principal amount) over the "issue price" of such Discount Bond. The issue price of a Discount Bond is the initial offering price to the public (other than to bond houses, brokers or similar persons acting in the capacity of underwriters or wholesalers) at which a substantial amount of the Discount Bonds of the same maturity are sold pursuant to that offering. For federal income tax purposes, OID accrues to the owner of a Discount Bond over the period to maturity based on the constant yield method, compounded semiannually (or over such shorter permitted compounding interval selected by the owner). The portion of OID that accrues during the period of ownership of a Discount Bond (i) is interest excludable from the owner's gross income for federal income tax purposes to the same extent and subject to the same considerations discussed above as to other interest on the Bonds, and (ii) is added to the owner's tax basis for purposes of determining gain or loss on the maturity, redemption, prior sale or other disposition of that Discount Bond. A purchaser of a Discount Bond at its issue price in the initial public offering who holds that Discount Bond to maturity will realize no gain or loss upon the retirement of that Discount Bond. Owners of Discount Bonds should consult their own tax advisers as to the determination for federal income tax purposes of the amount of OID properly accruable in any period with respect to such Discount Bonds and as to other federal tax consequences and the treatment of OID for state, Commonwealth and local tax purposes.

Premium Bonds

The Public Improvement Bonds maturing in July 1 of the years 1998 through 2016 and the Refunding Bonds (collectively, the "Premium Bonds") have been offered and sold to the public at an issue price in excess of their stated redemption price at maturity (the face amount). This excess constitutes bond premium. For federal income tax purposes, bond premium is amortized over the period to maturity of a Premium Bond, based on the yield to maturity of such Premium Bond, compounded semiannually. No portion of such bond premium is deductible by the owner of a Premium Bond. The tax basis of an owner of a Premium Bond is reduced by the amount of bond premium that accrues during the period of ownership for purposes of determining the owner's gain or loss on the sale, redemption (including redemption at maturity) or other disposition of a Premium Bond. As a result, an owner may realize taxable gain for federal income tax purposes from the sale of a Premium Bond for an amount equal to or less than the amount paid by that owner for the Premium Bond. A purchaser of a Premium Bond at its issue price in the initial offering who holds such Premium Bond to maturity will realize no gain or loss upon the retirement of that Premium Bond. Owners of Premium Bonds should consult their own tax advisers as to the determination for federal income tax purposes of the amount of bond premium properly accruable each year with respect to the Premium Bonds and as to other federal tax consequences and the treatment of bond premium for state, Commonwealth and local tax purposes.

UNDERWRITING

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Bonds from the Commonwealth at an aggregate discount of $3,995,936.93 from the initial public offering prices of the Bonds set forth or derived from information set forth on the cover page hereof. The obligations of the Underwriters are subject to certain conditions precedent, and the Underwriters will be obligated to purchase all the Bonds, if any Bonds are purchased. The Underwriters may offer to sell the Bonds to certain dealers and others at prices lower than the initial public offering prices, and such offering prices may be changed, from time to time, by the Underwriters.

Morgan Stanley & Co. Incorporated ("Morgan Stanley"), a managing underwriter, has entered into a written agreement with Popular Securities, Inc. ("Popular Securities"), a subsidiary of Popular Inc. and an affiliate of Banco Popular de Puerto Rico, Registrar for the Bonds, pursuant to which Popular Securities has agreed to cooperate in connection with Morgan Stanley's provision of underwriting and investment banking services to the Commonwealth with respect to the Bonds. Pursuant to these arrangements, the existence of which has been disclosed to the Commonwealth and Government Development Bank, Popular Securities will be entitled to receive a portion of Morgan Stanley's actual net profits, if any, in connection with the underwriting of the Bonds.

Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), a managing underwriter, has entered into a written agreement with Santander Securities Corporation of Puerto Rico ("Santander Securities"), a subsidiary of Banco Santander, S.A., pursuant to which Santander Securities has agreed to cooperate in connection with Merrill Lynch's provision of underwriting and investment banking services to the Commonwealth with respect to the Bonds. Pursuant to these arrangements, the existence of which has been disclosed to the Commonwealth and Government Development Bank, Santander Securities will be entitled to receive a portion of Merrill Lynch's actual net profits, if any, in connection with the underwriting of the Bonds.

LEGAL MATTERS

The proposed forms of opinions of Squire, Sanders & Dempsey L.L.P., Bond Counsel, are set forth in *Appendix II* to this Official Statement. Certain legal matters will be passed upon for the Underwriters by Pietrantoni Méndez & Alvarez, San Juan, Puerto Rico.

LEGAL INVESTMENT

The Bonds will be eligible for deposit by banks in Puerto Rico to secure public funds and will be approved investments for insurance companies to qualify them to do business in Puerto Rico, as required by law.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

Deloitte & Touche LLP will verify from the information provided to them the mathematical accuracy as of the date of the closing on the Bonds of (i) the computations contained in the schedules provided to Deloitte & Touche LLP to determine that the anticipated receipts from the securities and cash deposits listed in such schedules, to be held in escrow, will be sufficient to pay, when due, the principal, interest and call premium payment requirements of the Refunded Bonds (see *Plan of Financing*); and (ii) the computations of yield on both the securities and the Bonds contained in such schedules used by Bond Counsel in its determination that the interest on the Bonds is excludable from gross income for federal income tax purposes. Deloitte & Touche LLP will express no opinion on the assumptions provided to them, nor as to the exclusion from gross income for federal income tax purposes of the interest on the Bonds.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

As required by Act No. 272 of the Legislature of Puerto Rico, approved May 15, 1945, as amended, Government Development Bank has acted as financial advisor to the Commonwealth in connection with the Bonds offered hereby. As financial advisor, Government Development Bank participated in the selection of the Underwriters of the Bonds. Certain of the Underwriters have been selected by Government Development Bank to serve from time to time as underwriters of its obligations and the obligations of the Commonwealth, its instrumentalities and public corporations. Certain of the Underwriters or their affiliates participate in other financial transactions with Government Development Bank.

RATINGS

Moody's and Standard & Poor's have given the Bonds ratings of Baa1 and A, respectively. These ratings do not reflect the MBIA Bond Insurance Policies. Moody's and Standard & Poor's have given the Insured Bonds ratings of Aaa and AAA, respectively. Ratings reflect only the respective views of the rating agencies and an explanation of the significance of each rating may be obtained only from the respective rating agency.

Such rating agencies were provided with materials relating to the Commonwealth and the Bonds and other relevant information, and no application has been made to any other rating agency for the purpose of obtaining a rating on the Bonds.

There is no assurance that such ratings will remain in effect for any given period of time or that they will not be revised downward or withdrawn entirely by either or both of such rating agencies, if in the judgment of either or both, circumstances so warrant. Any such downward revision or withdrawal of such ratings, or either of them, may have an adverse effect on the market prices of the Bonds.

CONTINUING DISCLOSURE

In accordance with the requirements of Rule 15c2-12, as amended (the "Rule"), promulgated by the Securities and Exchange Commission (the "SEC"), the Commonwealth has covenanted in the Bond Resolution for the benefit of the Beneficial Owners (as defined in such Bond Resolution and generally the tax owners of the Bonds):

1. to file within 305 days after the end of each fiscal year commencing with the fiscal year ending June 30, 1998, with each NRMSIR and with any Commonwealth state information depository ("SID"), core financial information and operating data for the prior fiscal year, including (i) the Commonwealth's audited financial statements, prepared in accordance with generally accepted accounting principles in effect from time to time, and (ii) material historical quantitative data (including financial information and operating data) on the Commonwealth and revenues, expenditures, financial operations and indebtedness generally found in this Official Statement; and

2. to file, in a timely manner, with each NRMSIR or with the MSRB and with any Commonwealth SID, notice of any failure of the Commonwealth to comply with paragraph 1 above and of the occurrence of any of the following events with respect to the Bonds if material:

    a. principal and interest payment delinquencies;
    b. non-payment related defaults;
    c. unscheduled draws on debt service reserves reflecting financial difficulties;
    d. unscheduled draws on credit enhancements reflecting financial difficulties;
    e. substitution of credit or liquidity providers, or their failure to perform;
    f. adverse opinions or events affecting the tax-exempt status of the Bonds;
    g. modifications to rights of the holders (including Beneficial Owners) of the Bonds;
    h. bond calls;
    i. defeasances;
    j. release, substitution, or sale of property securing repayment of the Bonds; and
    k. rating changes.

Event (c) is included pursuant to a letter from the SEC staff to the National Association of Bond Lawyers, dated September 19, 1995. However, event (c) may not be applicable, since the terms of the Bonds do not provide for "debt service reserves". For a description of the Bonds, see *The Bonds*. In addition, with respect to the following events:

Events (d) and (e). The Commonwealth does not undertake to provide any notice with respect to credit enhancement added after the primary offering of the Bonds, unless the Commonwealth applies for or participates in obtaining the enhancement.

Event (f). For information on the tax status of the Bonds, see *Tax Exemption.*

Event (h). The Commonwealth does not undertake to provide the above-described event notice of a mandatory scheduled redemption, not otherwise contingent upon the occurrence of an event, if the terms, dates and amounts of redemption are set forth in detail in this Official Statement under "*The Bonds* — Redemption", the only open issue is which Bonds will be redeemed in the case of a partial redemption, notice of redemption is given to the Bondholders as required under the terms of the Bonds, and public notice of the redemption is given pursuant to Securities Exchange Act of 1934 Release No. 34-23856 of the SEC, even if the originally scheduled amounts are reduced by prior optional redemptions or Bond purchases.

The Commonwealth expects to provide the information described in paragraph 1 above by delivering its first bond official statement that includes its financial statements for the preceding fiscal year or, if no such official statement is issued by the 305-day deadline, by delivering its Comprehensive Annual Financial Report and a supplemental report containing other information to the extent necessary to provide the information described in paragraph 1 above by such deadline.

As of April 2, 1998, there is no Commonwealth SID, and the nationally recognized municipal securities information repositories are: Bloomberg Municipal Repository, P.O. Box 840, Princeton, New Jersey 08542-0840; Kenny Information Systems, Inc., Attn: Kenny Repository Service, 65 Broadway, New York, New York 10006; Thompson NRMSIR, 395 Hudson Street, New York, New York 10004, Attn: Municipal Disclosure; and DPC Data Inc., One Executive Drive, Fort Lee, New Jersey 07024.

The Commonwealth may from time to time choose to provide notice of the occurrence of certain other events in addition to those listed above if, in the judgment of the Commonwealth, such other events are material with respect to the Bonds, but the Commonwealth does not undertake to provide any such notice of the occurrence of any material event except those events listed above.

The Commonwealth acknowledges that its undertaking pursuant to the Rule described above is intended to be for the benefit of the Beneficial Owners of the Bonds, and shall be enforceable by any such Beneficial Owners; provided that the right to enforce the provisions of its undertaking shall be limited to a right to obtain specific enforcement of the Commonwealth's obligations hereunder.

No Beneficial Owner may institute any suit, action or proceeding at law or in equity ("Proceeding") for the enforcement of the foregoing covenants (the "Covenants") or for any remedy for breach thereof, unless such Beneficial Owner shall have filed with the Commonwealth written notice of any request to cure such breach, and the Commonwealth shall have refused to comply within a reasonable time. All Proceedings shall be instituted only in a Commonwealth court located in the Municipality of San Juan, Puerto Rico for the equal benefit of all Beneficial Owners of the outstanding Bonds benefitted by the Covenants, and no remedy shall be sought or granted other than specific performance of any of the Covenants at issue. Moreover, Proceedings filed by Beneficial Owners against the Commonwealth may be subject to the sovereign immunity provisions of Section 2 of Act No. 104, approved June 29, 1955, as amended (32 L.P.R.A. §3077 and §3077a), which governs the scope of legal actions against the Commonwealth, substantially limits the amount of monetary damages that may be awarded against the Commonwealth and provides certain notice provisions, the failure to comply with which may further limit any recovery.

The Covenants may only be amended if:

(1) the amendment is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the Commonwealth, or type of business conducted; the Covenants, as amended, would have complied with the requirements of the Rule at the time of award of the Bonds, after taking into account any amendments or change in circumstances; and the amendment does not materially impair the interest of Beneficial Owners, as determined by persons unaffiliated with the Commonwealth; or

(2) all or any part of the Rule, as interpreted by the staff of the SEC at the date of the adoption of such Rule, ceases to be in effect for any reason, and the Commonwealth elects that the Covenants shall be deemed amended accordingly.

The Commonwealth has further agreed that the annual financial information containing any amended operating data or financial information will explain, in narrative form, the reasons for the amendment and the impact of the change in the type of operating data or financial information being provided.

Any assertion of beneficial ownership must be filed, with full documentary support, as part of the written request described above.

The Covenants have been made in order to assist the Underwriters in complying with the Rule.

MISCELLANEOUS

The foregoing summaries of or references to the various acts, the Bonds, the Bond Resolution and the summaries of or references to the various acts contained in *Appendix I*, are made subject to all the detailed provisions thereof to which reference is hereby made for further information and do not purport to be complete statements of any or all of such provisions.

Appended to and constituting a part of this Official Statement is certain information concerning the Commonwealth *(Appendix I)*, the proposed forms of opinion of Bond Counsel *(Appendix II)*, and the specimen insurance policies of MBIA Insurance *(Appendix III)*.

The information set forth in this Official Statement, except for information pertaining to DTC, was supplied by certain officials of the Commonwealth or certain of its agencies or instrumentalities, in their respective official capacities, or was obtained from publications of the Commonwealth or certain of its agencies or instrumentalities, and is included in this Official Statement on the authority of such officials or the authority of such publications as public official documents. The information pertaining to DTC was supplied by DTC and the information pertaining to MBIA Insurance was supplied by MBIA Insurance.

This Official Statement will be filed with each NRMSIR and with the MSRB.

COMMONWEALTH OF PUERTO RICO

By: /s/ Xenia Vélez Silva
Secretary of the Treasury

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APPENDIX I

COMMONWEALTH OF PUERTO RICO

Geographic Location and Demography

Puerto Rico, the fourth largest of the Caribbean islands, is located approximately 1,600 miles southeast of New York City. It is approximately 100 miles long and 35 miles wide.

According to the United States Census Bureau, the population of Puerto Rico was approximately 3,522,000 in 1990, compared to 3,196,520 in 1980. According to estimates of the Planning Board, the population of Puerto Rico increased to 3,770,000 in fiscal 1997. As of 1990, the population of San Juan, the island's capital and largest city, was approximately 437,000.

Relationship with the United States

Puerto Rico was discovered by Columbus in 1493 and shortly thereafter the island was conquered and settled by the Spaniards. It remained a Spanish possession for four centuries.

Puerto Rico came under United States sovereignty pursuant to the Treaty of Paris, signed on December 10, 1898, which ended the Spanish-American War. Puerto Ricans became citizens of the United States in 1917, with the approval of the Jones Act by the United States Congress. In 1950, after a long evolution toward greater self-government, Congress enacted Public Law 600 which provided that the existing political, economic, and fiscal relationship between Puerto Rico and the United States would remain the same, but Puerto Rico would be authorized to draft and approve its own Constitution, guaranteeing a republican form of government. The Constitution was drafted by a popularly elected constitutional convention, approved in a special referendum by the people of Puerto Rico, amended and ratified by the United States Congress, and subsequently approved by the President of the United States. Puerto Rico's constitutional status is that of a territory of the United States, and pursuant to the territorial clause of the Federal Constitution, the ultimate source of power over Puerto Rico is the United States Congress. The relationship between the United States and Puerto Rico is referred to herein as commonwealth status.

Puerto Rico exercises virtually the same control over its internal affairs as do the fifty states; however, it differs from the states in its relationship with the federal government. The people of Puerto Rico are citizens of the United States but do not vote in national elections. They are represented in Congress by a Resident Commissioner who has a voice in the House of Representatives and limited voting power. Most federal taxes, except those such as Social Security taxes, are not levied in Puerto Rico. No federal income tax is collected from Puerto Rico residents on income earned in Puerto Rico, except for certain federal employees who are subject to taxes on their salaries. Income earned by Puerto Rico residents from sources outside of Puerto Rico, however, is subject to federal income tax. Federal excise taxes on shipments of alcoholic beverages from Puerto Rico and other rum producing countries (which are at $11.30 per gallon through October 1, 1998, and thereafter at $10.50 per gallon) and other taxes on shipments of tobacco products from Puerto Rico to the mainland are returned to the Treasury of Puerto Rico. The fiscal 1999 budget submitted to Congress proposes to increase the amount of federal excise taxes returned to the Treasury of Puerto Rico to $13.50 per gallon.

The official languages of Puerto Rico are Spanish and English. Although the culture of Puerto Rico is mostly Hispanic, a considerable intermingling of Hispanic and United States cultures has occurred.

On February 26, 1997 legislation was introduced in the U.S. House of Representatives (the "Political Status Act") proposing a mechanism to settle permanently the political relationship between Puerto Rico and the United States, either through full self-government (e.g., statehood or independence, including, as an alternative, free association via a bilateral treaty) or continued commonwealth status. Under the proposed legislation, failure to settle on full self-government after completion of the referenda process provided therein would result in retention of the current commonwealth status. On March 19, 1997, similar legislation was introduced in the U.S. Senate. On March 4, 1998, the U.S. House of

Representatives voted in favor of the Political Status Act. It is not possible at this time to predict, however, what course the legislation will follow in the Senate, and whether it will be subsequently enacted into law.

Governmental Structure

The Constitution of the Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico") provides for the separation of powers of the executive, legislative, and judicial branches of government. The Governor is elected every four years. The Legislature consists of a Senate and a House of Representatives, the members of which are elected for four-year terms. The highest court within the local jurisdiction is the Supreme Court of Puerto Rico. Decisions of the Supreme Court of Puerto Rico may be appealed to the Supreme Court of the United States under the same terms and conditions as decisions from state courts. Puerto Rico constitutes a District in the Federal Judiciary and has its own United States District Court. Decisions of this court may be appealed to the United States Court of Appeals for the First Circuit and from there to the Supreme Court of the United States.

Governmental responsibilities assumed by the central government of Puerto Rico are similar in nature to those of the various state governments. In addition, the central government assumes responsibility for local police and fire protection, education, public health and welfare programs, and economic development.

Pedro Rosselló was sworn in as Governor of Puerto Rico on January 2, 1993. He was re-elected for a second four year term in the November 1996 elections and sworn in again as Governor of Puerto Rico on January 2, 1997. He obtained a medical degree from Yale University in 1970, after completing his undergraduate studies at Notre Dame University in 1966. He specialized in General and Pediatric Surgery at Harvard University. In 1985, he was appointed Director of San Juan's Health Department, a position which he held for three years. As a member of the New Progressive Party, he was the party's candidate for Resident Commissioner to the United States Congress in 1988. In 1991, he was elected President of the New Progressive Party.

Xenia Vélez Silva, Secretary of the Treasury, took office on November 20, 1997. She is a graduate of the University of Puerto Rico, where she obtained a bachelor's degree in Business Administration and a Juris Doctor degree. Prior to her appointment, she was a partner in a San Juan law firm specializing in tax law.

Jorge E. Aponte Hernández, Director of the Office of Management and Budget, took office in January 1993. In November 1996, he was re-appointed by the Governor to continue in his position. He is a certified public accountant and a graduate of the University of Puerto Rico, where he obtained a bachelor's degree in Business Administration and Accounting. Prior to his appointment, he worked for twenty years as an accountant and auditor for various accounting firms.

Marcos Rodríguez-Ema, President of Government Development Bank for Puerto Rico ("Government Development Bank" or "GDB"), took office in January 1993. In November 1996, he was re-appointed by the Governor to continue in his position. He is a lawyer and a graduate of Georgetown University, where he obtained a Juris Doctor degree after completing his bachelor of science degree in foreign service. Prior to his appointment, he worked for five years as a lawyer in a San Juan law firm and for six years as an investment banker for two major securities firms.

