The Political Economy of Contemporary Puerto Rico

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Introduction

Any approach towards comprehending the evolution and current state of the socio-economic situation of Puerto Rico has to recognize both continuity and rupture in the economic history of this colonial possession of the United States.[1] While the economy of the island is one that has passed through different stages since the period of industrialization began in the late 1940s, the understanding of how to achieve and sustain industrialization, and by extension economic development, has basically remained the same: phases pertaining to light industry, i.e. apparel (1947-67); heavy industry, i.e petrochemicals (1968-75); and high technology, i.e, pharmaceuticals and electronics (1976-2006) all have had the common denominator of using substantial tax incentives (exemptions, preferential treatment, credits, subsidies, etc.) for foreign capital as the spearhead of a strategy to achieve capital accumulation and economic development.[2]

The general practical and ideological contours behind this project of *industrialization by invitation*, known as "Operation Bootstrap," are ones that during the last decade still permeate the policy approaches of the different governmental administrations of the colony.[3] Important among these is the idea that benefits generated at the top, i.e. the private business sector, will somehow "trickle-down" to the rest of society. While it is true that some limited success in terms of economic growth was achieved during the initial decades of Operation Bootstrap (6% average between the years 1947 and 1973) what is undeniable is that the perpetuation of the model has not contributed to the creation of a dynamic and sustainable economy; on the contrary, it has created both *economic dependence* on foreign capital, an unproductive local capitalist class that has focused on financial and merchant activities, and a highly skilled working class with limited access to employment and substantial incentives for emigration.

1 Throughout the paper we use the term "colonial" to refer the juridico-political situation of Puerto Rico as a territorial possession of the United States. We focus on this narrow definition of the term given our interest in highlighting the relative autonomy of the government in fiscal manners, which for us is a fundamental variable for understanding the current political economy of the island.
2 The debates pertaining to what is "economic development" are beyond the scope of this essay and are shared by the contributors of this book either explicitly or implicitly. For the sake of simplicity we assume that capital accumulation is a precondition for economic development, even though we understand the limits of such an economistic outlook.
3 For a discussion of the abandonment of state-capitalist planning in the island for what became Operation Bootstrap, see Catalá (2013) and Dietz (1986).

As of now the size of the economy of Puerto Rico, measured in terms of its Gross Domestic Product (GDP), totals $105 billion, while measured in terms of Gross National Product (GNP), it totals $70 billion. This gap between GDP and GNP represents an approximation of the total quantum of money that is extracted from the island to the U.S. mainland by U.S. multinational firms.[4]

The level of internal investment by the private sector equals 12% of GNP and is seven times smaller than the level of aggregate internal consumption, while imports outpace exports by ten percent.[5] More than 80% of what is consumed within the island is imported while less than 15% of the purchases done by multinationals are from local suppliers. Manufacturing accounts for 47% of GDP, followed by real-estate with 15% and finance and insurance with 5%.[6] Employment in the tourism sector (80,000 jobs) has recently outstripped that of manufacturing (76,000 jobs), even though it only provides a small fraction of what manufacturing adds to the economy.[7] Finally, the unemployment rate as of December of 2017 is 10.9%.

The statistical description provided above points to an economy that does not produce any substantial domestic capital accumulation, and therefore employment, and is one that 'consumes what it does not produce and produces what it does not consume.' Not surprisingly, the dependence on foreign capital, the anemic performance of the local capitalist sector, the changes in the global economy, and the relationship with the U.S. that imposes political and economics constraints, have all combined to transform Puerto Rico from a supposed 'success' story in the economics literature into an evident catastrophe.