Political Trends

For many years there have been two major views in Puerto Rico with respect to the island's relationship with the United States: one favoring statehood, represented by the New Progressive Party, and the other favoring the existing commonwealth status, represented by the Popular Democratic Party. The following table shows the percentages of the total vote received by the gubernatorial candidates of the various parties in the last five elections by voter preference with respect to statehood, commonwealth status, and independence. While the electoral choices of Puerto Rico's voters are not based solely on preferences regarding the island's relationship with the United States, candidates who support a continuing relationship between Puerto Rico and the United States have prevailed in elections for many years.

	1980	1984	1988	1992	1996
New Progressive Party	47.3%	45.5%	45.8%	49.9%	51.1%
Popular Democratic Party	47.0	48.5	48.7	45.9	44.5
Puerto Rico Independence Party	5.4	3.9	5.4	4.2	3.8
Others	0.3	2.1	0.1	--	0.6

With the results of the 1996 election, control of the executive and legislative branches continued under the New Progressive Party. The composition of the Senate and House by the several political parties is as follows:

	Senate	House
New Progressive Party	19	37
Popular Democratic Party	8	16
Puerto Rico Independence Party	1	1
	28	54

The next general election (gubernatorial, municipal, and legislative) in Puerto Rico will be held in November 2000. Voter participation in Puerto Rico is substantially higher than in the United States, averaging 85% since 1972.

THE ECONOMY

General

The Government of Puerto Rico has established policies and programs directed at developing the manufacturing and service sectors (with emphasis on the tourism industry) of the economy and expanding and modernizing the island's infrastructure. Domestic and foreign investment has been stimulated by selective tax exemption, development loans, and other financial and tax incentives. Infrastructure expansion and modernization have been to a large extent financed by bonds and notes issued by the Commonwealth, its public corporations and municipalities. Economic progress has been aided by significant increases in the levels of education and occupational skills of the island's population.

The economy of Puerto Rico is fully integrated with that of the United States mainland. During fiscal 1997, approximately 88% of Puerto Rico's exports went to the United States mainland, which was also the source of approximately 62% of Puerto Rico's imports. In fiscal 1997, Puerto Rico experienced a $2.7 billion positive adjusted merchandise trade balance.

The dominant sectors of the Puerto Rico economy are manufacturing and services. The manufacturing sector has experienced a basic change over the years as a result of increased emphasis on higher wage, high technology industries, such as pharmaceuticals, electronics, computers, microprocessors, professional and scientific instruments, and certain high technology machinery and equipment. The services sector, including finance, insurance, real estate, wholesale and retail trade, and hotel and related services, also plays a major role in the economy. It ranks second only to manufacturing in contribution to the gross domestic product and leads all sectors in providing employment. In recent years, the services sector has experienced significant growth in response to the expansion of the manufacturing sector.

Fiscal 1993 to 1997

Puerto Rico's more than decade-long economic expansion continued throughout the five-year period from fiscal 1993 through fiscal 1997. Almost every sector of the economy participated and record levels of employment were achieved. Factors behind this expansion included government-sponsored economic development programs, periodic declines in the exchange value of the United States dollar, increases in the level of federal transfers, and the relatively low cost of borrowing.

Gross product in fiscal 1993 was $25.1 billion ($24.5 billion in 1992 prices) and gross product in fiscal 1997 was $32.1 billion ($27.7 billion in 1992 prices). This represents an increase in gross product of 27.7% from fiscal 1993 to 1997 (13.0% in 1992 prices).

Since fiscal 1985, personal income, both aggregate and per capita, has increased consistently each fiscal year. In fiscal 1997, aggregate personal income was $32.1 billion ($30.0 billion in 1992 prices) and personal income per capita was $8,509 ($7,957 in 1992 prices).

Personal income includes transfer payments to individuals in Puerto Rico under various social programs. Total federal payments to Puerto Rico, which include transfers to local government entities and expenditures of federal agencies in Puerto Rico, in addition to federal transfer payments to individuals, are lower on a per capita basis in Puerto Rico than in any state. Transfer payments to individuals in fiscal 1997 were $7.3 billion, of which $5.2 billion, or 71.6%, represented entitlements to individuals who had previously performed services or made contributions under programs such as Social Security, Veterans' Benefits, Medicare and U.S. Civil Service retirement pensions.

Average employment increased from 999,000 in fiscal 1993, to 1,128,300 in fiscal 1997. Average unemployment decreased from 16.8% in fiscal 1993, to 13.1% in fiscal 1997.

The following table shows the gross product for the five fiscal years ended June 30, 1997.

Puerto Rico

Gross Product

	Fiscal Year Ended June 30,				
	1993	1994	1995	1996	1997(p)
Gross product — $ millions	$25,133	$26,641	$28,452	$30,331	$32,102
Real gross product — $ millions (1992 prices)	24,483	25,103	25,968	26,827	27,673
Annual percentage increase in real gross product (1992 prices)	3.3%	2.5%	3.4%	3.3%	3.2%
U.S. annual percentage increase in real gross product (1992 prices)(1)	2.8%	2.6%	2.7%	2.1%	3.2%

(p) Preliminary.
(1) Restated to correspond to Puerto Rico's fiscal year ending June 30.

Sources: Planning Board and Data Resources Inc.

Since the 1950's the Planning Board has prepared a complete set of macroeconomic measures like those prepared for the United States by the Bureau of Economic Analysis ("BEA") of the Department of Commerce. In contrast with the BEA, which computes the economic accounts on a quarterly basis, the Planning Board computes the economic accounts on an annual basis. Like the BEA, the Planning Board revises the macroeconomic numbers on a regular basis. The Planning Board has always classified the latest annual numbers as preliminary until they are revised in conjunction with the release of the new data each year. At present, all macroeconomic accounts for fiscal 1997 are preliminary until the revised figures are released.

Fiscal 1998

According to the Labor Department's Household Employment Survey, during the first eight months of fiscal 1998, total employment increased 0.4% over the same period in fiscal 1997. Total monthly employment averaged 1,129,000 during the first eight months of fiscal 1998, compared to 1,124,500 in the same period of fiscal 1997. The seasonally adjusted unemployment rate for February 1998 was 14.1%.

The Planning Board's gross product forecast for fiscal 1998, made in February 1998, projected an increase of 3.0% over fiscal 1997.

Economic Development Program - New Economic Model

Governor Rosselló's administration has developed and is implementing a new economic development program which is based on the premise that the private sector should provide the primary impetus for economic development and growth. This new program, referred to as the New Economic Model, promotes changing the role of the government from one of a provider of most basic services, to that of a facilitator for private sector initiatives, and encourages private sector investment by reducing government-imposed regulatory constraints.

The New Economic Model contemplates the development of initiatives that will foster private investment in, and private management of, sectors that are served more efficiently and effectively by private enterprise. One of the initiatives that has already been implemented is the adoption of a new tax code intended to expand the tax base, reduce top personal and corporate tax rates and simplify the tax system. Another initiative consists of improving and expanding Puerto Rico's infrastructure to facilitate private sector development and growth, such as the construction of the water pipeline and cogeneration facilities described below and the construction of a light rail system for the San Juan metropolitan area.

The New Economic Model seeks to identify and promote those areas in which Puerto Rico can compete more effectively in the global markets. In this regard, tourism has been targeted as a priority because of its potential for job creation and increased contribution to the gross product stemming from Puerto Rico's natural competitive advantage. As part of the initiatives directed at promoting the tourism sector, in 1993 a new Tourism Incentives Act was enacted providing special tax incentives for the development of new hotel projects. See "Tax Incentives" below. Also, in November 1993, the Tourism Development Fund was created for the purpose of promoting capital investments in and providing financing to entities that contribute to the development of the tourism industry. As a result of these initiatives, several new hotels have been constructed or are in the process of being constructed, increasing the number of total rooms on the island from 8,415 at the end of fiscal 1992 to 10,877 at the end of fiscal 1997 and to a projected 11,972 by the end of fiscal 1998. Similar tax incentives have been enacted in other areas targeted by the New Economic Model as areas of opportunity for the promotion of local and foreign investment in Puerto Rico, such as agriculture, solid waste management and venture capital.

The New Economic Model also seeks to reduce the size of government's direct contribution to gross domestic product. As part of this goal, the Government has transferred certain governmental operations and sold a number of its assets to private parties. On March 3, 1995, the Government completed the sale of the assets of the Maritime Shipping Authority to a private purchaser. On May 26, 1995, the Aqueduct and Sewer Authority executed a five-year agreement pursuant to which the management, operation, repair, and maintenance of the Authority's water and waste water treatment systems is being provided by a private company. On January 31, 1996, the Aqueduct and Sewer Authority executed a construction and operating agreement with a private consortium for the design, construction, and operation of an approximately 75 million gallon per day pipeline to deliver water to the San Juan metropolitan area from Dos Bocas reservoir in Utuado. The Electric Power Authority has entered into power purchase agreements with private power producers under which two cogenerating plants (with a total capacity of approximately 874 megawatts) using fuels other than oil will be constructed, operated and owned by these producers. The Administration of Corrections has entered into operating agreements with two private companies whereby three new correctional facilities are being operated by these companies. In 1995, the Government entered into a definitive agreement to sell to private companies certain assets of the pineapple juice processing business formerly operated by the Land Authority and sold certain government owned mango growing operations. The Government has transferred to local sugar cane growers the sugar processing facilities formerly operated by the Sugar Corporation. The Government has also sold two hotel properties formerly owned by a subsidiary of the Tourism Company and is currently negotiating the sale of a complex consisting of two hotels and a convention center to a Florida-based corporation. On April 7, 1997, Governor Rosselló announced the Government's intention to sell the Puerto Rico Telephone Company ("PRTC"), a subsidiary of the Telephone Authority. Legislation authorizing the Government to negotiate the sale of PRTC has been approved and the Government is currently conducting the sale process.

One of the goals of the Rosselló administration is to change Puerto Rico's public health care system from one in which the government provides free health services to low income individuals through public health facilities owned and administered by the government to one in which all medical services are provided by the private sector and the government provides comprehensive health insurance coverage for qualifying (generally low income) Puerto Rico residents. Under this new system, the Government selects, through a bidding system, one private health insurance company in each of several designated regions of the island and pays such insurance company the insurance premium for each eligible beneficiary within such region. This new health insurance system is now covering 61 municipalities out of a total of 78 on the island. It is expected that 11 municipalities will be added by the end of fiscal 1998 and 5 more by the end of fiscal 1999. The total cost of this program will depend on the number of municipalities included in the program, the number of participants receiving coverage, and the date coverage commences. As of December 31, 1997, approximately 1.1 million persons were participating in the program at an estimated annual cost to the General Fund of Puerto Rico for fiscal 1998 of approximately $672 million. In conjunction with this program, the operation of certain public health facilities has been transferred to private entities. The Government's current privatization plan for health facilities provides for the transfer of ownership of all health facilities to private entities. The Government has sold six health facilities to private companies and is currently in negotiations with other private companies for the sale of thirteen health facilities to such companies.

Employment and Unemployment

The number of persons employed in Puerto Rico during fiscal 1997 averaged 1,128,300. Unemployment, although at relatively low historical levels, remains above the average for the United States.

The following table presents annual statistics of employment and unemployment from fiscal 1993 through fiscal 1997 and monthly statistics for July 1997 to February 1998.

Puerto Rico

Employment and Unemployment

Fiscal Years Ended June 30	Labor Force[1]	Employed[1]	Unemployed[1]	Unemployment Rate[2]
		(Annual Average)		
1993	1,201	999	202	16.8%
1994	1,204	1,011	193	15.9
1995	1,219	1,051	168	13.8
1996	1,268	1,092	175	13.8
1997	1,298	1,128	170	13.1
Fiscal 1998		(Seasonally Adjusted)		
July	1,309	1,125	184	14.1%
August	1,314	1,141	173	13.2
September	1,337	1,162	175	13.1
October	1,303	1,126	177	13.6
November	1,316	1,132	184	14.0
December	1,298	1,108	190	14.6
January	1,298	1,112	186	14.4
February	1,310	1,126	184	14.1

(1) Thousands of persons age 16 years and over. Totals may not add due to rounding.
(2) Unemployed as percentage of labor force.

Source: Department of Labor and Human Resources — Household Survey.

Economic Performance by Sector

Puerto Rico has a diversified economy. During the period between fiscal 1993 and 1997, the manufacturing and services sectors generated the largest portion of gross domestic product. Three sectors of the economy provide the most employment: manufacturing, services and government.

The following table presents annual statistics of gross domestic product by sector and gross product for the five fiscal years ended June 30, 1997.

Puerto Rico

Gross Domestic Product by Sector and Gross Product
(in millions at current prices)

	Fiscal Year Ended June 30				
	1993	1994	1995	1996	1997(p)
Manufacturing	$15,428	$16,748	$17,867	$19,040	$19,797
Services(1)	14,109	15,214	16,443	17,450	18,365
Government(2)	3,881	3,987	4,440	4,841	5,220
Transportation, communication and public utilities	3,009	3,134	3,276	3,556	3,726
Agriculture, forestry and fisheries	411	369	318	375	368
Construction (3)	874	928	1,005	1,095	1,217
Statistical discrepancy	(789)	(689)	(703)	(846)	(591)
Total gross domestic product(4)	36,923	39,691	42,646	45,511	48,102
Less: net payment abroad	11,790	13,050	14,195	15,180	16,000
Total gross product(4)	$25,133	$26,641	$28,451	$30,331	$32,102

(p) Preliminary.
(1) Includes wholesale and retail trade, finance, insurance and real estate, hotel and related services, and other services.
(2) Includes the Government of Puerto Rico, its municipalities and the federal government; excludes public corporations.
(3) Includes mining.
(4) Totals may not add due to rounding.

Source: Planning Board

The following table presents annual statistics of average employment by sector for the five fiscal years ended June 30, 1997.

Puerto Rico

Average Employment by Sector
(thousands of persons age 16 and over)

	Fiscal Year ended June 30				
	1993	1994	1995	1996	1997
Manufacturing	168	166	172	167	162
Services(1)	467	478	496	527	550
Government(2)	217	224	232	246	261
Transportation, communication and public utilities	54	55	60	61	59
Construction(3)	59	54	57	59	65
Agriculture, forestry and fisheries	34	34	34	32	31
Total(4)	999	1,011	1,051	1,092	1,128

(1) Includes wholesale and retail trade, finance, insurance, real estate, hotels and related services and other services.
(2) Includes the Government of Puerto Rico, its municipalities and federal government; excludes public corporations.
(3) Includes mining.
(4) Totals may not add due to rounding.

Source: Department of Labor and Human Resources — Household Survey.

Manufacturing

Manufacturing is the largest sector in the economy of Puerto Rico, in terms of gross domestic product. The Planning Board estimates that in fiscal 1997 manufacturing generated $19.8 billion, or 41.2% of gross domestic product. The manufacturing sector employed 153,273 workers as of March 1997 (as reported in the Department of Labor and Human Resources — Monthly Survey on Employment Hours and Earnings). Most of the island's manufacturing output is shipped to the United States mainland, which is also the principal source of semifinished manufactured articles on which further manufacturing operations are performed in Puerto Rico. The United States minimum wage laws are applicable in Puerto Rico. As of March 1997 the average hourly manufacturing wage rate in Puerto Rico was 61% of the average mainland United States rate.

Manufacturing in Puerto Rico is now more diversified than during the earlier phases of the industrial development program. In the last two decades, industrial development has tended to be more capital intensive and more dependent on skilled labor. This gradual shift in emphasis is best exemplified by the heavy investment in pharmaceuticals, scientific instruments, computers, microprocessors, medical products, and electrical products industries over the last decade.

The following table sets forth gross domestic product by manufacturing sector for the five fiscal years ended June 30, 1997.

Puerto Rico

Gross Domestic Product by Manufacturing Sector
(in millions at current prices)

	Fiscal Year Ended June 30				
	1993	**1994**	**1995**	**1996**	**1997(p)**
Pharmaceuticals	$7,249	$8,229	$8,994	$9,488	$9,847
Machinery and metal products	3,226	3,310	3,371	4,215	4,476
Food products	2,456	2,694	2,707	2,686	2,729
Apparel	548	504	624	653	627
Other(1)	1,949	2,010	2,171	1,998	2,118
Total gross domestic product of manufacturing sector(2)	$15,428	$16,748	$17,867	$19,040	$19,797

(p) Preliminary.
(1) Includes petroleum products; petrochemicals and other chemical products; tobacco products; stone, clay and glass products; textiles and others.
(2) Totals may not add due to rounding.

Source: Planning Board.

The following table sets forth manufacturing employment by industry group as of March for the last five years.

Puerto Rico

Manufacturing Employment by Industry Group
(persons age 16 years and over)

Industry Group	As of March 31, 1993	1994	1995	1996	1997
Apparel and related products	29,018	25,213	26,034	23,918	21,750
Food and related products	20,608	20,471	20,882	20,343	19,949
Electrical machinery, equipment and supplies	17,721	19,676	22,928	23,464	24,671
Chemicals and related products (includes pharmaceuticals)	26,141	27,174	28,104	28,047	27,235
Professional and scientific instruments	16,437	15,495	14,390	15,131	14,914
Machinery, except electrical equipment	4,241	4,262	2,612	3,824	3,755
Petroleum refining and related industries; rubber and miscellaneous plastic products	5,294	5,593	4,983	5,268	5,768
Leather and leather products	7,196	7,260	7,282	6,636	6,566
Paper and related products; printing, publishing and related industries	5,944	6,118	6,628	7,184	7,441
Metal products	4,632	4,648	4,740	5,157	5,683
Stone, clay and glass products	4,465	4,716	4,708	4,825	4,972
Lumber and wood products; furniture and fixtures	2,882	2,927	2,894	3,183	3,352
Textile mill products	3,876	3,503	3,403	3,841	3,627
Tobacco products	850	763	953	989	1,206
Miscellaneous manufacturing industries	2,223	2,443	3,069	2,134	2,384
Total	151,528	150,262	153,610	153,944	153,273

Sources: Department of Labor and Human Resources — Census of Manufacturing.