A decade of economic depression

It is not an exaggeration to claim that the performance of the economy of Puerto Rico during the last decade evokes images of a disaster whose magnitude – in all its qualitative, quantitative and temporal determinations – is difficult to grasp. The "Economic and Intelligence Unit," a research division of the London based *The Economist*, has recently gone as far as declaring that Puerto Rico will be among the list

4 In other words, using GDP to measure economy of the island overestimates the income going to the island. This is one of the reasons why the measure of GNP is the main macroeconomic variable normally used locally to evaluate the performance of the economy of the island.
5 The data presented in this section is based on Junta de Planificación (2016, 2018). In the economics' literature, a "normal" level of consumption in relation to the size of the economy is usually around 75%. The relative big size of consumption vis a vis internal investment in Puerto Rico is evidence of the meagre size and anemic dynamism of the local private sector. Unfortunately, data for "foreign direct investment" by multinational firms in Puerto Rico is not available.
6 Agriculture accounts for less than 1% of GDP, and although it has experienced a resurgence in the last years, it experienced a major setback with the landfall of hurricane María, which destroyed around 80% of the harvest.
7 Measurements comparing the sectors in terms of productivity are difficult to make given that a substantial amount of the profits reported in manufacturing are actually not created in the island but are the result of "transfer-pricing" strategies by multinational firms to evade taxes. For an analysis of Puerto Rico's place in the circulation of global profits, see Quiñones-Pérez (2006).

of “slowest growing economies” (just behind Venezuela) for the year 2018 with no foreseen recovery in the near future (The Economist 2018). While the catastrophic nature of socio-economic reality in the island has been significantly augmented by recent natural disasters, there is no denying that the outcome of devastation was already visible on the horizon.[8]

Years of relative economic stagnation since the 1970s (less than 1.5% growth per year), followed by more than a decade of economic depression and a severe fiscal crisis (current public debt equals 100% of GNP), have been caused and shaped both by endogenous and exogenous factors. The results are staggering.

Since 2006, the total economic contraction of the economy, measured in term of the Gross National Product (GNP), reached 14%[9] while non-agricultural wage labor has fallen 16% (168,000 jobs).[10] There has also been a general collapse in the real-estate market in terms of loss of value, mortgage foreclosures and abandoned housing properties.[11] Not surprisingly inequality and poverty have increased, placing Puerto Rico among the most unequal countries in the world.[12] Finally, increasing waves of emigration and a lowering of the natural growth rate of the population have translated into a demographic imbalance.[13]

In response to this scenario, government administrations with different views on the colonial situation of the island in relation to the United States have converged in their responses by putting forward various regressive policies that have included an increase in the tax burden of consumption, the firing of thousands of public employees while reducing the fringe benefits of those remaining, big privatization projects, and market liberalization policies.[14] While the difference between administrations is one of degrees, a constant among them has been their attack on labor based on an *internal devaluation* strategy that seeks to make Puerto Rico more ‘competitive’ and ‘attractive’ for foreign investment by reducing labor costs. This approach has echoed the general global offensive by capital against labor in a moment where, contrary to the offensive of the 1970s and early 80s, labor’s institutions are weak and on the retreat.[15]

Another important dimension of the offensive on labor has been the standard neoliberal

8 In September of 2017 the island felt the effects of two hurricanes, Irma (category 4) and by María (category 5).
9 Author’s calculations based on Junta de Planificación (2015, 2016).
10 ibid.
11 The year 2016 saw an increment of 21.6% in cases of mortgage foreclosures in comparison to 2015, which is the highest in a decade (Tellado-Domenech, 2017)
12 According to the U.S. Census Bureau (2015),the island’s GINI index (a standard measure of income inequality) was measured at 0.559, higher than those of Washington DC (0.535) and New York (0.514). When compared to World Bank data for other countries, these levels of inequality place Puerto Rico among the most unequal countries in the world.
13 In 2016, over 89,000 persons emigrated, while in the ten years before, the average was 60,000 per year. This number is now spiking upwards even more after the onslaught of hurricane María.
14 See Quiñones-Pérez and Seda-Irizarry (2016 and 2017) for a discussion of concrete examples.
15 See Stiglitz (2016) for a general discussion of internal devaluation, specifically in the context of the EURO-crisis.

attack based on the size of the government, which in this case has gone beyond the mere rhetoric and has been put into practice.[16] Between 2009 and 2016, over 73,000 public employees were fired, a drop of around 24% in public employment. This and other measures concerning cuts in public spending are aligned with the discredited ideology of "expansive austerity," an ideology embraced by the different governmental administrations to supposedly revitalize the economy and be able to pay-off the public debt.[17] This approach to confronting the double whip of the economic depression and the massive fiscal crisis, instead of laying the foundations for a future recovery, has facilitated a process of "accumulation by dispossession" (Harvey 2003) where public assets have been sold, pensions and retirement systems have been unfunded, and other public budgets have been re-allocated with the aim of paying a stratospheric public debt in a country with a real budgetary fiscal constraint given the absence of monetary sovereignty.[18] The combined efforts of the government, banks, insurance firms, credit rating agencies, hedge-funds, local intermediaries, and the recently imposed fiscal control board have supposedly been oriented towards making Puerto Rico regain access to credit markets to fund the reconstruction of the island's economy. Instead, the socialization of costs within a regime of austerity to try and pay-off the debt has further undermined the capacity of the economy to grow, an outcome that is leading the island to a guaranteed future of *debt peonage*.

At the same time, the status of the island and the politico-economic constraints that it enforces have limited some of the maneuvering space for the local economy. Century old merchant laws that to a certain extent put a constraint on commerce, the double standards in terms of the lack of applicability of bankruptcy laws (e.g. Chapter 9), the lack of monetary policy, etc. are but some of these dimensions.[19]

Contending explanations of the crisis

When it comes to an understanding of what brought the island's economy to this debacle, explanations range from 1) pointing fingers to the history of colonial Puerto Rico, 2) the inept and corrupt management of local government administrations, and 3) the transformations in the global economic system during the last four decades that have, for example, provided capital with greater flexibility to move around its profits.

A good example that to some extent combines all of the above perspectives focuses on the effects of the elimination of section 936 of the U.S. tax code which provided the axis for manufacturing in the island. Since 1976, this tax regime gave a red-carpet treatment to multinational subsidiaries operating in Puerto Rico to remit profits earned in the island back to their parent company in the U.S. without paying taxes. Because of political pressures pertaining to lost tax revenue to the mainland, it was eliminated by the U.S.

16 For a view that problematizes the discourse for shrinking the state versus the transformed functions of the state under neoliberalism, see Mirowski (2013).

17 See Shapiro (2012) for a review of arguments against austerity.

18 For a discussion of the implications of having sovereign debt while having monetary sovereignty (i.e. ability to print money), see Wray (2016).

19 Chapter 9 is a section of the bankruptcy code of the United States that applies to insolvent local governments and their public utilities, but not to territories like Puerto Rico.

Congress in 1996 with a ten year transitional phase-out period. Three main empirical observations highlight the relation between the economic depression and the elimination of section 936:

1) Since the mid-1990s, industrial employment has decreased and firms have left in what is usually described as a process of *deindustrialization*.

2) The public debt of the government and its corporations experienced an increase starting in the 1990s. Deindustrialization implied less jobs, and less jobs implied less revenues for the government via tax collections. A choice was then made to close the gap between revenues and government spending via the emission of debt.

3) The year 2006 marks the end of the phase-out/transition period for section 936 and that same year, according to official statistics, also marks the beginning of the economic depression of the island.

The colonial legacy of section 936 could be interpreted in terms of the huge sums of money *extracted* from Puerto Rico, mainly by American firms, and not reinvested in the island's economy thanks to its implementation. The transformations of global capitalism associated with financial flexibility can be seen in terms of the quantum of profits reported in the island (not necessarily produced there) by firms to escape taxation.[20] Finally, the role of inept administrations is usually highlighted given the lack of a comprehensive strategy for economic growth and development that should have been worked out and implemented once the elimination of section 936 was finalized.

A critical political economy approach recognizes all of the above specifications to comprehend the complexities that shape the socio-economic fabric of Puerto Rico. Still, what we would like to do with our contribution in this book is to reposition the above characterizations within a slightly different set of coordinates to try and highlight the perpetuation of a failed model of economic development mentioned in the introduction, while recognizing the local determination of policies aligned with it. This perspective is usually not emphasized in the analysis provided by economists within and outside the island and has important implications for any political strategy seeking to alter the current *status quo* in the island.