Leading United States and Foreign Companies with Manufacturing Operations in Puerto Rico

Employment 2,500 and over	Product
American Home Products	Pharmaceuticals
Baxter International	Pharmaceuticals
Eaton Corp.	Electronic Instruments
General Electric Co.	Electrical Instruments
H. J. Heinz Co.	Food
Johnson and Johnson	Pharmaceuticals
Sara Lee Corp.	Apparel

Employment 1,500 to 2,499	
Abbott Laboratories, Inc.	Pharmaceuticals
Bristol-Myers Squibb	Pharmaceuticals
Hewlett-Packard	Computers
Intel	Computers
Merck & Co.	Chemicals
Unicord Co. LTD	Food
Warner-Lambert Co.	Pharmaceuticals

Employment 1,000 to 1,499	
Dexter Shoe	Footwear
Hampshire Designers Group	Textiles
Hubbell Incorporated	Electrical Instruments
Motorola, Inc.	Electronic Components
P.L. Industries, Inc.	Apparel
Pfizer	Pharmaceuticals
Schering-Plough Corp.	Pharmaceuticals
Sensormatic Electronics	Electronic Instruments

Employment 500 to 999	
Allergan	Pharmaceuticals
Angles Dairy Management	Dairy Products
Aramark	Apparel
Atlantron, Inc.	Communications
Avon Products Inc.	Costume Jewelry
B.Braun Medical Systems	Medical Equipment
Becton-Dickinson & Co.	Scientific Instruments
Checkpoint Systems, Inc.	Electronic
Coachman Inc.	Apparel
Coleman Co.	Luggage
Conagra	Food
DSC Communication Corp.	Communication Equipments
Dooney & Bourke	Leather
DuPont (E.I.) de Nemours	Chemicals
Echlin Mfg.	Motor Vehicles Parts
Eli Lilly and Co.	Pharmaceuticals
General Instruments Corp.	Communications
H.H. Brown Shoes Co., Inc.	Footwear
Ingersoll-Rand Co.	Electrical Instruments
Insilco Corporation	Office Equipment
Isla Verde Investment	Apparel
MacAndrews & Forbes Holdings	Tobacco Products
Maidenform	Apparel
Medtronics	Surgical and Medical Instruments
Monsanto	Pharmaceuticals
Nycomed ASA	Pharmaceuticals
Owens Illinois	Glass and Plastics
Penn-State Coats & Aprons	Apparel
Pharmacia Up-John Co.	Pharmaceuticals
Phillips Van-Heusen	Apparel and Footwear
Propper International	Apparel
R.J.R. Nabisco	Food and Cigarettes
Seaboard Fluor Corp.	Food
SmithKline Beecham	Pharmaceuticals
Storage Technology	Electronics
Thomas & Betts	Electrical Instruments
Timberland Company (The)	Leather
U.S. Surgical	Scientific Instruments
Wolverine World Wide	Footwear

Employment 300 to 499	
AMP Incorporated	Electronic Connectors
Amgen Manufacturing Co.	Pharmaceuticals
Block Drug Co.	Consumers Products
Carnival Creations	Apparel
Carolina Underwear Co.	Apparel
Centennial	Communications
Coca-Cola Company (The)	Food
Colgate-Palmolive Co.	Consumers Products
Collin & Aikman Group, Inc.	Stockings
Eagle Work Clothes	Apparel
Eastern Canvas Products	Leather
Emerson Electric	Electronic and Scientific Instruments
Esco Manufacturing Co.	Structural Steel
Goya Foods	Food
Granada Sales	Apparel
Lawson Mardon Wheaton	Glass and Plastics
Loctite Corp.	Chemicals
Millipore Corp.	Scientific Instruments
Nestle S.A.	Pharmaceuticals
Nypro	Medical Devices
Ocular Science-American Hydron	Ophthalmic Products
Packaging Coordinators Inc.	Packaging Products
Pall Corp.	Filters
Phillips Petroleum Co.	Petroleum Products
Procter & Gamble Co.	Pharmaceuticals
Productos del Trópico	Food
R.E. Phelon & Co.	Electronics
Randa Corporation	Textiles
Siecor Corp.	Optic Fibers
Siemens AG	Electrical Instruments
Standard Motor Products	Motor Vehicles Parts
Stryker Corp.	Surgical and Medical Instruments
Sundstrand Corp.	Electrical Instruments
Syntex Corp.	Pharmaceuticals
Unifirst Corp.	Work Garment
Unilever PLC	Consumers & Medicals
Wesley Jessen Corp.	Ophthalmic Products
Zeneca Group PLC	Pharmaceuticals

Source: Economic Development Administration, Office of Economic Research (as of January 1998).

Services

Puerto Rico has experienced significant growth in the services sector in terms of both income and employment over the past decade, showing a favorable trend as compared with certain other industrialized economies. During the period between fiscal 1993 and 1997, the gross domestic product in the services sector increased at an annual average rate of 5.4%. Employment in this sector (including finance, insurance, real estate, wholesale and retail trade, hotels and related services and other services) increased at an annual average rate of 3.3% during the period between fiscal 1993 and 1997. The development of the services sector in the local economy has shown a strong interaction among the following important sectors: manufacturing, tourism, construction, and agriculture. The services sector in Puerto Rico has a diversified base.

The high degree of knowledge, skills, and expertise in professional and technical services available in Puerto Rico places the island in a favorable competitive position with respect to Latin America and other trading countries throughout the world. A major element in the economic program of the present administration is the further development of the local services sector which has the capacity to increase its export potential and to generate more income and jobs during the coming years.

The services sector ranks second to manufacturing in its contribution to gross domestic product, and it is the sector with the greatest employment. In fiscal 1997, services generated $18.4 billion of gross domestic product, or 38.2% of the total. Service employment grew from 467,000 in fiscal 1993 to 551,000 in fiscal 1997, a cumulative increase of 17.8%, which increase was greater than the 12.9% cumulative growth in total employment over the same period. Wholesale and retail trade and finance, insurance and real estate have experienced significant growth in the fiscal 1993 to 1997 period, as measured by gross domestic product. Gross domestic product in the wholesale and retail trade increased from $5.3 billion in fiscal 1993 to $6.5 billion in fiscal 1997. In finance, insurance and real estate, gross domestic product increased from $4.9 billion in fiscal 1993 to $6.5 billion in fiscal 1997. There are 20 commercial banks and trust companies currently operating in Puerto Rico of which two are U.S. major money center banks, four are foreign banks and fifteen are local banks and trust companies. Total assets of these institutions as of June 30, 1997 were $34.7 billion. In addition, two federal thrift institutions and six major securities firms operate on the island.

The following tables set forth gross domestic product and services sector employment for the five fiscal years ended June 30, 1997.

Puerto Rico

Gross Domestic Product by Services Sector
(in millions at current prices)

	Fiscal Year Ended June 30				
	1993	1994	1995	1996	1997(p)
Wholesale and retail trade	$5,303	$5,635	$5,989	$6,290	$ 6,495
Finance, insurance and real estate	4,897	5,246	5,730	6,084	6,522
Hotels	373	432	471	495	506
Other services	3,536	3,901	4,253	4,580	4,842
Total[1]	$14,109	$15,214	$16,443	$17,450	$18,365

(p) Preliminary.
(1) Totals may not add due to rounding.

Source: Planning Board.

Puerto Rico

Average Employment by Services Sector
(thousands of persons age 16 and over)

	Fiscal Year Ended June 30				
	1993	1994	1995	1996	1997
Wholesale and retail trade	201	201	211	218	228
Finance, insurance and real estate	32	33	36	39	37
Other services(1)	234	244	249	270	285
Total(2)	467	478	496	527	550

(1) Includes hotels and related services.
(2) Totals may not add due to rounding.

Source: Department of Labor and Human Resources — Household Survey.

Hotels and Related Services - Tourism

Total visitors' expenditures accounted for 6.4% of the island's gross product in fiscal 1997. Visitors' expenditures and the number of visitors to the island have grown consistently since 1985, reaching $2.0 billion, and more than 4.3 million, respectively, in fiscal 1997. During fiscal 1997, the number of persons which registered in tourist hotels was 1,260,616, a 4.3% increase compared with fiscal 1996. The average occupancy rate in tourist hotels was 73.2% in fiscal 1997. The average number of rooms rented in tourist hotels increased 6.2% in fiscal 1997, compared with fiscal 1996. These increases are due in part to the increased marketing by the Government of Puerto Rico, the trends in the U.S. economy and increased hotel usage by Puerto Rico residents. Since fiscal 1992, a number of major hotels have undergone substantial renovation and more than 3,402 new rooms have been added with the opening of several major hotels. Various international hotel corporations have recently made substantial capital investments to develop additional tourist facilities. At June 30, 1997, the number of total rooms was 10,877 and is expected to increase to 11,972 during fiscal 1998 with the completion of several new hotels. A major reason for this increase in rooms has been the initiatives of the New Economic Model that encourage private development in tourism projects. See "Economic Development Program—New Economic Model" above and "Tax Incentives" below. During the first six months of fiscal 1998, the number of persons registered in tourist hotels totaled 648,100, a 7.9% increase compared with the same period in fiscal 1997. In the first six months of fiscal 1998, the average occupancy rate in tourist hotels was 67.9%. The average number of tourist hotel rooms available in December was 8,192.

San Juan has become the largest home port for cruise ships in the Caribbean and the second largest home port for cruise ships in the world.

The following table presents data relating to visitors to Puerto Rico and tourist expenditures for the five fiscal years ended June 30, 1997.

Puerto Rico

Tourism Data

	Number of Visitors				
Fiscal Year Ended June 30	Tourist Hotel(1)	Cruise Ship	Other(2)	Total	Total Visitors' Expenditures (in millions)
1993	688,509	1,014,490	2,165,959	3,868,958	$1,628.1
1994	702,310	980,220	2,340,065	4,022,595	1,728.3
1995	774,040	955,917	2,356,622	4,086,579	1,827.1
1996	828,251	1,045,104	2,336,805	4,110,160	1,898.3
1997(p)	906,706	1,107,913	2,335,068	4,349,687	2,046.3

(p) Preliminary.
(1) Includes visitors in guest houses.
(2) Including visitors in homes of relatives, friends, and in hotel apartments.

Sources: Puerto Rico Tourism Company and the Planning Board.

Government

The government sector of Puerto Rico plays an important role in the economy. In fiscal 1997, government accounted for $5.2 billion of Puerto Rico's gross domestic product, or 10.9% of the total. The government is also a significant employer, providing jobs for 261,000 workers, or 23.1% of total employment in fiscal 1997. The government sector employment does not include data relating to public corporations which are included in other sectors. These public corporations include significant employers such as the Electric Power Authority, the Telephone Authority, and the Aqueduct and Sewer Authority.

On February 25, 1998, the Governor signed into law Act No. 45, which permits the unionization of government employees (excluding municipal employees). Under this law, government employees have collective bargaining rights subject to a number of limitations. Among those limitations are: employees cannot go on strike; annual salary increases are limited; employees cannot be required to become union members and pay quotas; and collective bargaining negotiations cannot occur in an election year. Negotiations of non-economic conditions with government employees pursuant to this bill will commence in the year 2000 and negotiations of economic conditions will commence in 2001.

Transportation

Thirty-four shipping lines offer regular ocean freight service to eighty United States and foreign ports. San Juan is the island's leading seaport, but there are also seaport facilities at other locations on the island including Arecibo, Culebra, Fajardo, Guayama, Guayanilla, Mayagüez, Ponce, Vieques, and Yabucoa.

The Luis Muñoz Marín International Airport is currently served by 24 United States and international airlines. At present, there is daily direct service between San Juan and New York, Chicago, Dallas, Los Angeles, Miami, Atlanta, Boston, and numerous other destinations within the United States. There is also regularly scheduled service between Puerto Rico and other Caribbean islands and major Latin American and European cities. a major United States airline uses San Juan as a hub for its intra-Caribbean service. Several smaller airports serve intra-island traffic.

The island's major cities are connected by a modern highway system which, as of December 31, 1997, totaled approximately 4,600 miles.

Construction

The construction industry has experienced substantial real growth since fiscal 1987. In fiscal 1997, investment in construction rose to an unprecedented level of $4.7 billion, a nominal increase of 14.7%, as compared to $4.1 billion for fiscal 1996. The strong growth in the construction industry resulted from increased public and private investment in the past few years. Nominal public investment in key infrastructure projects increased 19.4% in fiscal 1997 and 33.0% in fiscal 1996. Private construction investment, particularly in housing and hotels, increased 8.8% in fiscal 1997 and 17.9% in fiscal 1996. During fiscal 1997, the total value of construction permits increased 19.0% and local cement consumption increased 7.2% in comparison with fiscal 1996. The Planning Board's construction investment forecast for fiscal 1998, made in July 1997, projected a nominal increase of 21.1%. In fiscal 1997, the average employment in the construction sector was 64,401, an increase of 9.4% over fiscal 1996. During the first six months of fiscal 1998, cement sales increased 9.5% in comparison with the same period in fiscal 1997. In the first six months of fiscal 1998, the average employment in the construction sector was 68,168.

Agriculture

The Department of Agriculture and related agencies have directed their efforts at increasing and improving local agricultural production, increasing efficiency and quality of produce, and stimulating import substitution where economically feasible. During fiscal 1997, gross income from agriculture was $694.7 million, an increase of $29.9 million in comparison with fiscal 1996. Agriculture gross income consists of the total value of production in the principal agricultural sectors, which include traditional crops, cattle products, farinaceous, vegetables, fruits, and other products. Recently, cattle products, non-traditional crops, and livestock products have contributed a higher percentage of the sector's income.

The Government of Puerto Rico supports agricultural activities through incentives, subsidies, and technical and support services, in addition to income tax exemptions for qualified income derived by bona fide farmers. Act No. 225, approved on December 1, 1995, increased the tax benefits available to bona fide farmers. The Act provides a 90% income tax exemption for income derived from agricultural operations, an investment tax credit equal to 50% of the investment in qualified agricultural projects, and a 100% exemption from excise taxes, real and personal property taxes, municipal license taxes and tariff payments. It also provides full income tax exemption for interest income from bonds, notes and other debt instruments to be issued by financial institutions to provide financing to agricultural businesses. Recent legislation imposes an aggregate annual limitation of $15 million on the investment tax credits available under Act No. 225.

As part of the programs embodied in the New Economic Model, the Government of Puerto Rico has sold or has entered into a definitive agreement to sell to private entities various agricultural operations previously conducted by governmental entities. These include certain assets of the pineapple processing operation and a mango growing facility. Currently, the Government is in the process of transferring the sugar processing facilities of the Sugar Corporation to local private sugar cane growers.

Higher Education

During the four decades from 1950 to 1990, Puerto Rico made significant advances in the field of education, particularly at the college and graduate school level. The transformation of Puerto Rico during the 1950's and 1960's from an agricultural economy to an industrial economy brought about an increased demand for educational services at all levels. During the 1970's and 1980's, certain higher wage, higher technology industries became more prominent in Puerto Rico. More recently, employment in the services sector has increased significantly. This has resulted in an increased demand for workers having a higher level of education, in general, and, in particular, greater expertise in various technical fields. During the same time period, enrollments in institutions of higher learning rose very rapidly due to growth in the college-age population, and the increasing proportion of college attendance by such population. After the 1980's, college attendance has remained relatively stable as a percentage of the college age population, generally following the trend in the United States.

The University of Puerto Rico, the only public university in Puerto Rico, includes eleven campuses located throughout the island. Total enrollment of the University was 68,020 students during academic year 1997-1998. The government of Puerto Rico is legally bound to appropriate annually to the University an amount equal to 9.60% of the average annual revenue from internal sources for each of the two fiscal years immediately preceding the current fiscal year.

The following table presents comparative trend data for Puerto Rico and the United States with respect to college age population and percentage of such population attending institutions of higher learning.

Trend in College Enrollment

	Puerto Rico			Mainland United States		
Academic Year	Population 18-24 Years of Age	Higher Education Enrollment	Percent(1)	Population 18-24 Years of Age	Higher Education Enrollment	Percent(1)
1970	341,448	57,340	16.8%	23,714,000	8,580,887	36.2%
1980	397,839	130,105	32.7	30,022,000	12,096,895	40.3
1990	417,636	156,147	37.4	26,950,000	13,820,000	51.3
1994	444,252	161,689	36.4	25,289,000	14,279,000	56.5
1995	453,476	167,172	36.9	24,932,000	14,209,000	57.0
1996	454,055	171,548	37.8	24,616,000	14,399,000	58.5

(1) Number of persons of all ages enrolled in institutions of higher education as percent of population 18-24 years of age.

Sources: Planning Board, U.S. Bureau of the Census, U.S. National Center for Education Statistics and Council on Higher Education of Puerto Rico.

In addition to the University of Puerto Rico, there are 37 private institutions of higher education located in Puerto Rico. Such institutions have current enrollment in excess of 109,180 students and provide programs of study in liberal arts, education, business, natural sciences, technology, secretarial and computer sciences, nursing, medicine, and law. Degrees are offered by these institutions at the associate, bachelor, master, and doctoral levels.

Tax Incentives

One of the factors assisting the development of the manufacturing sector in Puerto Rico has been the various local and federal tax incentives available, particularly those under Puerto Rico's Industrial Incentives Program and Sections 30A and 936 of the Internal Revenue Code of 1986, as amended (the "Code"). New tax and other incentives have been established to promote the development of the tourism industry. These incentives are summarized below.

Industrial Incentives Program

Since 1948, Puerto Rico has had various industrial incentives laws designed to stimulate industrial investment in the island. Under these laws, companies engaged in manufacturing and certain other designated activities were eligible to receive full or partial exemption from income, property, and other local taxes. The most recent of these industrial incentives laws is Act No. 135 of December 2, 1997 (the "1998 Tax Incentives Law"), a new industrial incentives law aimed at attracting and retaining foreign investment in Puerto Rico.

The benefits provided by the 1998 Tax Incentives Law are available to new companies as well as companies currently conducting tax exempt operations in Puerto Rico which choose to renegotiate their existing tax exemption grant. The activities eligible for tax exemption include manufacturing, certain designated services performed for markets outside Puerto Rico, the production of energy from local renewable sources for consumption in Puerto Rico and laboratories for scientific and industrial research. For companies qualifying thereunder, the 1998 Tax Incentives Law would impose income tax rates ranging from 2% to 7%. In addition, it would grant 90% exemption from property taxes, 100% exemption from municipal license taxes during the first eighteen months of operation and between 80% and 60% thereafter, and 100% exemption from municipal excise taxes. The 1998 Tax Incentives Law also provides various special deductions designed to stimulate employment and productivity, research and development and capital investment in Puerto Rico.

Under the 1998 Tax Incentives Law, companies can repatriate or distribute their profits free of tollgate taxes. In addition, passive income derived from the investment of eligible funds in Puerto Rico financial institutions, obligations of the Government of Puerto Rico and other designated investments are fully exempt from income and municipal license taxes. Individual shareholders of an exempted business are allowed a credit against their Puerto Rico income taxes equal to 30% of their proportionate share in the exempted business' income tax liability. Gain from the sale or exchange of shares of an exempted business by its shareholders during the exemption period is subject to a 4% income tax rate.

Tourism Incentives Program

For many years Puerto Rico has also had incentives laws designed to stimulate investment in hotel operations on the island. The most recent of these laws, the Tourism Incentives Act of 1993, provides exemptions from income, property, and municipal license taxes for a period of up to 10 years. In addition, it provides certain tax credits for qualifying investments in hotel development projects.

As part of the incentives to promote the tourism industry, the Government of Puerto Rico established the Tourism Development Fund as a subsidiary of GDB with the authority to make investments in or provide financing to entities that contribute to the development of the tourism industry. The Fund was initially capitalized with $50,000,000 and was authorized to provide financial guarantees for financing hotel development projects. To date the Fund has provided financial guarantees to private entities issuing bonds or borrowing funds to finance the development of five hotel projects which provided approximately 1,350 new hotel rooms.

Sections 30A and 936 of the Code

For many years, United States companies operating in Puerto Rico enjoyed a special tax credit that was available under Section 936 of the Code. Originally, the credit provided an effective 100% federal tax exemption for operating and qualifying investment income from Puerto Rico sources. Amendments to Section 936 made in 1993 (the "1993 Amendments") instituted two alternative methods for calculating the tax credit and limited the amount of the credit that a qualifying company could claim. These limitations are based on a percentage of qualifying income (the "percentage of income limitation") and on qualifying expenditures on wages, other wage related benefits and other qualifying expenditures (the "economic activity limitation", also known as the "wage credit limitation"). As a result of amendments incorporated in the Small Business Job Protection Act of 1996 enacted by the United States Congress and signed into law by President Clinton on August 20, 1996 (the "1996 Amendments"), as described below, the tax credit is now being phased out over a ten-year period for existing claimants and is no longer available for corporations that establish operations in Puerto Rico after October 13, 1995 (including existing Section 936 Corporations (as defined below) to the extent substantially new operations are established in Puerto Rico). The 1996 Amendments also moved the credit based on the economic activity limitation to Section 30A of the Code and phased it out over 10 years. In addition, the 1996 Amendments eliminated the credit previously available for income derived from certain qualified investments in Puerto Rico. The Section 30A Credit and the remaining Section 936 credit are discussed below.

Section 30A. The 1996 Amendments added a new Section 30A to the Code. Section 30A permits a "qualifying domestic corporation" ("QDC") that meets certain gross income tests (which are similar to the 80% and 75% gross income tests of Section 936 of the Code discussed below) to claim a credit (the "Section 30A Credit") against the federal income tax imposed on taxable income derived from sources outside the United States from the active conduct of a trade or business in Puerto Rico or from the sale of substantially all the assets used in such business ("possession income").

A QDC is a United States corporation which (i) was actively conducting a trade or business in Puerto Rico on October 13, 1995, (ii) had a Section 936 election in effect for its taxable year that included October 13, 1995, (iii) does not have in effect an election to use the percentage limitation of Section 936(a)(4)(B) of the Code, and (iv) does not add a "substantial new line of business."