An alternative outlook

The first step in our endeavor to explore the contemporary political economy of Puerto Rico is to emphasize that the crisis of Puerto Rico's Commonwealth, i.e. the *Estado Libre Asociado*, and the crisis of its economic model, although intertwined, have to be kept conceptually distinct from one another. It is our position that collapsing one into another has obscured the *internal relations of power* at play in the island, relations that

20 For an analysis of this phenomenon known as "transfer-pricing," see Quiñones (2006). While section 936 no longer exists, this mechanism still works via the "controlled foreign corporations" clause of the U.S. tax system.

have shaped the responses to the economic crisis and are useful for explaining the fiscal crisis and the neoliberal structural adjustment that has been imposed to pay off the debt.

As in any other society, relations of power run at different levels throughout the economic fabric of Puerto Rican society. Unfortunately, and for reasons that go beyond the space and purpose of this chapter, politics and power in Puerto Rico have historically been reduced and understood in relation to the colonial status condition of the island as a territory of the United States. In that understanding, to say that the problem of the crisis is political is usually translated into a belief that if the colonial condition is abolished, the crisis will be solved. Common in these approaches is the *unilateral* emphasis on the politico-legal relationships with the United States. Also, the fact that the economic downturn of the island predated the global recession by two years is taken by many as evidence that this is a crisis of the colonial model and that therefore, the solution has to be sought in changing the present colonial relationship to a non-colonial status, be it statehood, independence, or variants of so-called sovereignty.[21] As we hope to make clear by the end of this chapter, the ending of the colonial relationship with the United States is a necessary but not sufficient condition to address the deep roots of the crisis. Important dimensions of the current socio-economic arrangement can still be compatible with non-colonial status options.

Another important dimension to understand the current political economy of Puerto Rico is the recognition that certain individuals and groups within the island have benefited during the economic depression. As in many other parts of the world, income inequality has been one of the major plot stories in Puerto Rico. Not only is the distribution of income in the island more unequal than any state in the United States, but the island is also one of the most unequal countries in the world. From a critical political economy perspective, this fact has to be further deconstructed by looking at the distribution of income in relation to its sources: For example, during the ten years of economic depression (2006 to 2016), data on the functional distribution of income pointed to a decrease in income of 3.9% for those whose income was based on employee's compensations while income based on property (profits, interests, etc.) increased by 59%. Another way to visualize the impact of this massive redistributive outcome is to directly compare the relative sizes of income going to property vis a vis that going to labor. For the year 2006, the total income based on property amounted to 56% of the total income based on employee's compensations. By 2016, that proportion had increased to 92%.[22] These and other statistics show the class bias of the redistributive effects of the crisis where not everybody in the island is experiencing the economic depression in the same way. These results are in part explained by the regressive tax policies that have characterised the different administrations in power. These policies have been the outcome of the common ideological beliefs of the different governmental administrations well as of the intense pressure from socio-economic interests that

21 See Backiel (2015) for a recent example of this colonialocentric approach.
22 Authors' calculations based on Junta de Planificación (2015, 2016: table 11). Also of note is the fact that "payments to the rest of the world" had increased by 19% over the same decade.

represent the organized strata of the local business and political elites.[23] A case in point is the “Coalition of the Private Sector,” an umbrella organization constituted by more than two dozen associations of the private sector in the island that have historically pushed for conservative/pro-market policies regarding the labor market while seeking to push for more corporate welfare for themselves.

Another important methodological step to understand the crisis of Puerto Rico is to place it in a historical context. The current socio-economic catastrophe of Puerto Rico has to be understood in relation to the crisis conjuncture of the mid-1970s and the whole ‘development’ project begun in the mid-to late 1940s. Critical in this is the recognition of the *relative autonomy* that different governmental administration have had in fiscal matters, be it in terms of levels of public spending, types of public spending, incentives provided to the private sector (both foreign and local), etc. Specifically, we want to highlight the perpetuation of a failed model of economic development that privatizes the gains and socializes the costs via the continued reliance on all types of tax incentives (credits, preferential rates, subsidies, etc.) with no connection to a well-developed and long-term industrial policy.

Perpetuation of a failed model

Puerto Rico faced its first post-war fiscal and economic crisis during the mid-1970s. This conjuncture demonstrated that the economic model in place had run its course and that fundamental changes were required so that its inherent structural deficiencies would not be triggered by new historical circumstances.

As mentioned in the beginning of this chapter, the strategy of ‘industrialization by invitation,’ provided substantial incentives to attract foreign direct investment. These included subsidized public utilities, infrastructure, and land; the provision of environmental subsidies; and tax credits and exemptions. This arrangement had originally been seen as an initial stage in the industrialization process to plant the seeds for the development of a robust local industry that would then ‘take-off’ and compete in world markets.[24]

Since the 1940s, various warnings had been made, especially about the excessive use of tax exemptions as the spearhead for an attempt at equitable and sustainable growth and development. The crisis of the mid-70s, which disrupted the fragile relative balance that had been attained between economic growth and distribution that had sought to legitimize the capitalist colony since 1947, showed the limits of dependent growth, limits that were not addressed. Instead the dependency on foreign capital was further

23 It is important to note that one can still assign the last name of local families to different forms of capital operating in the island: the Fonalledas family as representatives of merchant capital, the Carrión family as representatives of financial capital, and the Ferré family representing productive capital in intermediary goods (i.e. cement, although now a subsidiary of a the Mexican firm CEMEX) and owning the major media outlets in the country.
24 See Dietz (1986) and Catalá (2013) for a description of the expectations surrounding the application of this model of industrialization by invitation. See Quiñones-Pérez and Seda-Irizarry (2016a) for a historical overview of the performance of the economy.

strengthened with the implementation of section 936 in 1976.[25] The new tax exemption incentives for firms reflected the new global landscape in terms of flexibility for financial flows, as well as a continuation of the failed strategy of industrialization by invitation. As Dietz (1986: 251) states, “the tax-exemption program shifted from being a temporary measure, as originally conceived, to being a permanent feature of the development strategy.”

When examining the reactions to the current economic depression by the various administrations, one cannot fail to notice the continuation of the failed strategy of development based on tax incentives to both local and foreign capital. In the year 2004, two years before the economic crisis began, there were around 40 tax exemption laws. In 2008, two years after the start of the crisis, there were around 60 laws. Now there are more than 90 tax exemption laws and the current government administration does not show any signs of diverting from this path.

Apart from the number of laws, what jumps out is the fact that none of these laws has been ever submitted to a thorough analysis to see if their purported aims actually materialized.[26] Given the double-digit unemployment, the severe economic contraction with no end in sight, the increase in inequality, and the increase in the money being extracted from the island, one would think that there would be an urgent need to revisit this approach.[27]

What has indeed come out of this arrangement is a parasitic local private sector that cannot create jobs, and that sustains itself via the subsidies of the state. The regime of corporate welfare for both local and foreign capital has taken away resources that could provide the basis for countercyclical policies that might offset or at least soften the economic downturn. Estimates by a former secretary of the treasury point out that the potential revenue foregone by the government because of all the tax incentive scaffold stands at $25 billion dollars.[28] Even if we assume that in reality half of that total is actually needed for the survival of businesses, the remaining $12.5 billion is more than the total level of local investment ($8,608 for FY 2016). It also is more than the general fund of the government (around $9 billion dollars). These two results point to the existence of what could be called a ‘rentier state’ arrangement of corporate welfare, where the government practically guarantees the survival of firms that do not create jobs or economic activity on par with the help provided, with these firms continually receiving public benefits.