The Section 30A Credit is limited to the sum of (i) 60% of qualified possession wages as defined in the Code, which includes wages up to 85% of the maximum earnings subject to the OASDI portion of Social Security taxes plus an allowance for fringe benefits of 15% of qualified possession wages, (ii) a specified percentage of depreciation deductions ranging between 15% and 65%, based on the class life of tangible property, and (iii) a portion of Puerto Rico income taxes paid by the QDC, up to a 9% effective tax rate (but only if the QDC does not elect the profit-split method for allocating income from intangible property).

A QDC electing Section 30A of the Code may compute the amount of its active business income, eligible for the Section 30A Credit, by using either the cost sharing formula, the profit-split formula or the cost-plus formula, under the same rules and guidelines prescribed for such formulas as provided under Section 936 (see discussion below). To be eligible for the first two formulas, the QDC must have a significant presence in Puerto Rico.

In the case of taxable years beginning after December 31, 2001, the amount of possession income that would qualify for the Section 30A Credit would be subject to a cap based on the QDC's possession income for an average adjusted base period ending before October 14, 1995 (the "income cap").

Section 30A applies only to taxable years beginning after December 31, 1995 and before January 1, 2006.

Section 936. Under Section 936 of the Code, as amended by the 1996 Amendments, United States corporations that meet certain requirements and elect its application ("Section 936 Corporations") are entitled to credit against their United States corporate income tax, the portion of such tax attributable to income derived from the active conduct of a trade or business within Puerto Rico ("active business income") and from the sale or exchange of substantially all assets used in the active conduct of such trade or business. To qualify under Section 936 in any given taxable year, a corporation must derive for the three-year period immediately preceding the end of such taxable year, (i) 80% or more of its gross income from sources within Puerto Rico, and (ii) 75% or more of its gross income from the active conduct of a trade or business in Puerto Rico.

Under Section 936, a Section 936 Corporation may elect to compute its active business income, eligible for the Section 936 credit, under one of three formulas: (i) a cost-sharing formula, whereby it is allowed to claim all profits attributable to manufacturing intangibles and other functions carried out in Puerto Rico provided it makes a cost sharing payment in the amount required under Section 936; (ii) a profit-split formula, whereby it is allowed to claim 50% of the combined net income of its affiliated group from the sale of products manufactured in Puerto Rico; or (iii) a cost-plus formula, whereby it is allowed to claim a reasonable profit on the manufacturing costs incurred in Puerto Rico. To be eligible for the first two formulas, the Section 936 Corporation must have a significant business presence in Puerto Rico for purposes of the Section 936 rules.

As a result of the 1993 Amendments and the 1996 Amendments, the Section 936 credit is only available to companies that were operating in Puerto Rico on October 13, 1995 and had elected the percentage of income limitation, and is limited in amount to 40% of the credit allowable prior to the 1993 Amendments, subject to a five-year phase-in period from 1994 to 1998 during which period the percentage of the allowable credit is reduced from 60% to 40%.

In the case of taxable years beginning on or after 1998, the possession income subject to the 936 credit will be subject to a cap based on the Section 936 Corporation's possession income for an average adjusted base period ending on October 14, 1995. The 936 credit is eliminated for taxable years beginning in 2006.

Proposal to Extend the Phaseout of Section 30A. During 1997, Governor Rosselló proposed to Congress the enactment of a new permanent federal incentive program similar to what is now provided under Section 30A. Such program would provide U.S. companies a tax credit based on qualifying wages paid and other wage related expenses, such as fringe benefits, as well as depreciation expenses for certain tangible assets and research and development expenses. Under the Governor's proposal, the credit granted to qualifying companies would continue in effect until Puerto Rico shows, among other things, substantial economic improvements in terms of certain economic parameters. The fiscal 1998 budget submitted by President Clinton to Congress in February 1997 included a proposal to modify Section 30A to (i) extend the availability of the Section 30A Credit indefinitely, (ii) make it available to companies establishing operations in Puerto Rico after October 13, 1995, and (iii) eliminate the income cap. Although said proposal was not included in the final fiscal 1998 federal budget, President Clinton's fiscal 1999 budget submitted to Congress again included these modifications to Section 30A. While the Government of Puerto Rico plans to continue lobbying for this proposal, it is not possible at this time to predict whether the Section 30A Credit will be so modified.

Outlook. It is not possible at this time to determine the long-term effect on the Puerto Rico economy of the enactment of the 1996 Amendments. The Government of Puerto Rico does not believe there will be short-term or medium-term material adverse effects on Puerto Rico's economy as a result of the enactment of the 1996 Amendments. The Government of Puerto Rico further believes that during the phase-out period sufficient time exists to implement additional incentive programs to safeguard Puerto Rico's competitive position.

DEBT

Public Sector Debt

Public sector debt comprises bonds and notes of the Commonwealth, its municipalities, and public corporations ("notes" as used in this section refers to certain types of non-bond debt regardless of maturity), subject to the exclusions described in the following paragraph. Direct debt of the Commonwealth is supported by Commonwealth taxes. Debt of municipalities, other than bond anticipation notes, is supported by real and personal property taxes, and municipal license taxes. Debt of public corporations, other than bond anticipation notes, is generally supported by the revenues of such corporations from rates charged for services or products. See *Public Corporations*. However, certain debt of public corporations is supported, in whole or in part, directly or indirectly, by Commonwealth appropriations or taxes.

The following table presents a summary of public sector debt as of January 31, 1998. Excluded from this table is debt not primarily payable from either Commonwealth or municipal taxes, Commonwealth appropriations or rates charged by public corporations for services or products. Also excluded from the following table is debt the inclusion of which would reflect double counting, including, but not limited to, $602,985,000 of bonds issued by the Municipal Finance Agency to finance its purchase of bonds of Puerto Rico municipalities, and $1,332,206,000 of obligations of GDB issued to purchase certain Commonwealth public sector debt and for other purposes, of which $267,000,000 is guaranteed by the Commonwealth.

Puerto Rico

Public Sector Debt
(in thousands)

	January 31, 1998
Puerto Rico direct debt(1)	$ 4,919,668
Municipal debt	880,904
Public corporations debt	
Puerto Rico guaranteed debt(2)	446,420
Debt supported by Puerto Rico appropriations or taxes(3)	8,216,736
Other non-guaranteed debt(4)	6,128,558
Total public corporations debt	14,791,714
Total public sector debt	$20,592,286

(1) Includes a $21,415,921 loan from GDB to the Department of the Treasury to settle certain property tax claims of the municipalities (the "GDB Tax Claims Loan") and $117,571,000 of certain indebtedness originally issued by Urban Renewal and Housing Corporation that was transferred to the Commonwealth by virtue of Act No. 134 of the Legislature of Puerto Rico, approved on December 13, 1994 ("Act No. 134 of 1994") (such indebtedness referred to as "Transferred CRUV Debt").

(2) Excludes $1,889,138,000 of Public Buildings Authority bonds and notes which are primarily payable from Commonwealth appropriations and $267,000,000 of GDB bonds payable from available moneys of GDB. Consists of bonds issued by Housing Bank and Finance Agency and Aqueduct and Sewer Authority.

(3) Represents, among others, bonds and notes issued by Aqueduct and Sewer Authority, Highway and Transportation Authority, Public Buildings Authority, Public Finance Corporation, Infrastructure Financing Authority, Economic Development Bank (and its affiliate, the Agriculture and Commercial Development Corporation), Health Facilities and Services Administration, and Housing Bank and Finance Agency. On March 19, 1998, Puerto Rico Highway and Transportation Authority issued its $1,129,643,740 Transportation Revenue Bonds (Series A), a portion of which was used to repay a Government Development Bank line of credit and to refund outstanding bonds of the Authority. Also, the Puerto Rico Infrastructure Financing Authority is expected to issue on April 2, 1998 its $134,660,000 Special Tax Revenue Refunding Bonds, Series 1998A. After adjusting for such bond issue, the repayment of such line of credit and such refundings, the amount appearing in the table under "Debt supported by Puerto Rico appropriations or taxes" would be $9,058,012,000.

(4) The Puerto Rico Electric Power Authority is expected to issue, on or about April 7, 1998, its $508,555,000 Power Revenue Bonds, Series DD and $380,515,000 Power Revenue Refunding Bonds, Series EE, a portion of which will be used to repay a Government Development Bank line of credit and to refund outstanding bonds of the Authority. After adjusting for such bond issue, repayment of such line of credit and such refunding, the principal amount appearing in the table above under "Other non-guaranteed debt" would be $6,604,068,000.

Source: GDB.

No deductions have been made in the above table for debt service funds and debt service reserve funds. The table above and the amounts shown throughout this section as representing outstanding debt include outstanding capital appreciation bonds at their respective original principal amounts and do not include any accretion thereon.

Debt Service Requirements for Commonwealth General Obligation Bonds and Certain Guaranteed Debt

The following table presents debt service requirements for general obligation bonds and bonds of Aqueduct and Sewer Authority for which debt service payments are being made under the Commonwealth guaranty, in each case outstanding on January 31, 1998, adjusted for the issuance on April 14, 1998 of the Commonwealth's $500,000,000 Public Improvement Bonds of 1998 and $38,500,000 Public Improvement Refunding Bonds, Series 1998B and the refunding effected thereby. See "Commonwealth Guaranteed Debt" below. With respect to other debt of Aqueduct and Sewer Authority, see *Public Corporations*. Debt service requirements for each fiscal year, as shown in the following table, include principal and interest due on July 1 immediately following the close of such fiscal year.

Puerto Rico
Debt Service Requirements*
(in thousands)

Fiscal Year Ending June 30	Outstanding Bonds Principal	Outstanding Bonds Interest	Total	Aqueduct and Sewer Authority Bonds Debt Service	Grand Total
1998	$ 179,000	$ 230,818	$ 409,818	$ 33,473	$ 443,291
1999	207,951	246,560	454,511	33,530	488,041
2000	235,875	231,890	467,765	33,509	501,273
2001	242,261	219,310	461,571	33,473	495,044
2002	243,619	208,372	451,991	33,542	485,533
2003	177,339	274,770	452,109	32,745	484,854
2004	148,850	267,899	416,749	30,125	446,874
2005	224,492	188,695	413,187	30,127	443,314
2006	186,518	201,649	388,168	30,121	418,288
2007	161,059	206,852	367,910	30,126	398,037
2008	135,373	170,782	306,154	30,131	336,285
2009	145,050	142,848	287,897	30,123	318,021
2010	155,770	132,198	287,967	29,984	317,952
2011	163,832	123,646	287,478	29,928	317,407
2012	173,010	107,421	280,431	30,127	310,558
2013	164,405	98,355	262,760	30,128	292,888
2014	133,673	108,423	242,096	30,125	272,221
2015	139,555	102,724	242,278	30,126	272,404
2016	144,990	97,218	242,208	30,121	272,329
2017	152,287	90,096	242,382	30,122	272,504
2018	158,635	83,653	242,287	30,126	272,413
2019	170,005	51,358	221,363	30,125	251,488
2020	179,690	42,806	222,496	0	222,496
2021	145,740	33,504	179,244	0	179,244
2022	130,970	26,233	157,203	0	157,203
2023	114,220	19,699	133,919	0	133,919
2024	96,610	13,807	110,417	0	110,417
2025	78,530	8,631	87,161	0	87,161
2026	58,260	4,514	62,774	0	62,774
2027	32,025	1,601	33,626	0	33,626
Total	$4,679,591	$3,736,331	$8,415,922	$681,937	$9,097,859

* Totals may not add due to rounding.

Sources: GDB and Department of the Treasury.

Commonwealth Guaranteed Debt

As of January 31, 1998, $46,080,000 of Commonwealth guaranteed bonds of Housing Bank and Finance Agency were outstanding. These bonds were originally issued by Urban Renewal and Housing Corporation and refinanced in fiscal 1992 by Housing Bank and Finance Agency. Annual debt service on these bonds is $13,252,708 in fiscal 1999, which constitutes their maximum annual debt service. Their final maturity is October 1, 2001.

As of January 31, 1998, $1,814,511,000 of Commonwealth guaranteed bonds of Public Buildings Authority were outstanding. Annual debt service on these bonds is $150,008,064 in fiscal year ending June 30, 1998, with their final maturity being July 1, 2027.

No payments under the Commonwealth guaranty have been required to date for bonds of Housing Bank and Finance Agency or Public Buildings Authority.

As of January 31, 1998, $267,000,000 of Commonwealth guaranteed obligations of GDB were outstanding. No payments under the Commonwealth guaranty have been required for any obligations of GDB to date.

As of January 31, 1998, the Commonwealth had guaranteed certain outstanding revenue bonds of the Aqueduct and Sewer Authority in the aggregate principal amount of $400,340,000. On January 1, 1997, the Commonwealth began to make debt service payments under the Commonwealth guaranty and expects to make all debt service payments required on these revenue bonds.

The Farm Credit Corporation ("Farm Credit"), created pursuant to Act No. 68, approved on June 8, 1960, as amended, assumed responsibility in 1971 for the administration of the Farm Credit Security Fund (the "Security Fund") from the Department of Agriculture. The Security Fund has guaranteed, under the good faith and credit of the Commonwealth, certain loans made by financial institutions and Farm Credit to farmers. The Security Fund is authorized to guarantee loans, of which approximately $11,335,114 has been committed as of January 31, 1998. As of January 31, 1998, $3,095,637 was available in the Security Fund to cover loan payment defaults by farmers.

The functions of Farm Credit and the administration of the Security Fund were transferred to Commercial and Agricultural Credit and Development Corporation, a new public corporation (which is an affiliate of Economic Development Bank) created to provide, among other things, loans to the commercial and agricultural sectors. Simultaneously with the creation of this new corporation, the amount of guarantees was limited to the outstanding loans which carry such guaranty. A joint resolution adopted by the Legislature on August 19, 1990, appropriated $8,000,000 per year beginning in fiscal 1993, to provide funds for the Security Fund. The proceeds of these appropriations were used to pay a $40,000,000 loan made by GDB to the Security Fund used to cover payment on loans guaranteed by the Security Fund. The GDB loan was fully repaid on November 4, 1996.

Trends of Public Sector Debt

Historically, Puerto Rico has maintained a fiscal policy which provides for a prudent relationship between the growth of public sector debt and the growth of the economic base required to service that debt. In that respect, during fiscal 1992 to 1996, public sector debt and gross product increased 27.5% and 27.7%, respectively. The Government of Puerto Rico has also sought opportunities to realize debt service savings by refunding outstanding debt with obligations bearing lower interest rates.

During fiscal 1993 to 1997, however, public sector debt increased 37.0% while gross product increased 27.7%. This higher level of growth of public sector debt over the growth of gross product is due to the increase during fiscal 1996 and 1997 in the amount of debt incurred to finance certain key infrastructure projects, which are important to the development of the economy and are expected to produce long term economic benefits. For fiscal 1996 and 1997, public sector debt increased 10.2% and 10.7%, while gross product increased 6.6% and 5.8%, respectively. This trend of higher levels of public sector debt relative to the growth in gross product is expected to continue during the next few fiscal years as the level of public sector capital investment remains high.

As of January 31, 1998, outstanding short-term debt, relative to total debt, was 10.6%, including $600 million tax and revenue anticipation notes of the Commonwealth issued on December 3, 1997 and payable on July 30, 1998.

The following table shows the trends in gross product (in current dollars) and public sector debt for the five fiscal years ended June 30, 1997 and the first seven months of fiscal 1998.

Puerto Rico
Public Sector Debt and Gross Product
(dollars in millions)

	Public Sector Debt					Gross Product(1)	
June 30	Long Term	Short Term(2)	Short Term as % of Total	Total*	Rate of Increase	Amount	Rate of Increase
1993	$13.257	$ 985(3)	6.9%	$14.242	3.0%	$25.133	6.1%
1994	14.077	1.181(3)	7.7	15.258	7.1	26.641	6.0
1995	14.688	1.305	8.2	15.993	4.8	28.452	6.8
1996	16.316	1.310	7.4	17.626	10.2	30.331	6.6
1997	17.865	1,642(3)	8.4	19.507	10.7	32.102(p)	5.8
January 31, 1998	18.417	2.175(4)	10.6	20.592	5.6	-	-

* Totals may not add due to rounding.
(p) Preliminary.
(1) In current dollars.
(2) Obligations (other than bonds) issued with an original maturity of three years or less and lines of credit with a remaining maturity of three years or less are considered short term debt.
(3) Does not include the tax and revenue anticipation notes which were outstanding at the close of the indicated fiscal years because sufficient funds had been set aside for the payment of such notes in full prior to the end of said fiscal years.
(4) Includes $600.000.000 Tax and Revenue Anticipation Notes, Series 1998A, maturing July 30, 1998.

Source: GDB.

The following table shows the trend of public sector debt by major category for the five fiscal years ended June 30, 1997 and the first seven months of fiscal 1998.

Puerto Rico
Public Sector Debt by Major Category
(dollars in millions)

	Commonwealth			Municipalities			Public Corporations(1)			Total*		Grand Total*
June 30	Long Term	Short Term(2)	Total*	Long Term	Short Term(2)	Total*	Long Term	Short Term(2)	Total*	Long Term	Short Term(2)	
1993	$3,483	$120(3)	$3.603	$497	$39	$536	$9.276	$ 825	$10.102	$13.257	$ 985(3)	$14.242
1994	3.713	120(3)	3,833	571	47	618	9.792	1.014	10.807	14.077	1.181(3)	15.257
1995	4,236	30	4.266(4)	679	53	732	9.773	1.222	10.995	14.688	1.305	15.993
1996	4,203	0	4.203(4)	706	58	765	11.405	1.251	12.657	16.316	1.310	17.625
1997	4.512	0(3)	4.512	843	51	894	12.509	1.590	14.000	17.865	1.642(3)	19.507
Jan.31, 1998	4.320	600(5)	4.920	837	44	881	13.261	1.531	14.792	18.417	2.175	20.592

* Totals may not add due to rounding.
(1) Includes Commonwealth guaranteed debt.
(2) Obligations (other than bonds) issued with an original maturity of three years or less and lines of credit with a remaining maturity of three years or less are considered short term debt.
(3) Does not include the tax and revenue anticipation notes which were outstanding at the close of the indicated fiscal years because prior to the end of said fiscal years sufficient funds had been set aside for the payment of such notes in full.
(4) Includes the GDB Tax Claims Loan and the Transferred CRUV Debt.
(5) Includes $600.000.000 Tax and Revenue Anticipation Notes, Series 1998A, maturing July 30, 1998.

Source: GDB.

PUBLIC CORPORATIONS

In Puerto Rico, many governmental or quasi-governmental functions are performed by public corporations. These are governmental entities created by the Legislature with varying degrees of independence from the central government. Public corporations are generally created to perform a single function or a limited number of related functions. Most public corporations obtain revenues from rates charged for services or products, but many are subsidized to some extent by the central government. Most public corporations are governed by boards appointed by the Governor with the advice and consent of the Senate, but some public corporations are subsidiaries of departments of the central government. Capital improvements of most of the larger public corporations are financed by revenue bonds under trust agreements or bond resolutions or notes under loan agreements. The following table presents the outstanding bonds and notes of certain of the public corporations as of January 31, 1998 ("notes" as used in this section refers primarily to certain types of non-bonded debt regardless of maturity). Debt of certain other public corporations is excluded from this table because such debt is payable primarily from the Federal government or is payable from sources other than Commonwealth appropriations or taxes, or revenues of public corporations, or is payable from revenues derived from services or products, such as industrial development bonds. Also excluded from this table is debt of certain public corporations the inclusion of which would reflect double counting. No deductions have been made in the table for debt service funds and debt service reserve funds. More detailed information about the major public corporations is presented in the following sections.