At the same time there is a class-biased regime of austerity that seeks to balance a

25 See Tobin et al (1976) and Villamil (1976). In some senses, especially in terms of economic growth, the industrialization period 1947-1973 could be considered the “golden-age” of Operation Bootstrap.
26 It is interesting to note that the data for ‘foreign direct investment’ of multinational firms stopped being collected by the government some decades ago. One would suppose that this information would be fundamental for analyzing the effectiveness of tax incentives.
27 Between 2006 and 2016, “payments to the rest of the world” increased by 18% (Junta de Planificación 2016, 2017). Author’s calculations.
28 These numbers were publicly shared to the media in August of 2016 by the then secretary of the treasury, Juan Zaragoza.

depleted budget by cutting important government expenditures (pensions, public employment, etc.) that directly affect the victims of the crisis while not touching the scaffold that provides all of these unexamined incentives.

The fact that the tax incentive laws were *locally determined* by different governmental administrations, irrespective of status preference, within the relative autonomy of the state under the Commonwealth, gives credence to the perspective that the crisis was in important ways *self-inflicted*.[29] From a political economy perspective, the relevant question then becomes, which are the groups that have continuously benefitted from the laws and policies enacted by the different governments? How do these extractive elites function to maintain the status quo?

Although a thorough analysis of the current class structure and its relation to the state is highly complicated and is yet to be produced, we can catch a glimpse of the main actors given what we have discussed so far. Outcomes pertaining to income inequality, the class bias of the tax reforms enacted, the internal devaluation strategy for cutting labor costs, the increasing amounts of wealth extracted from the island, and the accumulation by dispossession and privatization of public assets all point towards the need to understand the crisis not merely in terms of a colonial relationship in which many Puerto Ricans are victims of the imperial cravings of the United States, but where the looting of the public coffers is “rooted in [certain] coincidences of interest between local dominant classes and international ones” (Cardoso and Faletto, 1979: xvi). One example of this is the recent (January 2017) labor reform law passed by the current government, endorsed by the ‘Coalition of the Private Sector,’ and celebrated by multiple bondholder groups. This law basically increases the stress on the labor market conditions which translates into an increase in the precarity of work and an added incentive for emigration, especially for those that are entering the labor market.

Another example of the presence of extractive elites throughout the institutional scaffold of the island is apparent even when that scaffold seems, on a superficial level, to be fundamentally undermined. Specifically, the recent abolition of the relative autonomy of the government to control fiscal matters with the appointment of a Fiscal Control Board (FCB) by the U.S. Congress in August of 2016 points to an apparent rupture with important elements of continuity. Former government officials under both main parties that have had direct connections with the financial sector now serve on a board that is supposed to balance the finances (i.e. pay a debt equal to 100% of GNP) of bankrupt Puerto Rico. This board, which can be seen as both a colonial imposition and also as the result of local lobbying from certain sectors within the island, reflects continuity with the local administrations in terms of the neoliberal structural adjustment that is seen as a solution and also in terms of the perpetuation of the failed economic model that we have discussed.[30]

Conclusion

29 See Quiñones-Pérez and Seda-Irizarry (2017).

30 For an analysis of the FCB, see Quiñones-Pérez and Seda-Irizarry (2016b).

The economic model of Puerto Rico is one where gains are privatized and costs socialized for the benefit of local and foreign extractive elites. The class content of the relationship within the island and in relation to the U.S. can be clearly seen through the perpetuation of an economic model through locally determined policies that did not serve the needs of the majority of Puerto Ricans. Unfortunately, the emphasis on the colonial status of the island deprived of a class analysis has obscured the role that local governments, intermediaries and economic elites have had in the shaping of economic policies that have reinforced local and foreign corporate welfare with no “trickle-down” effect to the rest of the population.

Even though the relative autonomy of the government of Puerto Rico has been put into question with the recent approval of a fiscal control board, an important insight of the general analysis is that the current socio-economic arrangement can potentially transcend an independent formula for Puerto Rico. This is an important dimension of a colonial legacy that transcends the colonial relationship between Puerto Rico and the United States that needs to be addressed in fundamental ways if the island is to escape its present state of socio-economic catastrophe.

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