Outstanding Debt
January 31, 1998
(in thousands)

	Bonds			Notes			Total Bonds and Notes		
	With Guaranty	Without Guaranty	Total	With Guaranty	Without Guaranty	Total	With Guaranty	Without Guaranty	Total
Agricultural Services Administration	$ 0	$ 0	$ 0	$ 0	$ 44,121	$ 44,121	$ 0	$ 44,121	$ 44,121
Aqueduct and Sewer Authority	400,340	67,216(1)	467,556	0	247,865	247,865	400,340	315,081	715,421
Agricultural and Commercial Credit and Development Corporation	0	0	0	0	21,176	21,176	0	21,176	21,176
Electric Power Authority(2)	0	3,513,266	3,513,266	0	186,300	186,300	0	3,699,566	3,699,566
Health Facilities and Services Administration	0	0	0	0	848,145(3)	848,145(3)	0	848,145	848,145
Highway and Transportation Authority	0	2,411,955	2,411,955	0	211,053	211,053	0	2,623,008	2,623,008
Housing Bank	46,080	783,345	829,425	0	245,554	245,554	46,080	1,028,899	1,074,979
Industrial Development Company(2)	0	198,818	198,818	0	25,088	25,088	0	223,906	223,906
Infrastructure Financing Authority	0	1,017,045	1,017,045	0	0	0	0	1,017,045	1,017,045
Public Finance Corporation(2)	0	464,173(3)	464,173	0	0	0	0	464,173	464,173
Office for the Improvement of Public Schools	0	0	0	0	229,313	229,313	0	229,313	229,313
Ports Authority	0	122,455	122,455	0	154,538	154,538	0	276,993	276,993
Public Buildings Authority(2)	1,814,511	0	1,814,511	0	74,627	74,627	1,814,511	74,627	1,889,138
Sugar Corporation	0	0	0	0	28,411(3)	28,411(3)	0	28,411	28,411
Telephone Authority	0	850,130	850,130	0	0	0	0	850,130	850,130
University of Puerto Rico	0	330,330	330,330	0	185	185	0	330,515	330,515
Others	0	10,998	10,998	0	444,676	444,676	0	455,674	455,674
Total	$2,260,931(4)	$9,769,731	$12,030,662	$ 0	$2,761,052	$2,761,052	$2,260,931(4)	$12,530,783	$14,791,714

(1) Principal of and interest on this debt is reimbursed from Commonwealth appropriations.

(2) Does not include accretion of interest from the respective issuance dates on capital appreciation bonds as follows: Electric Power Authority $108,659,199 as of January 31, 1998; Industrial Development Company $5,571,933, as of January 31, 1998; Public Buildings Authority $44,465,194, as of January 31, 1998; and Puerto Rico Public Finance Corporation $7,125,525 as of January 31, 1998.

(3) Payable primarily from Commonwealth appropriations.

(4) Authorization for Commonwealth guarantee of debt as of January 31, 1998, was $3,483,000,000. Excludes $11,335,114 of loans from lending institutions to farmers guaranteed by the Security Fund as of January 31, 1998.

Source: GDB.

Government Development Bank for Puerto Rico

The principal functions of GDB are to act as financial advisor to and fiscal agent for the Commonwealth, its municipalities and public corporations in connection with the issuance of bonds and notes, to make loans and advances to public corporations and municipalities, and to make loans to private enterprises to aid in the economic development of Puerto Rico.

As of January 31, 1998, $1,122,693,000 of bonds and notes of GDB were outstanding. GDB has $2,656,940,000 in loans to local public corporations and municipalities. Act No. 12 of May 9, 1975, as amended, provides that the payment of principal of and interest on specified notes and other obligations of GDB, not exceeding $550,000,000, may be guaranteed by the Commonwealth, of which $267,000,000 were outstanding as of January 31, 1998.

GDB has the following principal subsidiaries:

Higher Education Assistance Corporation was established in May 1981 for the purpose of guaranteeing loans made to post-secondary school students under federal insurance programs. The operations of this Corporation were transferred to the Great Lakes Higher Education Corporation, a guarantee agency based in Wisconsin, and the Corporation is in the process of liquidation.

Housing Finance Corporation was created in November 1977 to provide needed rental housing units and stimulate the construction industry under federally subsidized programs. The Corporation has issued tax-exempt revenue bonds and notes to finance the construction of housing units approved for federal rental subsidies, which bonds and notes are limited obligations of the Corporation payable solely from revenues collected in respect of such housing units. The Federal Housing Administration has insured mortgages on certain of the housing units. As of January 31, 1998, $1,048,325,881 of bonds of Housing Finance Corporation were outstanding.

Tourism Development Fund was created in November 1993 to promote the hotel and tourism industry of Puerto Rico, primarily by making available guarantees to secure the payment of private financing used for new hotel development projects. The Tourism Development Fund is also authorized to make capital investments and provide direct financing to tourism related projects. As of January 31, 1998, the Tourism Development Fund had issued guarantees totaling $225,949,987.

Development Fund was created in 1977 to provide an alternate source of financing to private enterprises in Puerto Rico that have difficulties in obtaining financing from traditional sources. The Development Fund may also guarantee obligations of these enterprises and invest in their equity securities.

Capital Fund was created in November 1993 for trading in debt obligations and publicly traded shares of domestic and foreign corporations.

Public Finance Corporation was established in December 1984 to provide agencies and instrumentalities of Puerto Rico with alternate means of meeting their financing requirements. On June 30, 1995, the Corporation issued $296,393,974 of bonds to purchase from GDB certain debt issued by Maritime Shipping Authority, a portion of which bonds was subsequently refunded. On April 23, 1996, the Corporation issued $192,108,735 of bonds to purchase from GDB a portion of a debt of the Secretary of the Treasury relating to advances made to the municipalities to settle certain property tax claims. As of January 31, 1998, Corporation had $464,173,000 aggregate principal amount of bonds outstanding. The Corporation intends to issue bonds in April 1998 to purchase from GDB the debt incurred by the Office of Public School Improvements totalling approximately $385,000,000.

A description of certain other affiliates of GDB is provided in "Other Public Corporations."

Other Public Corporations

Aqueduct and Sewer Authority owns and operates a system of public water supply and sanitary sewer facilities. Capital expenditures are financed by revenues of the system, debt issuances, and federal and Puerto Rico grants. Debt service on revenue bonds is payable from net revenues of the system after payment of current expenses.

Facilities and operations of the Authority's system are subject to regulation under numerous federal and Puerto Rico environmental laws, including the federal Clean Water Act administered by the United States Environmental Protection Agency ("EPA"). The Authority has embarked on an extensive capital improvement program for the five-year period ending June 30, 2002, that is estimated to cost approximately $1.7 billion. A portion of the capital improvement program is designed to enable the Authority to comply with federal and Commonwealth laws and regulations.

The Authority needs to make a substantial investment in infrastructure and a major overhaul of its operations to maintain the viability of the existing system and to finance its expansion for new users. Funds for this investment are expected to be provided through a combination of bond issues, legislative appropriations and federal grants. Due to the Authority's financial difficulties (discussed below) and its inability to access the bond market, Act No. 45 was enacted in July 1994 to provide a Commonwealth guaranty of the principal and interest payments to the bondholders of all outstanding debt previously issued by the Authority which, at that time, amounted to $388 million, and to also guarantee all future bonds or any other similar obligations incurred by the Authority to refinance such debt. In December 1995, the Authority issued $400,340,000 of its Refunding Bonds, Series 1995 (the "Series 1995 Bonds") to refund all of the Authority's outstanding revenue and revenue refunding bonds. The Series 1995 Bonds are guaranteed by the Commonwealth pursuant to Act No. 45. On January 2, 1997, the Commonwealth began making all debt service payments under said guaranty in respect of the Series 1995 Bonds.

The Authority has reported net losses during the past three fiscal years ended June 30, 1997 of approximately $60.5 million, $91.0 million and $55 million, respectively. These losses reflect the continuing financial and operating difficulties that the Authority has experienced in recent years, and were further aggravated in fiscal 1996 by extraordinary items, including the required adoption of new government accounting requirements relating to required expense reserves, the posting of previous years' non-registered entries and adjustments, employees' salary increases and early retirement bonuses, and non-budgeted or underestimated expenses relating to the PSG Agreement (as described below). Legislation was approved in July 1994 providing for annual Commonwealth appropriations to the Authority to pay a portion of the principal of and interest on the Authority's indebtedness and/or to defray a portion of the Authority's operating and maintenance expenses, as follows: $20 million for fiscal 1995, $25 million for fiscal 1996, $30 million for fiscal 1997, and $35 million for fiscal 1998. Additional legislation was approved in August 1997 providing for annual Commonwealth appropriations of $35 million annually through fiscal 2008.

On May 26, 1995, the Authority and Professional Services Group, Inc. ("PSG") entered into a five-year agreement (the "Agreement") for the operation, management, repair and maintenance of the Authority's public water supply and sanitary sewer facilities (including its customer services systems) (the "Authority System"). PSG, which is headquartered in Houston, Texas, is a subsidiary of Compagnie Generale des Eaux, a French based international waste and wastewater utility and operations service company. The Agreement includes terms and conditions that are expected to result in improved efficiency of the Authority System. Fees and other amounts payable to PSG under the Agreement for fiscal years 1998 to 2001 will be approximately $360.1 million. The Agreement includes incentives to encourage PSG to improve collections from the Authority's customers, as well as penalties in the event PSG fails to operate the Authority System within specified employment parameters. The annual fees may be adjusted to provide for certain unforeseen events and circumstances, such as excessive overtime. The Agreement gives the Authority the right, without penalty, to terminate the contract at the end of the third year. PSG began its management and operations at the Authority on September 1, 1995.

The Authority has also entered into an agreement with Thames-Dick Superaqueduct Partners, Inc. for the planning, design, construction, operation and maintenance of the North Coast Superaqueduct Project (the "Project") to supply additional potable water to certain municipalities, mainly in the San Juan Metropolitan Area. The total estimated cost for the Project is approximately $345 million. GDB is providing interim financing for this Project, which is being paid over time from Commonwealth General Fund appropriations and is expected to be permanently financed with the proceeds of a bond issue payable from Commonwealth appropriations. On May 20, 1997, in a suit brought by a local environmental group challenging the validity of the permits issued for the Project, the Puerto Rico Circuit Court of Appeals issued an order revoking the land use permit granted by the Planning Board and staying the construction of the

Project. This decision was affirmed by the Puerto Rico Supreme Court. Construction of the Project resumed in June, 1997, however, after approval of legislation authorizing, among other things, a special permitting process for the Project. The Project is now approximately 65% complete and is expected to be completed by late 1998, as originally scheduled.

Included in the Authority's strategic projects is a major dredging program of the Carraízo Reservoir with an estimated cost of $60 million. The Carraízo Reservoir is the main water supply source for the San Juan Metropolitan Area. This dredging project is directed at recovering reservoir storage capacity by removing approximately 6 million cubic meters of sediment. Under the agreement signed on October 7, 1996 with Weeks Marine Corporation, with headquarters in New Jersey, the Authority entered into a multi-year dredging program to remove sediment from the Carraízo Reservoir which includes the construction, operation, and maintenance of the areas that will be used to dispose of the dredged materials. GDB approved a $50 million line of credit to the Authority to provide partial interim financing to pay for the dredging and related costs. This financing will be paid from the proceeds of Commonwealth general obligation bonds or from Commonwealth General Fund appropriations. The dredging commenced in August, 1997.

Economic Development Bank was created in July 1985 to engage primarily in granting small direct loans, providing loan guarantees to private enterprises, and making equity investments in such enterprises. Its initial capital was provided by a transfer of loans in the principal amount of $15,000,000 previously administered by a now inactive subsidiary of GDB. As of January 31, 1998, the Economic Development Bank had outstanding $42,000,000 of collateralized Promissory Notes.

Electric Power Authority owns and operates the island's electric system. Capital improvements are financed primarily by borrowed funds, supplemented by internally generated funds. The Authority's bonded debt consists of Power Revenue Bonds, secured by a lien on net revenues of the electric system. As of January 31, 1998, the Authority had $3,513,266,000 in bonds outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds). The Authority is expected to issue on or about April 7, 1998, its $508,555,000 Power Revenue Bonds, Series DD and $380,515,000 Power Revenue Refunding Bonds, Series EE. The Authority has entered into power purchase contracts relating to the construction of certain cogeneration plants that will use fuels other than oil. See "Economic Development Program—New Economic Model" under *The Economy* above.

Health Facilities and Services Administration ("AFASS") was created by Act No. 26 of November 13, 1975, as amended, for the purpose of carrying out the following functions: planning, evaluation and development of health services, alleviation of environmental contamination, operation of public hospitals and other health facilities, prevention and treatment of mental illness and administration of family planning programs and maternal and child care activities. The operations of AFASS are funded substantially by appropriations from the Commonwealth. AFASS' outstanding indebtedness to GDB as of January 31, 1998 was $848,145,000 payable primarily from Commonwealth appropriations. Such indebtedness is expected to be paid also from the proceeds of the sale of certain health facilities. The Government expects to introduce legislation which would authorize the refinancing of AFASS' existing indebtedness to GDB with a bond issue of Public Finance Corporation payable from Commonwealth appropriations.

Highway and Transportation Authority is responsible for highway construction in Puerto Rico. Such construction is financed by debt (interim notes and revenue bonds), revenues of the Authority, and federal and Puerto Rico grants. Debt service on the Authority's revenue bonds constitutes a first lien on its gross revenues, which consist currently of all the proceeds of the gasoline tax, one-half of the proceeds of the tax on gas oil or diesel oil, all the proceeds of the excise taxes on crude oil, unfinished oil and derivative products, up to $120 million per fiscal year, highway toll revenues, and the gross receipts of $15.00 per vehicle per year from certain motor vehicle license fees. Such revenues (except for toll revenues) may be applied first to the payment of debt service on general obligation bonds and notes of the Commonwealth and payments required to be made by the Commonwealth under its guarantees of bonds and notes to the extent that no other revenues are available for such purpose. The Government of Puerto Rico has never applied such revenues for such payment. As of January 31, 1998, the Highway and Transportation Authority had $2,411,955,000 in bonds outstanding. On March 19, 1998 the Authority issued its $1,129,643,740 Transportation Revenue Bonds (Series A).

The Authority is a party to a concession agreement under which a private company designed, constructed and currently is operating a toll bridge spanning the San José Lagoon. The toll bridge was financed with special facility revenue bonds of the Authority payable by the private company principally from toll revenues. The concession is for a term of 35 years, subject to earlier termination or extension. The bridge opened for traffic in February 1994. In certain circumstances as described in the concession agreement, including where toll revenues are insufficient to generate certain rates of return to the private operator, the private company may require the Authority, among other things, to assume the private company's obligations with respect to the special facility revenue bonds. Some of those circumstances, including low toll revenues, exist at this time, but the Authority does not currently anticipate that the private company will exercise its remedy against the Authority.

The Authority has contracted with various qualified firms for the planning, design, construction, and operation of certain segments of a mass transit rail system to serve a portion of the San Juan metropolitan area.

Housing Bank and Finance Agency is engaged in insuring mortgages and servicing mortgages originated by Urban Renewal and Housing Corporation and issues bonds and notes to provide interim and permanent financing for low-income housing projects and single-family home ownership programs. The Agency obtains funds from legislative appropriations, sales of mortgages, mortgage repayments and other sources.

As of January 31, 1998, the Agency had outstanding $829,425,000 of bonds (of which $46,080,000, originally issued by the Urban Renewal and Housing Corporation, are guaranteed by the Commonwealth) issued to pay obligations of the Commonwealth under law, otherwise payable from Commonwealth appropriations, to fund certain payments of the Commonwealth under its mortgage subsidy program for low and moderate income families, to guarantee certain insurance obligations of the Agency under certain programs, and to refund bonds originally issued by Urban Renewal and Housing Corporation to carry out activities related to the provision of low-cost housing for moderate income families, federally aided public housing for low income families, and urban renewal, housing and related activities. These bonds are payable principally from appropriations in substantially the amount that the Commonwealth would otherwise have been bound to appropriate for such purposes.

Industrial Development Company participates in the Commonwealth-sponsored economic development program by providing physical facilities, general assistance, and special incentive grants to manufacturers. The Company was merged into the Economic Development Administration on January 1998. Rentals derived from the leasing of specified facilities of the Company are pledged to the payment of the Company's revenue bonds. As of January 31, 1998, the Company had $198,818,000 in bonds outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds).

Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority was created in June 1977. The Authority has issued revenue bonds to finance industrial, tourist, pollution control, medical, and educational facilities in Puerto Rico for the use of private companies, non-profit entities, or government agencies. The bonds are payable solely from payments to be made to the Authority by such private companies, non-profit entities, or government agencies, and do not constitute a debt of the Commonwealth or any of its other public corporations or municipalities. As of January 31, 1998, $2,182,950,181 of the Authority's bonds were outstanding.

Infrastructure Financing Authority was created in June 1988 by virtue of Act No. 44 of June 21, 1988, as amended ("Act No. 44") to provide financial, administrative, consulting, technical, advisory, and other types of assistance to other public corporations and governmental instrumentalities of Puerto Rico authorized to develop infrastructure facilities and to establish alternate means for financing infrastructure facilities. Act No. 44 also established the Puerto Rico Infrastructure Fund, funded in the amount of $30 million during fiscal 1989 and $40 million for the following twenty-nine fiscal years with the first proceeds of federal excise taxes imposed on rum and other articles produced in Puerto Rico and sold in the United States which are transferred to Puerto Rico pursuant to the Internal Revenue Code of 1986, as amended. On July 7, 1997, Act No. 44 was amended to increase to $60 million for fiscal year 1998 and $70 million for each subsequent year until fiscal year 2028 the amount of federal excise taxes transferred to the Authority. The increased level of appropriations will be used by the Authority to provide additional financial support to Aqueduct and Sewer Authority.

In November 1988, the Authority issued $327,740,000 of Special Tax Revenue Bonds, Series 1988A to refund in advance certain outstanding revenue bonds and other debt of the Aqueduct and Sewer Authority. As of December 31, 1997, $209,285,000 of such bonds were outstanding. The Authority's Special Tax Revenue Bonds, Series 1988A are secured by a pledge of a portion of such federal excise taxes, subject to the prior application of such taxes to the payment of Puerto Rico's general obligation bonds and notes and certain other obligations guaranteed by Puerto Rico.

In December 1997, the Authority issued $801,760,000 Special Tax Revenue Bonds, Series 1997A and 1997B, to finance certain capital projects and working capital needs of Aqueduct and Sewer Authority. The Authority is expected to issue $134,660,000 Special Tax Revenue Refunding Bonds, Series 1998A, on or about April 2, 1998, to refund certain of its outstanding revenue bonds. The Authority had $1,017,045,000 in Bonds outstanding as of January 31, 1998.

In January 1998, the Authority expanded the assistance given to Aqueduct and Sewer Authority to include assistance covering the design and construction of ten strategic regional water and sewer projects intended to provide improved services to targeted regions throughout the island, the implementation of an immediate action plan to address a number of small water and sewer rehabilitation projects and legal and technical assistance in achieving compliance with certain environmental laws and in establishing a prioritized capital program. The Authority is undertaking these projects at the request of the Aqueduct and Sewer Authority. It is expected that the costs of the strategic projects and the immediate action plan will be funded with a portion of the proceeds of the Series 1997A and 1997B Bonds, borrowings of the Authority secured by revenues of a special fund intended to be (a) created by the Authority and (b) funded with certain proceeds from the sale of the Puerto Rico Telephone Company transferred to the Authority by the Commonwealth, and in some cases, funds provided by private companies contracted to build and operate the particular facilities.

Maritime Shipping Authority commenced operations in 1974 upon the acquisition of three shipping lines serving Puerto Rico and the United States mainland. The Authority acquired vessels and other equipment financed by the issuance of notes on a secured basis to the previous owners. As of the date of the sale of the Authority's assets referred to below, the Authority carried approximately 30% of the total cargo shipped between Puerto Rico and the United States mainland.

On March 3, 1995, the assets and operations of Maritime Shipping Authority were acquired by an investor group headed by BTIP, a subsidiary of Bankers Trust New York Corporation, under the terms and conditions approved by the Legislature of Puerto Rico and signed by the Governor on September 27, 1994.

Act No. 112 of September 27, 1994, restructured the operations and administration of the Authority by creating the Maritime Shipping Authority as a public corporation affiliated with GDB, subject to the control of the President of GDB, but as a separate legal entity, apart from GDB and any of its other affiliates and subsidiaries. The remaining debt of the Authority was refinanced, as allowed under Act No. 113 of September 27, 1994, by the issuance of bonds by Public Finance Corporation, a subsidiary of GDB. The aggregate principal amount of such bonds as of January 31, 1998, was $288,823,973. The bonds are payable from funds to be appropriated annually by the Legislature of Puerto Rico. Public Finance Corporation purchased a note of the Authority from GDB with the proceeds of the bonds issued.

Municipal Finance Agency was created in 1972 as a municipal "bond bank" for Puerto Rico. The Agency is authorized to issue bonds to purchase general obligation bonds and notes of Puerto Rico municipalities and to fund a debt service reserve. Debt service on the Agency's bonds is payable from debt service payments on municipal bonds held by the Agency and from the reserve, including investment income thereon. The Government of Puerto Rico has agreed to pay such amounts to the reserve as may be necessary to maintain it at its required level, subject to appropriation by the Legislature, which appropriation is not legally required to be made. To date no such payments have been required.

Ports Authority owns and operates the major airport and seaport facilities in Puerto Rico. The Authority derives revenues from a variety of sources, including charges on airplane fuel sales, air terminal space rentals, landing fees, wharfage, dockage and harbor fees, and rentals for the lease of seaport equipment and property. The Authority has a $126.3 million line of credit from GDB for capital improvements, of which approximately $99.3 million was outstanding as of December 31, 1997. This line of credit has been increased to $144.2 million to partially finance the dredging of San Juan Bay. In addition, GDB has approved a $32.9 million line of credit for the Authority to finance the construction of a new multi-level parking facility at the Luis Muñoz Marín International Airport. The Authority had total net losses of approximately $70 million during fiscal years 1993 and 1994, and, as a result, was not in compliance with its rate covenant with bondholders. After eliminating its operating losses through a comprehensive rate revision process including the implementation of annual (instead of triennial) rate revision analyses, the Authority is currently in compliance with its rate covenant. The Authority is implementing a plan to restructure its operations which, among other things, encompasses revisions to its capital improvement program, measures to increase collections from certain users of its facilities and proposals to improve the efficiency of its operations. As of January 31, 1998, the Authority had $122,455,000 in bonds outstanding.

Public Buildings Authority is authorized to construct, purchase or lease office, school, health, and social welfare facilities for lease to departments, public corporations, and instrumentalities of the Government of Puerto Rico. Bonds that have been issued by the Authority to finance such facilities (through retirement of interim notes or otherwise) are payable from lease payments, which are largely derived from legislative appropriations, and are further secured by the Commonwealth's guaranty. The Authority is authorized by Act No. 17 of 1968, as amended, to have outstanding at any one time up to $2,100,000,000 of bonds guaranteed by the Commonwealth. As of January 31, 1998, $1,814,511,000 of such bonds of the Authority were outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds). The Authority has six lines of credit for its capital improvement program totaling $786,022,805 of which $74,627,000 was outstanding as of January 31, 1998.

The Authority is undertaking a program to construct additional correctional facilities to be completed by the end of fiscal 2001 at an estimated cost of $187,000,000. The Authority has previously issued $126,972,552 in bonds to finance the construction of three correctional facilities, which will be operated by private companies.

At present, the Government of Puerto Rico is a defendant in a lawsuit filed in United States District Court in which it is charged with violating the constitutional rights of correctional system inmates as a result of severe overcrowding in the island's correctional system. Fines to assure compliance with minimum space standards have been assessed in the past against the Government of Puerto Rico. Most of these fines have been earmarked for improving the conditions of inmates but not for construction of additional correctional facilities to alleviate prison overcrowding. In April 1995, the District Court judge overseeing the above lawsuit imposed an additional series of fines against the Government of Puerto Rico for noncompliance with the minimum space standards, which fines may exceed $30 million. The Government of Puerto Rico can give no assurance that additional fines will not be levied in connection with the above mentioned lawsuit.

Sugar Corporation was created in 1973 to consolidate ownership and management of the Government of Puerto Rico's interests in Puerto Rico's sugar industry. Sugar Corporation owns or leases and operates virtually all the sugar production facilities on the island. Sugar Corporation buys all cane grown by private growers, processes the cane, and sells crude and refined sugar and molasses. For many years, its operations produced substantial operating deficits. For fiscal 1998 appropriations of approximately $8,543,086 were made to cover the operating deficit. As of January 31, 1998, the total debt of the Corporation was $28,411,000 payable primarily from Commonwealth appropriations.

On September 5, 1996, the Governor of Puerto Rico signed into law Act No. 189, which authorizes the transfer, for a nominal sum, of certain assets and liabilities of the Corporation to entities created by the sugar cane growers. Pursuant thereto, the Government of Puerto Rico has transferred the operations of the Corporation to certain entities formed by sugar cane growers. The Corporation retained substantially all its liabilities.

Telephone Authority was created in July 1974 when the Government of Puerto Rico purchased Puerto Rico Telephone Company ("PRTC") from International Telephone and Telegraph Corporation. Puerto Rico Telephone Company operates the principal telephone system in Puerto Rico. The Telephone Authority acquired the assets of the Puerto Rico Communications Authority on May 30, 1990. Capital improvements at present are financed by internally generated funds, although in the past they have also been financed with revenue bonds. The Authority's revenue bonds are payable from net revenues, which consist primarily of moneys received after payment of the Company's operating expenses. As of January 31, 1998, the Authority had $850,130,000 of bonds and other obligations outstanding, none of which was supported by the guaranty of the Commonwealth.

On April 7, 1997, Governor Rosselló announced the Government's intention to sell PRTC. The Government is currently conducting the sale process. The proceeds of the sale are expected to be used to create a trust fund for infrastructure to assist in the solution of the problems associated with the supply and distribution of water resources, to mitigate the unfunded pension benefit obligation of the Employees Retirement System of the Government of Puerto Rico and its Instrumentalities, and to pay certain benefits to PRTC employees.

University of Puerto Rico, with 68,020 students during academic year 1997-1998, is by far the largest institution of higher education on the island. Government appropriations are the principal source of University revenues, but additional revenues are derived from tuition, student fees, auxiliary enterprises, interest income, federal grants, and other sources. University capital improvements have been financed mainly by revenue bonds of which $330,330,000 were outstanding as of January 31, 1998.

Public corporations, in addition to those mentioned above, have outstanding debt in the aggregate amount of $709,859,000 as of January 31, 1998. Debt service on $280,638,000 of such outstanding debt is being paid from legislative appropriations. However, the Government of Puerto Rico is not obligated to make any such appropriations. Additional legislative appropriations are made to enable certain of such corporations to pay their operating expenses.

INSURANCE MATTERS

Government-owned property is insured through policies obtained by the Secretary of the Treasury and through self-insurance, except for property owned by the Electric Power Authority, the Aqueduct and Sewer Authority, and the Telephone Authority, which are insured through arrangements and policies obtained by the respective Authorities. Personal injury awards against the Government of Puerto Rico are limited by law to $150,000 per occurrence.

RETIREMENT SYSTEMS

Public employees of the Government of Puerto Rico and its instrumentalities are covered by five retirement systems: the Employees Retirement System of the Government of Puerto Rico and its Instrumentalities (the "Employees Retirement System"), the Annuity and Pension System for the Teachers of Puerto Rico (the "Teachers Retirement System"), the Commonwealth of Puerto Rico Judiciary Retirement System (the "Judiciary Retirement System"), the Retirement System of the University of Puerto Rico (the "University Retirement System"), and the Employees Retirement System of Puerto Rico Electric Power Authority (the "Electric Power Authority Retirement System").

The University Retirement System and the Electric Power Authority Retirement System apply to employees of the University of Puerto Rico and Electric Power Authority, respectively. The Government of Puerto Rico is not required to contribute directly to those two systems, although a large portion of University revenues are derived from legislative appropriations.

The Teachers Retirement System covers primarily public school teachers, the Judiciary Retirement System covers judges, and the Employees Retirement System covers all other employees of the Government of Puerto Rico, its municipalities and instrumentalities. As of June 30, 1997, the preliminary total number of active members of the three systems was as follows: Employees Retirement System, 159,680; Teachers Retirement System, 61,134 and Judiciary Retirement System, 346. The three systems are financed by contributions made by employers (the Government of Puerto Rico, public corporations, or municipalities), employees, and investment income. The government is responsible for approximately 66% of total employer contributions to the Employees Retirement System and 100% and 99% of total employer contributions to the Judiciary and Teachers Retirement Systems, respectively. Retirement and related benefits provided by the systems and required contributions to the systems by employees are determined by statute. Required contributions to the systems by employers are determined by statute with respect to the Teachers Retirement System and, with respect to the Employees and Judiciary Retirement Systems, by the Administrators of the Systems. In fiscal 1998, the Government of Puerto Rico has budgeted approximately $275,206,000 as its contribution to the Employees Retirement System, $4,323,000 as the contribution to the Judiciary Retirement System and $85,309,760 as its contribution to the Teachers Retirement System.

According to the most recent actuarial valuation of the Employees Retirement System and Judiciary Retirement System submitted by a firm of independent consulting actuaries, as of June 30, 1997, the total pension benefit obligation for the Employees Retirement System and Judiciary Retirement System was $6,913,900,000 and $76,500,000, respectively. The unfunded pension benefit obligation of the Employees Retirement System and Judiciary Retirement System for the same period was $5,469,429,000 and $19,245,000, respectively. The actuarial valuation was completed in accordance with the "Projected Unit Credit" method. An investment return of 8.5% per year, a salary increase of 5% per year and a post-retirement benefit increase for the Employees Retirement System of 3% every third year were assumed. This benefit increase was provided by the Legislature of Puerto Rico by Act No. 10 of May 10, 1992. The first 3% increase was granted to retirees who have been receiving their annuities for three or more years as of that date. The second 3% increase was granted to retirees who have been receiving their annuities for three or more years as of January 1, 1995. This increase is being financed by additional contributions from the employers. Subsequent increases will depend upon the explicit approval of the System's Board of Trustees and the Legislature, based on a favorable recommendation from the System's independent consulting actuary and given a minimum of 24 months of benefit payment reserves.

On February 1, 1990, the Legislature of Puerto Rico enacted Act No. 1 which is directed at ensuring the solvency of the Employees Retirement System for the next fifty years. Among other provisions, the legislation increases the level of contribution to the System and limits benefits for new employees by increasing the length of time for the vesting of certain benefits and reducing the level of benefits in the case of early retirement. The legislation also reduces the level of occupational injury and death benefits received by new employees.

The Governor of Puerto Rico has announced that he will submit legislation amending the Employees Retirement System to change it, prospectively, from a defined benefit system to a defined contribution system. Under the proposed legislation, an individual account will be established for each future employee who participates in the System and for those current employees who elect to transfer from the existing defined benefit system. The individual account of each current employee will be credited initially with an amount equal to his aggregate contributions to the Employees Retirement System, plus interest. Current employees who do not elect to transfer to the new defined contribution system will continue accruing benefits under the current system.

Based on actuarial studies conducted by the actuary of the Employees Retirement System, it is expected that the implementation of the proposed defined contribution system will allow the Government to reduce the current actuarial deficit of the Employees Retirement System.

The most recent actuarial valuation of the Teachers Retirement System was submitted by a firm of independent consulting actuaries in December 1996. As of June 30, 1996, the actuarial accrued liability of the system was $2,615,833,862, the actuarial value of assets amounted to $1,652,819,537, and the resulting unfunded actuarial accrued liability was $963,014,325, a decrease of $163,357,932 from the valuation as of June 30, 1995. It is recognized that it will be necessary to further strengthen the finances of the Teachers Retirement System in order to assure that combined contributions and investment income continue to exceed benefit payments, avoiding the possible future drawdown of assets.

The following table presents in summary form, income and expenses of the retirement systems for the fiscal years ended June 30, 1996 and June 30, 1997 and estimates for the fiscal year ending June 30, 1998.

Retirement Systems
Income and Expenses
(in thousands)

	Employees Retirement System	Judiciary Retirement System	Teachers Retirement System
Fiscal Year Ended June 30, 1996	Actual	Actual	Actual
Income:			
Employers contributions	$224,942	$ 3,890	$ 79,324
Employee contributions	177,250	1,618	62,991
Investment income	178,616	9,348	127,841
Total	580,808	14,856	270,156
Expenses:			
Benefit payments	399,665	5,846	153,493
Administrative and other expenses	26,907	1,072	14,369
Total	426,572	6,918	167,862
Net Income	$154,236	$ 7,938	$102,294
Fiscal Year Ended June 30, 1997	Actual	Actual	Actual
Income:			
Employers contributions	$248,523	$4,102	$ 82,431
Employee contributions	206,094	1,763	68,777
Investment income	230,412	9,290	268,167
Total	685,029	15,155	419,375
Expenses:			
Benefit payments	437,069	6,080	168,643
Administrative and other expenses	33,001	1,815	21,480
Total	470,070	7,895	190,123
Net Income	$214,959	$7,260	$229,252
Fiscal Year Ending June 30, 1998	Estimated	Estimated	Estimated
Income:			
Employers contributions	$270,000	$4,326	$ 87,250
Employee contributions	239,000	2,100	71,400
Investment income	250,000	9,000	294,984
Total	759,000	15,426	453,634
Expenses:			
Benefit payments	463,000	6,300	186,200
Administrative and other expenses	28,000	1,100	21,300
Total	491,000	7,400	207,500
Net Income	$268,000	$8,026	$246,134

Sources: Employees Retirement System, Judiciary Retirement System and Teachers Retirement System.

SUMMARY OF COMMONWEALTH FINANCIAL STATEMENTS

Since fiscal 1990, the complete financial statements of the Commonwealth are audited. For fiscal 1997, such financial statements were audited by Deloitte & Touche LLP, whose report thereon is dated December 15, 1997. Preparation of the audited financial statements of the Commonwealth involves the collection and combination of audited financial statements from 48 separate reporting entities.

PUERTO RICO TAXES, OTHER REVENUES AND EXPENDITURES

The Secretary of the Treasury has custody of the funds of the central government and is responsible for the accounting, disbursement and investment of such funds. Central government funds are grouped into three major categories or "types" of funds, as follows: (i) Governmental Fund Types, which include the General, Special Revenue, Debt Service (also referred to herein as Redemption), and Capital Project Funds; (ii) Proprietary Fund Types, which include the Enterprise and Internal Service Funds; and (iii) Fiduciary Fund Types, which include the Trust and Agency Funds. These funds do not include funds of the municipalities, because the municipalities are governmental entities with independent treasuries. The Special Revenue Fund was incorporated into the General Fund commencing in fiscal 1993.

The General Fund is the primary operating fund of the Government of Puerto Rico. General Fund revenues are broadly based and include revenues raised internally as well as those from non-Puerto Rico sources. Internal revenues consist principally of income taxes and excise taxes. Revenues from non-Puerto Rico sources are derived from federal excise taxes and customs duties returned to the Government of Puerto Rico. The primary expenditures of the Government of Puerto Rico through the General Fund are for grants and subsidies, and personal and other services.

Summary and Management Discussion of General Fund Results

The following table presents revenues and expenditures of the General Fund on a cash basis for fiscal 1994 through fiscal 1998. Insofar as the information relates to fiscal 1998, it is based on estimates provided by the Secretary of the Treasury as of February, 1998. The information for fiscal 1994 through fiscal 1997 is based on actual fiscal year end results. General Fund revenues, expenditures, and transfers as presented in the table, differ from the General Fund revenues, expenditures, and transfers as presented in the financial statements, as the latter statements reflect an expanded General Fund entity in accordance with generally accepted accounting principles.

Puerto Rico
General Fund Revenues, Expenditures, and Changes in Cash Balance
(in thousands)

	1994	1995	1996	1997	1998(1)
Beginning cash balance	$(116,501)	$ 309,055	$ 534,929	$ 147,066	$127,477
Revenues from internal sources:					
Income Taxes:					
Individuals	1,409,824	1,578,269	1,709,116	1,825,337	2,020,000
Corporations	1,107,265	1,304,612	1,348,160	1,440,691	1,506,000
Partnerships	1,802	3,391	3,323	2,120	2,000
Withheld from non-residents	73,626	79,072	78,235	88,603	137,000
Tollgate taxes	224,356	220,873	179,454	210,245	148,000
Interest	5,293	6,070	6,662	7,582	9,000
Dividends	33,968	28,650	43,225	35,438	38,000
Total income taxes	2,856,134	3,220,937	3,368,175	3,610,016	3,860,000
Commonwealth excise taxes					
Alcoholic beverages	220,882	222,187	237,915	229,043	238,000
Cigarettes	115,453	107,943	107,177	120,287	120,000
Motor vehicles	275,654	319,676	307,931	365,820	372,000
Other excise taxes	588,411	602,521	651,001	704,203	620,000
Total Commonwealth excise taxes	1,200,400	1,252,327	1,304,024	1,419,353	1,350,000
Property taxes	4,568	7,889	5,107	8,286	0
Inheritance and gift taxes	934	1,535	1,547	4,028	2,000
Licenses	49,084	49,100	50,467	53,535	66,000
Other:					
Lottery	62,348	63,317	60,856	52,829	58,000
Electronic Lottery	52,193	59,414	57,008	47,994	57,000
Miscellaneous non-tax revenues	131,909	125,973	127,734	139,838	153,000
Total other	246,450	248,704	245,598	240,661	268,000
Total revenues from internal sources	4,357,570	4,780,492	4,974,918	5,335,879	5,546,000
Revenues from non-Commonwealth sources:					
Federal excise taxes	185,285	187,494	194,917	203,755	200,000
Customs	122,477	112,153	77,781	61,114	74,000
Total revenues from non-Commonwealth sources	307,762	299,647	272,698	264,869	274,000
Sub-total revenues	4,665,332	5,080,139	5,247,616	5,600,748	5,820,000
Proceeds from special funds	56,527	14,155	20,716	23,217	37,000
Total Revenues	4,721,859	5,094,294	5,268,332	5,623,965	5,857,000
Other Income	558,069	307,931	113,515	80,388	321,004
Less tax refunds - previous years	0	0	0	0	0
Total revenues - net	5,279,928	5,402,225	5,381,847	5,704,353	6,178,004
Transfers to debt service fund (2)	(284,346)	(316,766)	(359,638)	(375,000)	(368,546)
Note proceeds (3)	700,000	0	0	551,186	601,892
Repayment of notes (4)	(717,850)	0	0	(563,628)	(617,775)
Adjusted revenues	4,977,732	5,085,459	5,022,209	5,316,911	5,793,575
Expenditures:					
Grants and subsidies	1,251,879	1,308,511	1,620,347	1,676,929	1,741,396
Personal services	1,559,152	1,805,996	1,993,176	2,164,007	2,690,821
Other services	492,653	579,568	602,460	666,004	664,007
Materials and supplies	64,945	82,701	86,370	84,789	103,223
Equipment purchases	41,885	54,288	54,685	37,507	64,701
Capital outlays and other debt service	128,396	54,691	116,863	47,269	217,588
Transfers to agencies	565,696	537,649	564,360	355,213	244,384
Other expenditures	447,570	436,181	371,811	304,782	157,000
Total expenditures	4,552,176	4,859,585	5,410,072	5,336,500	5,883,120
Adjusted revenues less expenditures	425,556	225,874	(387,863)	(19,589)	(89,545)
Ending cash balance	$ 309,055	$ 534,929	$ 147,066	$ 127,477	$ 37,932

(1) Revised estimate as of February, 1998.
(2) Consists of amounts to pay principal of and interest on general obligation bonds and notes of the Commonwealth. Does not include amounts deposited directly to the redemption fund from non-General Fund revenues.
(3) Consists of proceeds from Commonwealth tax and revenue anticipation notes issued in each such fiscal year.
(4) Consists of repayment of Commonwealth tax and revenue anticipation notes in each such fiscal year.

Source: Department of the Treasury

Estimated Fiscal 1998 Compared to Fiscal 1997

As of February, 1998, General Fund total revenues for fiscal 1998 are forecast at $5,820 million, an increase of $219 million (3.90%) over fiscal 1997. Major projected changes are: an increase in income taxes of individuals of $250 million; an increase in license fees of $12.4 million, an increase in non-tax revenues of $27.3 million and a decrease in excise taxes of $69.3 million.

Total projected expenditures for fiscal 1998 are estimated at $5,883 million, an increase of $546.6 million (10.24%) from fiscal 1997. The ending cash balance for the General Fund for fiscal 1998 is estimated to be $37.9 million, a decrease of $89 million from fiscal 1997.

Fiscal 1997 Compared to Fiscal 1996

General Fund total revenues for fiscal 1997 were $5,601 million, an increase of $353.1 million (6.73%) over fiscal 1996. Major changes were: an increase in income taxes of $241.8 million and an increase in excise taxes of $115.3 million.

Total expenditures for fiscal 1997 decreased by $73.6 million, when compared to fiscal 1996. The ending cash balance for the General Fund for fiscal 1997 was $127.5 million, a decrease of $19.6 million from fiscal 1996.

Fiscal 1996 Compared to Fiscal 1995

General Fund total revenues for fiscal 1996 were $5,247 million, an increase of $167.5 million (3.3%) over fiscal 1995. Major changes were: an increase in income taxes of $147.2 million; an increase in excise taxes of $51.7 million; and a decrease in customs of $34.4 million.

Total expenditures for fiscal 1996 increased by $550.5 million, when compared to fiscal 1995. The ending cash balance for the General Fund for fiscal 1996 decreased by $387.9 million.

Fiscal 1995 Compared to Fiscal 1994

General Fund total revenues for fiscal 1995 were $5,080 million, an increase of $414.8 million (8.9%) over fiscal 1994. Major changes were the following: total income taxes and excise taxes increased by $364.8 million and $51.9 million, respectively.

Total expenditures for fiscal 1995 increased by $307.4 million (6.8%), when compared to fiscal 1994. The ending cash balance for the General Fund for fiscal 1995 increased by $225.8 million.

Major Sources of General Fund Revenues

Income Taxes

Puerto Rico's Internal Revenue Code of 1994 (the "P.R. Code"), adopted on October 31, 1994, imposes a tax on the income of individual residents of Puerto Rico, trusts, estates, and domestic and foreign (if engaged in a trade or business in Puerto Rico) corporations and partnerships. The P.R. Code represented a major revision to the prior income tax structure. The purpose of the P.R. Code was to establish a more equitable tax structure that lowered tax rates and simplified and enhanced compliance.

Individuals. Resident individuals are subject to tax on their taxable income from all sources. The P.R. Code has five tax brackets with tax rates of 8%, 12%, 18%, 31% and 33%. Dividend income from Puerto Rico sources is taxed at a rate of 10%. Gains realized from the sale or exchange of a capital asset, if held for more than 6 months, are taxed at a rate of 20%.

Interest income in excess of $2,000 on deposits with Puerto Rico financial institutions is taxed at a rate of 17%; the first $2,000 of interest income is exempt from taxation.

Corporations and Partnerships. Puerto Rico corporations and partnerships are subject to tax on income from whatever source; foreign corporations and partnerships that are engaged in a trade or business in Puerto Rico are subject to tax on their income from Puerto Rico sources and on income from sources outside Puerto Rico that is effectively connected with the conduct of a trade or business in Puerto Rico. Unless a corporation or partnership qualifies for partial exemption from corporate income and other taxes under the industrial incentives program (see "Tax Incentives" under *The Economy*), it is subject to tax at graduated rates.

The P.R. Code provides six income tax brackets for corporations and partnerships, with the highest rate (39%) applicable to taxable income in excess of $275,000. Certain corporations and partnerships covered by the tax incentives act continue to be subject to a maximum tax rate of 45% on their taxable income. Corporations and partnerships covered by the Puerto Rico Tourism Incentives Acts are subject to a maximum tax rate of 42% on their taxable income. The P.R. Code maintains the alternative minimum tax at 22%.

The P.R. Code imposes a branch profits tax on resident foreign corporations. The tax is 10% of an annual dividend equivalent amount and it applies without regard to the Puerto Rico source of income rules.

Interest from Puerto Rico sources paid to non-resident non-affiliated recipients is no longer subject to withholding tax. Interest paid to certain related non-resident recipients is subject to a withholding tax of 29%. Dividends paid to non-resident corporate recipients is subject to a withholding tax of 10%. Gains realized from the sale or exchange of a capital asset, if held for more than six months, is taxed at a maximum rate of 25%. Payments in excess of $1,000 made by the Government of Puerto Rico and persons engaged in a trade or business in consideration of the receipt of services are now subject to a 7% withholding tax.

In July 1997 the P.R. Code was amended to include certain provisions designed to promote investments in local capital market instruments. The amendments include (i) reducing to 7% the long term capital gains rate applicable to gains from the conversion prior to the year 2001 of any privately owned Puerto Rico corporation or partnership to a publicly owned corporation or partnership; (ii) reducing to 17% the tax rate applicable to interest received by non-corporate taxpayers on certain debt instruments of Puerto Rico corporations or partnerships; and (iii) eliminating the special tax exemption for interest on GNMA Certificates issued after July 31, 1997 (other than those issued in connection with the initial conveyance of newly constructed low and moderate residential property in Puerto Rico).

Excise Taxes

The P.R. Code imposes a tax on articles and commodities that are imported into or manufactured in Puerto Rico for consumption in Puerto Rico and a tax on certain transactions, such as hotel occupancy, public shows, and horse racing. The excise tax on certain articles and commodities, such as cigarettes and petroleum products, is based upon the quantity of goods imported. The excise tax on motor vehicles is based on the suggested retail prices. The P.R. Code imposes a tax at an effective rate of 6.6% of the F.O.B. factory price for imported goods and 3.6% of the sales price of goods manufactured in Puerto Rico, except sugar, cement, cigarettes, motor vehicles and certain petroleum products which are taxed at different rates. Goods to be used by the government, except for motor vehicles and construction equipment, are not exempt. Exemptions apply to certain articles, such as food and medicines, and to articles designated for certain users.

Other Taxes and Revenues

Motor vehicle license plate and registration fees comprise the major portion of license tax receipts.

Non-tax revenues consist principally of lottery proceeds, documentary stamps, permits, fees and forfeits, proceeds of land sales, and receipts from certain public corporations in lieu of taxes.

Revenues from non-Puerto Rico sources include customs duties collected in Puerto Rico and excise taxes on shipments of alcoholic beverages from the island to the mainland United States. The customs duties and excise taxes on shipments are imposed and collected by the United States and returned to the Government of Puerto Rico.

Property Taxes

Personal property, which accounts for approximately 55% of total collections of taxable property, is self-assessed. Real property taxes are currently assessed at 1958 values. No real property reassessment has been made since 1958, and construction taking place after that year has been assessed on the basis of what the value of the property would have been in 1958. Accordingly, the overall assessed valuation of real property for taxation purposes is substantially lower than the actual market value. Also, an exemption on the first $15,000 of assessed valuation in owner-occupied residences is available.

On August 30, 1991, legislation was adopted in Puerto Rico providing a municipal reform program which also involved the creation of the Municipal Revenues Collection Center to collect property taxes. The program transferred the previous functions of the Department of the Treasury with respect to real and personal property tax assessment, notification, determination, and collection to the Municipal Revenues Collection Center, as of July 1, 1993. The special 1.03% tax on the assessed value of all property (other than exempted property) imposed by the Commonwealth for purposes of paying the Commonwealth's general obligation debt continues to be deposited in the Commonwealth's Redemption Fund.

Puerto Rico

Assessed Valuations and Real and Personal Property Taxes
(Commonwealth and Municipalities Combined)
(in thousands)

Fiscal Year Ended June 30	Assessed Valuations(1)	Taxes Levied	Collections of Current Year	Collections of Previous Years	Total
1993	$11,337,421	$378,750	$267,220	$21,579	$288,799
1994	11,735,626	443,448	329,058	32,654	361,712
1995	12,508,656	508,275	370,029	54,241	424,270
1996	17,499,974	533,362	400,207	70,571	470,778
1997(2)	19,272,428	619,344	471,445(p)	50,418(p)	521,863(p)

(p) Preliminary.
(1) Valuation set as of July 1 of fiscal year.
(2) Municipal Revenues Collection Center Distribution Report August 1997.

Source: Municipal Revenues Collection Center.

During 1997, legislation was enacted authorizing the Center to sell past due property taxes on residential and commercial properties to persons who, after payment of the purchase price to the Center, would then be responsible for collecting such taxes from the delinquent property tax payers. Pursuant to this legislation, the Government proposes to securitize all eligible property tax debts of the Center by issuing bonds secured by such property tax debts on or about June 1998. The portion of the proceeds of this bond issue representing property taxes owed prior to fiscal 1991 would be paid to the Secretary of the Treasury and the balance would be paid to the Center.

Collections of Income and Excise Taxes

The Department of the Treasury has continued its program for improving tax collections which began in fiscal 1986. The program has consisted, in part, of taking the initiative in sponsoring and implementing tax reform, particularly in the areas of excise taxes and income taxes, in order to decrease the incidences of nonpayment of taxes, and to expand the taxpayer base. The program has also included (a) improving the methods by which delinquent taxpayers are identified, primarily through the use of computer analyses, (b) computerizing the processing of tax returns, and (c) identifying and eliminating taxpayer abuses of the existing tax laws.

Transfers to General Obligation Redemption Fund

These consist of transfers from the General Fund to the Redemption Fund for the amortization of the principal of and interest on general obligation bonds and notes of the Commonwealth.

Components of General Fund Expenditures

Grants and Subsidies

This category includes grants and contributions to municipalities, public corporations with independent treasuries, and contributions to charitable institutions. It also includes items for or included in court awards, damage awards for personal injury or property damage, as well as payment of taxes and payment in lieu of taxes.

Personal Services

This category includes compensation paid for personal services rendered to the Government of Puerto Rico and its public instrumentalities by individuals or firms in the form of salaries, wages, *per diems*, fees, commissions, or other forms of compensation.

Other Services

This category includes the payment of services other than the services referred to above, including advertising, printing, communication services, legal expenses, utility services, building and equipment rental and maintenance expenses, insurance premiums and miscellaneous services.

Materials and Supplies

This category includes all articles which ordinarily have short life and durability, lose their characteristic identity in the process of use, have only nominal value ($25 or less), or are not otherwise chargeable as equipment.

Equipment Purchases

The category includes items which have three special characteristics which distinguish them from materials; durability, long useful life, and high unit cost. In addition, these items are subject to centralized inventory control as fixed assets.

Other Debt Service and Capital Outlays

Includes payments on notes held by GDB to be paid from the balance in the General Fund and payments for the amortization of the principal of and interest on non-general obligations payable from Commonwealth appropriations. Capital outlays are made primarily for land acquisition or interests in land, construction of buildings, roads, bridges and other structures, as well as permanent improvements and additions.

Transfers to Agencies

Includes repayment of loans and advances to other funds, certain refunds, advances from other funds and other receipts, repayment of advances from other funds, grants and contributions to other funds under the custody of the Secretary of the Treasury and other items. The major portion of grants and contributions in recent fiscal years consists of transfers to the Health Facilities and Services Administration and advances to the municipalities.

Other Expenditures

This category represents recurring General Fund expenditures not appropriately attributable to other expenditures line items, such as advances to government agencies and municipalities which advances are to be reimbursed to the General Fund by law.

Federal Grants

Puerto Rico receives federal grants under numerous programs. The following table presents revenues from federal grants by broad program areas which are accounted in the central accounting system of the Department of the Treasury.

Puerto Rico

Federal Grants
(in thousands)

	Fiscal Year Ending June 30				
	1994	1995	1996	1997(p)	1998(e)
Education	$ 427,407	$ 472,409	$ 529,084	$ 518,254	$ 513,709
Social Services	1,329,671	1,440,351	1,463,802	1,508,969	1,524,318
Health	399,056	392,076	382,497	329,469	322,502
Labor and Human Resources (1)	196,736	150,857	136,508	107,800	116,286
Public Works and Transportation(2)	45	306	136	39	0
Crime	11,161	15,569	20,876	27,198	25,726
Housing(3)	201,695	222,312	239,586	224,965	224,787
Drug and Justice	6,417	5,148	5,613	9,209	9,714
Agriculture and Natural Resources	6,764	12,558	11,546	14,516	6,771
Contributions to Municipalities	61,801	65,993	66,389	64,911	64,911
Other	16,755	4,687	4,495	5,929	5,629
Total	$2,657,508	$2,782,266	$2,860,812	$2,811,259	$2,814,254

(p) Preliminary
(e) Estimated
(1) Amounts include grants to Right to Work Administration and the Occupational Development and Human Resources Council.
(2) Amounts of federal grants to the Highway and Transportation Authority are not included in the Public Works and Transportation area. For fiscal 1994, 1995, 1996 and 1997 the federal grants to this agency are $75.9 million, $90.8 million, $101.9 million and $128.2 million, respectively
(3) Amounts include grants to the Public Housing Administration.

BUDGET OF THE GOVERNMENT OF PUERTO RICO

Office of Management and Budget

The fundamental objective of the Office of Management and Budget ("OMB") is to improve and strengthen the relationship between policy formulation and budgetary and fiscal management. The law creating OMB also strengthened budgetary controls and created an Operational Audit Division with the primary function of evaluating government operations and programs.

Budgetary Process

The fiscal year of the Government of Puerto Rico begins each July 1. The Governor is constitutionally required to submit to the Legislature an annual balanced budget of capital improvements and operating expenses of the central government for the ensuing fiscal year. The annual budget is prepared by OMB, working with the Planning Board, the Department of the Treasury, and other government offices and agencies. Section 7 of Article VI of the Constitution provides that "The appropriations made for any fiscal year shall not exceed the total revenues, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided by law."

The annual budget, which is developed utilizing elements of program budgeting and zero-base budgeting, includes an estimate of revenues and other resources for the ensuing fiscal year under (i) laws existing at the time the budget is submitted, and (ii) legislative measures proposed by the Governor and submitted with the proposed budget, as well as the Governor's recommendations as to appropriations that in his judgment are necessary, convenient, and in conformity with the four-year investment plan prepared by the Planning Board.

The Legislature may amend the budget submitted by the Governor but may not increase any items so as to cause a deficit without imposing taxes to cover such deficit. Upon passage by the Legislature, the budget is referred to the Governor who may decrease or eliminate any item but may not increase or insert any new item in the budget. The Governor may also veto the budget in its entirety and return it to the Legislature with his objections. The Legislature, by a two-thirds majority in each house, may override the Governor's veto. If a budget is not adopted prior to the end of the fiscal year, the annual budget for the preceding fiscal year as originally approved by the Legislature and the Governor is automatically renewed for the ensuing fiscal year until a new budget is approved by the Legislature and the Governor. This permits the Government of Puerto Rico to continue to make payments of its operating and other expenses until a new budget is approved.

Financial Control and Adjustment Procedures

Revenue estimates for budgetary purposes are prepared by the Department of the Treasury, except for estimates of federal grants, which are prepared by OMB and various departments and other recipients of such grants. Revenue and federal grant estimates are under continuous review and, if necessary, are revised at least quarterly during the fiscal year. Fiscal control over expenditures is exercised severally by the Governor, through the Director of OMB, and the Secretary of the Treasury. Quarterly reviews and expenditure cut-off procedures are designed to prevent expenditures in excess of appropriations.

During any fiscal year in which the resources available to the Commonwealth are insufficient to cover the appropriations approved for such year, the Governor may take administrative measures to reduce expenses and submit to both houses of the Legislature a detailed report of any adjustment necessary to balance the budget, or make recommendations to the Legislature for new taxes or authorize borrowings under provisions of existing legislation or take any other necessary action to meet the estimated deficiency. Any such proposed adjustments shall give effect to the "priority norms" established by law for the disbursement of public funds in the following order of priority: first, the payment of the interest on and amortization requirements for public debt (Commonwealth general obligations and guaranteed debt for which the Commonwealth's guarantee has been exercised); second, the fulfillment of obligations arising out of legally binding contracts, court decisions on eminent domain, and certain commitments to protect the name, credit and good faith of the Commonwealth; third, current expenditures in the areas of health, protection of persons and property, education, welfare and retirement systems; and fourth, all other purposes.

A Budgetary Fund was created by Act No. 147 of June 18, 1980, as amended (the "Budgetary Fund Act"), to cover the appropriations approved in any fiscal year in which the revenues available for such fiscal year are insufficient, honor the public debt, and provide for unforeseen circumstances in the provision of public services. The Budgetary Fund Act was amended in 1994 to require that an annual legislative appropriation equal to one third of one percent (.33%) of the total budgeted appropriations for each fiscal year be deposited in the Budgetary Fund. In 1997, the Budgetary Fund Act was further amended to increase the annual legislative appropriation required to be deposited in the Budgetary Fund to one percent (1%) of the total revenues of the preceding fiscal year, beginning in fiscal year 2000. In addition, other income (not classified as revenues) that is not assigned by law to a specific purpose is also required to be deposited in the Budgetary Fund. The maximum balance of the Budgetary Fund may not exceed six percent (6%) of the total appropriations included in the budget for the preceding fiscal year.

Appropriations

Appropriations in the central government budget of Puerto Rico consist of the following:

(i) General Fund appropriations for recurring ordinary operating expenses of the central government and for contributions to public corporations, municipalities, and private organizations. Such appropriations are made by a single annual law known as the Joint Resolution of the General Budget.

(ii) General Fund appropriations for special operating expenses and for capital expenditures. Such appropriations are authorized by separate laws for one or more years for special programs or activities, which may be permanent or transitory.

(iii) Disbursements of Special Funds for operating purposes and for capital improvements. For the most part, such disbursements do not require annual legislative authorization, because they are authorized by previous legislation or by the United States Congress. Federal grants constitute the major part of the resources of the Special Funds.

(iv) Bond Fund appropriations for capital expenditures financed by bonds. Such expenditures may occur in one or more years.

In Puerto Rico, the central government has many functions which in the fifty states are the responsibility of local government, such as providing public education and police and fire protection. The central government also makes large annual grants to the University of Puerto Rico and to the municipalities. In the summaries of the budgets of the central government presented below, grants to the University of Puerto Rico are included in current expenses for education and debt service on general obligation bonds is included in current expenses for debt service. Debt service on Sugar Corporation notes paid by the Government of Puerto Rico is included in current expenses for economic development, and debt service on Urban Renewal and Housing Corporation bonds and notes and on Housing Bank and Finance Agency mortgage subsidy bonds paid by the Government of Puerto Rico is included in current expenses for housing.

Approximately 24.9% of the General Fund is committed, including debt service on direct debt of the Commonwealth and on the debt of the Sugar Corporation, municipal subsidies, grants to the University of Puerto Rico, contributions to Aqueduct and Sewer Authority, and rental payments to Public Buildings Authority, among others.

Fiscal 1998 Budget

The following table presents a summary of the Commonwealth budget for the fiscal year ended June 30, 1998 as adjusted in February, 1998.

Puerto Rico
Summary of Central Government Annual Budget
Fiscal Year Ended June 30, 1998
(in thousands)

	General Fund	Bond Fund	Special Funds	Total
Resources:				
Revenues from internal sources:				
Property taxes	$ -	$ -	$ 90,406	$ 90,406
Personal income taxes	2,020,000	-	-	2,020,000
Income tax withheld from non-residents	137,000	-	-	137,000
Corporation income taxes	1,506,000	-	-	1,506,000
Partnership income taxes	2,000	-	-	2,000
Tollgate taxes	148,000	-	-	148,000
17% withholding tax on interest	9,000	-	-	9,000
10% withholding tax on dividends	38,000	-	-	38,000
Inheritance and gift taxes	2,000	-	-	2,000
Excise taxes:				
Alcoholic beverages	238,000	-	-	238,000
Motor vehicles and accessories	372,000	-	200	372,200
Cigarettes	120,000	-	-	120,000
Special excise tax on certain petroleum products	38,000	-	-	38,000
General 5% excise tax	479,000	-	-	479,000
Other	103,000	-	72,630	175,630
Licenses	66,000	-	-	66,000
Miscellaneous non-tax revenues:				
Contributions from lottery fund	58,000	-	-	58,000
Electronic lottery	57,000	-	-	57,000
Registration and document certification fees	109,000	-	-	109,000
Other	44,000	-	140,642	184,642
Total revenues from internal sources	5,546,000	-	303,878	5,849,878
Revenues from non-Commonwealth sources:				
Federal excise taxes on off-shore shipments	200,000	-	15,400	215,400
Federal grants	-	-	2,849,015(1)	2,849,015
Customs	74,000	-	-	74,000
Total revenues from non-Commonwealth sources	274,000	-	2,864,415	3,138,415
Total revenues	5,820,000	-	3,168,293	8,988,293
Other:				
Miscellaneous income	60,075	-	-	60,075
Total other income	60,075	-	-	60,075
Payment in lieu of taxes PRTC	58,550	-	-	58,550
Others income	140,000	-	-	140,000
Assets sales (VBC)	1,379	-	-	1,379
Balance from previous year	14,662	-	251,904	266,566
Bonds authorized	-	500,000	-	500,000
Total other sources	274,666	500,000	251,904	1,026,570
Total resources	6,094,666	500,000	3,420,197	10,014,863

	General Fund	Bond Fund	Special Funds	Total
Appropriations:				
Current expenses:				
General government	528.772	-	26.205	554.977
Education	1.937.134	-	593.321	2.530.455
Health	928.856	-	338.433	1.267.289
Welfare	307.470	-	1.731.724	2.039.194
Economic development	210.399	-	28.733	239.132
Public safety and protection	1.025.738	-	62.249	1.087.987
Transportation and communications	62.150	-	5.283	67.433
Housing	19,526	-	126.629	146.155
Contributions to municipalities	266.158	-	2,209	268.367
Special pension contributions	29.595	-	-	29.595
Debt service	368.544	-	90.406	458.950
Other debt service	410.094	-	19.000	429.094
Total appropriations--current expenses	6.094,436	-	3.024.192	9.118.628
Capital improvements	230	500.000	167.251	667.481
Total appropriations	6,094,666	500.000	3.191.443	9.786.109
Year-end balance	-	-	228.754	228.754
Total appropriations and year-end balance	$6.094.666	$500.000	3.420.197	$10.014.863

(1) Does not include grants received by agencies whose accounting systems are not centralized in the Department of the Treasury.

Sources: Department of the Treasury resources and Office of Management and Budget as reported on March 10, 1998.

In the fiscal 1998 budget revenues and other resources of all budgetary funds total $9,248,297,000 excluding balances from the previous fiscal year and general obligation bonds authorized. The estimated net increase in General Fund revenues in fiscal 1998 are accounted for by increases in personal income taxes (up $194,663,000), corporation income taxes (up $65,309,000), retained non-resident income tax (up $48,397,000), general excise of 5% (up $32,500,000), registration and document certification fees (up $13,131,000), customs (up $12,886,000), licences (up $12,465,000), electronic lottery (up $9,006,000), alcoholic beverages (up $8,957,000), motor vehicles and accessories (up $6,180,000), contributions from lottery fund (up $5,171,000), and decrease in federal excise taxes on off-shore shipments (down $3,755,000), property taxes (down $8,286,000), tollgate taxes (down $62,245,000), and special excise tax on certain petroleum products (down $120,739,000).

Current expenses and capital improvements of all budgetary funds total $9,786,109,000, an increase of $560,591,000 from fiscal 1997. The major changes in General Fund expenditures by program in fiscal 1998 are: health (up $141,418,000), education (up $120,362,000), other debts (up $109,270,000), public safety and protection (up $95,340,000), economic development (up $2,916,000), contributions to municipalities (up $3,917,000), special pension contributions (up $1,508,000), housing (down $3,044,000), debt service (down $6,456,000), general government (down $8,115,000), transportation and communications (down $16,596,000), and welfare (down $12,129,000).

The general obligation bond authorization for the fiscal 1998 budget is $500,000,000.

Proposed Fiscal 1999 Budget

The following table presents a summary of the proposed Commonwealth budget for the fiscal year ended June 30, 1999.

Puerto Rico
Summary of Central Government Annual Budget
Fiscal Year Ending June 30, 1999
(in thousands)

	General Fund	Bond Fund	Special Funds	Total
Revenues from internal sources:				
Property taxes	$ -	$ -	$ 94,927	$ 94,927
Personal income taxes	2,280,000	-	-	2,280,000
Income tax withheld from non-residents	144,000	-	-	144,000
Corporation income taxes	1,671,000	-	-	1,671,000
Partnership income taxes	3,000	-	-	3,000
Tollgate taxes	134,000	-	-	134,000
17% withholding tax on interest	10,000	-	-	10,000
10% withholding tax on dividends	40,000	-	-	40,000
Inheritance and gift taxes	2,000	-	-	2,000
Excise taxes:				
Alcoholic beverages	240,000	-	-	240,000
Motor vehicles and accessories	395,000	-	200	395,200
Cigarettes	121,000	-	-	121,000
Special excise tax on certain petroleum products	46,000	-	-	46,000
General 5% excise tax	517,000	-	-	517,000
Slot machines and machines for entertainment	-			-
Other	107,000	-	74,240	181,240
Licenses	67,000	-	-	67,000
Miscellaneous non-tax revenues:				
Contributions from lottery fund	58,000	-	-	58,000
Electronic lottery	61,000	-	-	61,000
Registration and document certification fees	113,000	-	-	113,000
Other	48,000	-	191,103	239,103
Total revenues from internal sources	6,057,000	-	360,470	6,417,470
Revenues from non-Commonwealth sources:				
Federal excise taxes on off-shore shipments	224,000	-	15,000	239,000
Federal grants	-	-	2,987,191(1)	2,987,191
Customs	75,000	-	-	75,000
Total revenues from non-Commonwealth sources	299,000	-	3,002,191	3,301,191
Total revenues	6,356,000	-	3,362,661	9,718,661
Other:				
Miscellaneous income	48,398	-	-	48,398
Total other income	48,398	-	-	48,398
Payment of lieu of taxes PRTC	50,000	-	-	50,000
Housing Bank and Finance Agency	41,857	-	-	41,857
Recover for Department of the Treasury	55,514			55,514
Balance from previous year	-	-	228,754	228,754
Bonds authorized	-	475,000	-	475,000
Total other sources	195,769	475,000	228,754	899,523
Total resources	6,551,769	475,000	3,591,415	10,618,184

	General Fund	Bond Fund	Special Funds	Total
Appropriations:				
Current expenses:				
General government	555,531	-	32,774	588,305
Education	2,097,062	-	612,741	2,709,803
Health	1,054,656	-	334,688	1,389,344
Welfare	332,153	-	1,871,917	2,204,070
Economic development	207,313	-	28,400	235,713
Public safety and protection	1,151,368	-	63,796	1,215,164
Transportation and communications	62,067	-	9,575	71,642
Housing	18,171	-	136,217	154,388
Contributions to municipalities	223,821	-	2,169	225,990
Special pension contributions	44,640	-	-	44,640
Debt service	320,242	-	94,927	415,169
Other debt service	484,745	-	51,244	535,989
Total appropriations—current expenses	6,551,769	-	3,238,448	9,790,217
Capital improvements	-	475,000	164,380	639,380
Total appropriations	6,551,769	475,000	3,402,828	10,429,597
Year-end balance	-	-	188,587	188,587
Total appropriations and year-end balance	$6,551,769	$475,000	3,591,415	$10,618,184

(1) Does not include grants received by agencies whose accounting systems are not centralized in the Department of Treasury.

Sources: Department of the Treasury and Office of Management and Budget.

In the fiscal 1999 budget proposal, revenues and other resources of all budgetary funds total $9,914,430,000 excluding balances from the previous fiscal year and general obligation bonds authorized. The estimated net increase in General Fund revenues in fiscal 1999 are accounted for by increases in personal income taxes (up $260,000,000), corporation income taxes (up $165,000,000), general excise of 5% (up $38,000,000), federal excise taxes on off-shore shipments (up $24,000,000), motor vehicles and accessories (up $23,000,000), special excise tax on certain petroleum products (up $8,000,000), non-resident income tax withholding (up $7,000,000), electronic lottery (up $4,000,000), registration and document certification fees (up $4,000,000), alcoholic beverages (up $2,000,000), and a decrease in tollgate taxes (down $14,000,000).

Current expenses and capital improvements of all budgetary funds total $10,429,597,000, an increase of $643,488,000 from fiscal 1998. The major changes in General Fund expenditures by program in fiscal 1999 are: education (up $159,928,000), health (up $125,800,000), public safety and protection (up $125,630,000), other debts (up $74,651,000), general government (up $26,759,000), welfare (up $24,683,000), special pension contributions (up $15,045,000), transportation and communications (down $83,000), housing (down $1,355,000), economic development (down $3,086,000), contributions to municipalities (down $42,337,000), and debt service (down $48,302,000).

The general obligation bond authorization for the fiscal 1999 budget is $475,000,000.

Differences between Budget and General Purpose Financial Statements

Revenues and expenditures, as reported by the Department of the Treasury in its General Purpose Financial Statements, may differ substantially from resources and appropriations in the annual budget for a number of reasons, including the following:

(i) The budgetary accounts are on a cash basis, while the financial statements prepared by the Department of the Treasury include accruals and other adjustments as required by government accounting standards.

(ii) Expenditures for current purposes in a particular fiscal year may include amounts appropriated for earlier periods but not previously expended and, conversely, may exclude amounts appropriated for such fiscal year but not expended until later periods.

(iii) Bonds are authorized by the Commonwealth in accordance with a four-year capital improvement program. Since bond sales are determined by bond market conditions and other factors, the amount of bonds sold in any year does not necessarily equal the amount of bonds authorized in the budget for that year. Expenditures for capital improvements are financed by advances from the General Fund to the Capital Projects Fund, which are later reimbursed from proceeds of bond or note sales.

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FORM OF OPINION OF BOND COUNSEL

Upon delivery of the Public Improvement Bonds, Squire, Sanders & Dempsey L.L.P. is prepared to render its final opinion with respect to the Public Improvement Bonds in substantially the following form:

April __, 1998

Hon. Xenia Vélez Silva
Secretary of the Treasury of Puerto Rico
San Juan, Puerto Rico

Dear Madam:

We have served as bond counsel in connection with the issuance by the Commonwealth of Puerto Rico of its $500,000,000 principal amount of Public Improvement Bonds of 1998 (the "Bonds"). The Bonds are dated, mature on July 1 of the years and in such principal amounts, bear interest at the rates, all as set forth in the Resolution referred to hereinbelow. The Bonds are issuable as fully registered Bonds without coupons, in authorized denominations of $5,000 and integral multiples thereof, in the manner and in accordance with the terms and conditions of the Resolution.

In our capacity as bond counsel, we have examined the transcript of the proceedings (the "Transcript") of the Commonwealth of Puerto Rico relating to the issuance of the Bonds, including, without limitation, Act No. 81 of the Legislature of Puerto Rico, approved August 14, 1997 (the "Act") and a resolution adopted on April 2, 1998 by the Secretary of the Treasury of Puerto Rico and approved by the Governor of Puerto Rico (the "Resolution"), and such other documents as we have deemed necessary to render this opinion.

We have also examined a copy of one of the Bonds as executed and authenticated. We assume that all other Bonds have been similarly executed and authenticated.

From such examination, we are of the opinion that:

1. The Act is valid.

2. Said proceedings have been validly and legally taken.

3. The Act and said proceedings show lawful authority for the issuance and sale of the Bonds, and the Bonds constitute valid and binding general obligations of the Commonwealth of Puerto Rico for the prompt payment of the principal of and the interest on which the good faith, credit and taxing power of the Commonwealth of Puerto Rico are pledged.

4. The interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103(a) of the Internal Revenue Code of 1986, as amended (the "Code"), and is not an item of tax preference under Section 57 of the Code for purposes of the federal alternative minimum tax imposed on individuals and corporations. The Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation.

In giving the opinion set forth in numbered paragraph 4. hereof, we have relied upon and assumed compliance with the Commonwealth of Puerto Rico's covenants and the accuracy, which we have not independently verified, of the representations and certifications of the Commonwealth of Puerto Rico contained in the Transcript. The accuracy of those representations and certifications, and the Commonwealth of Puerto Rico's compliance with those covenants, may be necessary for the interest on the Bonds to be and to remain excluded from gross income for federal income tax purposes. Failure to comply with certain of those covenants subsequent to issuance of the Bonds could cause interest on the Bonds to be included in gross income for federal income tax purposes retroactively to the date of issuance of the Bonds. We are not aware of any provisions of the Constitution or laws of the Commonwealth of Puerto Rico which would prevent the Commonwealth of Puerto Rico from complying with the requirements of the Code.

Under the Code, portions of the interest on the Bonds earned by certain corporations (as defined for federal income tax purposes) may be subject to a corporate alternative minimum tax and interest on the Bonds may be subject to a branch profits tax imposed on certain foreign corporations doing business in the United States and to a tax imposed on excess net passive income of certain S corporations.

In rendering the opinions set forth herein, we have assumed the accuracy and truthfulness of all public records and of all certifications, documents and other proceedings examined by us that have been executed or certified by public officials acting within the scope of their official capacities and have not verified the accuracy or truthfulness thereof. We have also assumed the genuineness of the signatures appearing upon such public records, certifications, documents and proceedings. As to questions of fact material to our opinion, we have relied on representations of the Commonwealth of Puerto Rico furnished to us, without undertaking to verify such representations by independent investigation.

Respectfully submitted,

[To be signed "Squire, Sanders & Dempsey L.L.P."]

FORM OF OPINION OF BOND COUNSEL

Upon delivery of the Refunding Bonds, Squire, Sanders & Dempsey L.L.P. is prepared to render its final opinion with respect to the Refunding Bonds in substantially the following form:

April __, 1998

Hon. Xenia Vélez Silva
Secretary of the Treasury of Puerto Rico
San Juan, Puerto Rico

Dear Madam:

We have served as bond counsel in connection with the issuance by the Commonwealth of Puerto Rico of its $38,500,000 principal amount of Public Improvement Refunding Bonds, Series 1998B (the "Bonds"). The Bonds are dated, mature on July 1 of the years and in such principal amounts and bear interest at the rates, all as set forth in the Resolution referred to hereinbelow. The Bonds are issuable as fully registered Bonds without coupons, in authorized denominations of $5,000 and integral multiples thereof, in the manner and in accordance with the terms and conditions of the Resolution.

In our capacity as bond counsel, we have examined the transcript of the proceedings (the "Transcript") of the Commonwealth of Puerto Rico relating to the issuance of the Bonds, including, without limitation, Act No. 2 of the Legislature of Puerto Rico, approved October 10, 1985, and Joint Resolution No. 57 of the Legislature of Puerto Rico, approved July 12, 1993 (collectively, the "Act") and a resolution adopted on April 2, 1998 by the Secretary of the Treasury of Puerto Rico and approved by the Governor of Puerto Rico (the "Resolution"), and such other documents as we have deemed necessary to render this opinion.

We have also examined a copy of one of the Bonds as executed and authenticated. We assume that all other Bonds have been similarly executed and authenticated.

From such examination, we are of the opinion that:

1. The Act is valid.

2. Said proceedings have been validly and legally taken.

3. The Act and said proceedings show lawful authority for the issuance and sale of the Bonds, and the Bonds constitute valid and binding general obligations of the Commonwealth of Puerto Rico for the prompt payment of the principal of and the interest on which the good faith, credit and taxing power of the Commonwealth of Puerto Rico are pledged.

4. The interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103(a) of the Internal Revenue Code of 1986, as amended (the "Code"), and is not an item of tax preference under Section 57 of the Code for purposes of the federal alternative minimum tax imposed on individuals and corporations. The Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation.

In giving the opinion set forth in numbered paragraph 4. hereof, we have relied upon and assumed compliance with the Commonwealth of Puerto Rico's covenants and the accuracy, which we have not independently verified, of the representations and certifications of the Commonwealth of Puerto Rico contained in the Transcript. The accuracy of those representations and certifications, and the Commonwealth of Puerto Rico's compliance with those covenants, may be necessary for the interest on the Bonds to be and to remain excluded from gross income for federal income tax purposes. Failure to comply with certain of those covenants subsequent to issuance of the Bonds could cause interest on the Bonds to be included in gross income for federal income tax purposes retroactively to the date of issuance of the Bonds. We are not aware of any provisions of the Constitution or laws of the Commonwealth of Puerto Rico which would prevent the Commonwealth of Puerto Rico from complying with the requirements of the Code.

Under the Code, portions of the interest on the Bonds earned by certain corporations (as defined for federal income tax purposes) may be subject to a corporate alternative minimum tax and interest on the Bonds may be subject to a branch profits tax imposed on certain foreign corporations doing business in the United States and to a tax imposed on excess net passive income of certain S corporations.

In rendering the opinions set forth herein, we have assumed the accuracy and truthfulness of all public records and of all certifications, documents and other proceedings examined by us that have been executed or certified by public officials acting within the scope of their official capacities and have not verified the accuracy or truthfulness thereof. We have also assumed the genuineness of the signatures appearing upon such public records, certifications, documents and proceedings. As to questions of fact material to our opinion, we have relied on representations of the Commonwealth of Puerto Rico furnished to us, without undertaking to verify such representations by independent investigation.

Respectfully submitted,

[To be signed "Squire, Sanders & Dempsey L.L.P."]

APPENDIX III

MBIA

FINANCIAL GUARANTY INSURANCE POLICY

MBIA Insurance Corporation
Armonk, New York 10504

Policy No. [NUMBER]

MBIA Insurance Corporation (the "Insurer"), in consideration of the payment of the premium and subject to the terms of this policy, hereby unconditionally and irrevocably guarantees to any owner, as hereinafter defined, of the following described obligations, the full and complete payment required to be made by or on behalf of the Issuer to [PAYING AGENT/TRUSTEE] or its successor (the "Paying Agent") of an amount equal to (i) the principal of (either at the stated maturity or by any advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Obligations (as that term is defined below) as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed hereby shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law. The amounts referred to in clauses (i) and (ii) of the preceding sentence shall be referred to herein collectively as the "Insured Amounts." "Obligations" shall mean:

[PAR]
[LEGAL NAME OF ISSUE]

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by the Insurer from the Paying Agent or any owner of an Obligation the payment of an Insured Amount for which is then due, that such required payment has not been made, the Insurer on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with State Street Bank and Trust Company, N.A., in New York, New York, or its successor, sufficient for the payment of any such Insured Amounts which are then due. Upon presentment and surrender of such Obligations or presentment of such other proof of ownership of the Obligations, together with any appropriate instruments of assignment to evidence the assignment of the Insured Amounts due on the Obligations as are paid by the Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the Obligations in any legal proceeding related to payment of Insured Amounts on the Obligations, such instruments being in a form satisfactory to State Street Bank and Trust Company, N.A., State Street Bank and Trust Company, N.A. shall disburse to such owners, or the Paying Agent payment of the Insured Amounts due on such Obligations, less any amount held by the Paying Agent for the payment of such Insured Amounts and legally available therefor. This policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Obligation.

As used herein, the term "owner" shall mean the registered owner of any Obligation as indicated in the books maintained by the Paying Agent, the Issuer, or any designee of the Issuer for such purpose. The term owner shall not include the Issuer or any party whose agreement with the Issuer constitutes the underlying security for the Obligations.

Any service of process on the Insurer may be made to the Insurer at its offices located at 113 King Street, Armonk, New York 10504 and such service of process shall be valid and binding.

This policy is non-cancellable for any reason. The premium on this policy is not refundable for any reason including the payment prior to maturity of the Obligations.

IN WITNESS WHEREOF, the Insurer has caused this policy to be executed in facsimile on its behalf by its duly authorized officers, this day of

COUNTERSIGNED:

MBIA Insurance Corporation

Resident Licensed Agent

President

SPECIMEN

City, State

Attest:

Assistant Secretary

STD-RCS-6
4/95

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