

# Puerto Rico



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**NEGOTIATING  
DEVELOPMENT  
AND CHANGE**

**JAMES L. DIETZ**

# PUERTO RICO

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## Negotiating Development and Change

James L. Dietz



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# Contents

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<i>List of Tables</i>	vii
1 An Overview of Economic and Social Progress	1
2 The Development Path: A Comparison with East Asia and Latin America	29
3 Dimensions of Ownership and Control	79
4 Accounting for Economic Growth	119
5 The End of Operation Bootstrap	139
6 The “New” Economy	175
<i>References</i>	199
<i>Index</i>	209
<i>About the Book</i>	221

# Tables

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1.1	Income per Capita: Puerto Rico Versus Richest and Poorest U.S. States, 1980 and 2000	6
1.2	Selected Social Economic Statistics, Puerto Rico, 1940–2000	8
1.3	Income per Capita: Puerto Rico, South Korea, Taiwan, Mexico, and Brazil, 1955–1989	18
1.4	Average Annual Growth Rate of Real GDP per Capita: Puerto Rico, South Korea, Taiwan, Mexico, and Brazil, 1955–1989	20
1.5	Change in Commonwealth Spending and Revenues, 1940–1980	26
2.1	Deposits in Puerto Rican Commercial Banks, 1980–2000	61
2.2	Manufacturing and Service Contributions to Income and Output, 1975–2000	62
2.3	Stages of Economic Transformation	64
2.4	Personal Savings Rate, 1940–2000	73
3.1	Estimates of Puerto Rico's Wealth Distribution, 1950–1980	81
3.2	Employment Generated per \$1 Million Increase in Available Income, 1992	90
3.3	The GDP/GNP Gap and Manufacturing's Share of Output, 1960–2000	95
3.4	Contribution to GNP by Sector, 2000	96
3.5	Estimates of Output and Income Multipliers, 1992	100
3.6	Sectoral Contribution to Total Output from a \$500,000 Change in Total Income, 1992	102

3.7	Import Coefficients, 1950–2000	105
4.1	Sources of Economic Growth, 1950–1990	127
4.2	World Bank Model and Puerto Rico’s GDP Growth, 1960–1985	134
5.1	Tax and Income Measures for Possessions Corporations, 1976–1999	150
5.2	Evolution of Employment in Key Sectors, 1976–2000	152
5.3	Impact on Employment and Unemployment of Ending 936 Tax Exemption, 1995–2001	156
5.4	Federal Transfers to Puerto Rico, 1970–2000	161
5.5	Income Distribution, 1970–1990	168
6.1	Educational Attainment, 1950–1990	185

# An Overview of Economic and Social Progress

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Throughout the 1980s and the 1990s significant changes in Puerto Rico's economic and political environment transformed the edifice of the "Puerto Rican model of development."<sup>1</sup> Some of these were the consequence of trends evident in the international economy since the Bretton Woods era came to a definitive end in 1973. Other transformations were the product of peculiarities surrounding Puerto Rico–U.S. political, legal, and economic relations, a veritable albatross around the metaphorical necks of both polities. Puerto Rico at the beginning of the twenty-first century now finds itself searching for a new path to a higher level of development to meet the still unresolved needs of its citizens, needs that continue to be beyond the reach of the style of economic growth in place since the late 1940s.

Some of the changes affecting the economy and society since the 1970s have been of Puerto Rico's own making and were within the control of local political and economic actors. Other effects, perhaps the most significant ones, were the consequence of exogenous forces emanating from the dynamics of U.S. and international political economic forces outside the reach of Puerto Rican decisionmakers. Taken as a whole, unparalleled technological, economic, and political changes that have accelerated over the last two decades of the twentieth century have fundamentally altered the nature of Puerto Rico's position in the international economy, especially vis-à-vis the United States, just as some of the same forces have propelled other economies into new relationships at the world level. A more open international economy and "liquid" bor-



ders for both goods and finance flowing between most nations in the world economy—what many call the forces of globalization—have created an entirely different economic environment for Puerto Rico, just as for virtually every other economy. It is a radical change from the environment that existed up to the 1970s and has altered in crucial ways the so-called special relation that has bound Puerto Rico to the United States since it became a U.S. possession in 1898.

Political economist Emilio Pantojas-García (2000: 228, 232–233) believes that there has been an obsession by social scientists in focusing on Puerto Rico's past development model and its failures to the exclusion of better understanding Puerto Rico's place in the "transnationalized economic spaces" that have dominated the last quarter of the twentieth century. While there is some truth to this perspective, it is my contention that even in "dependent" economies such as Puerto Rico the particular development strategy chosen and pursued is exceedingly important for at least partly defining and determining what the place of that economy will be within these transnationalized economic spaces.

Pantojas-García's viewpoint tends to imply that Puerto Rico is completely subordinated within this transnationalized economy. One of the emphases of this work is to suggest that this need not be so with the proper economic policies, even without a change in Puerto Rico's political status. Puerto Rico has had much more freedom to define its economic path than has commonly been thought and certainly more than has been exercised. Even dependent economies and societies have room to maneuver in determining their path of development if those in positions of power wish to make changes and understand what needs to be done. Many smaller independent economies face similar forces in the more open and competitive world economy of the twenty-first century. Puerto Rico is not alone in facing challenges.

What has been the nature of the changes in the Puerto Rico–U.S. relationship? How have these changes impacted Puerto Rico's economic and social development? What external events have contributed to these transformations? How does the Puerto Rican growth and development experience compare to that of the Latin American economies and to the more successful East Asian economies over the same period of time? Is the Puerto Rican experience *sui generis*, or is it a recognizable strategy replicated in other developing economies? And perhaps most important, what does the future of Puerto Rico promise in terms of economic, social, and political progress for its nearly 4 million citizens?

These are the fundamental motivating questions to be examined in this and the following chapters. These are the questions that do and should engage the attention of policymakers and others seriously concerned with Puerto Rico's future. The objective of this book is not to rehash the past and restate well-known criticisms of Puerto Rico's development path. Rather, the intent is to understand this past as having set the stage for the present and for delineating possibilities in the future. The purpose of this book is to suggest how and why the economic strategy has been a partial failure for the majority of Puerto Ricans. It is of course possible to argue that the economic path followed has benefited certain sectors, especially external investors, but the focus here is global social welfare.

It is impossible to begin the process of altering Puerto Rico's future without starting with the opportunities and challenges of the present, and this present is a product of the past. In doing so, the past is viewed through the lens of recent debates and theoretical scholarship in the field of economic development that can illuminate not only where Puerto Rico faltered but also what needs to be done in the future.

### **Income Convergence and the Gains from Operation Bootstrap**

In 1950, just three years after Puerto Rico had initiated its development strategy directed at shifting the economy from its agricultural base to a more robust and dynamic system grounded in industrialization, per capita income had grown to \$328 from about \$150 in 1940 (Junta de Planificación 1981: tab. A-1).<sup>2</sup> By comparison, U.S. income per capita in 1950 was \$1,935, nearly six times larger. In 1960, Puerto Rico's per capita income had risen to \$723 and by 1970 income once again had more than doubled, reaching \$1,857 per person.<sup>3</sup>

Relative to the United States, Puerto Rico's per capita income gained ground rapidly over the first two decades of the industrialization program. U.S. per capita gross domestic product (GDP) as a multiple of Puerto Rico's income at first fell to just four times larger in 1960 (\$2,915) and then to only 2.7 times greater in 1970 (\$5,050) (U.S. Bureau of the Census 1999: 861, 888). It was over this period, from 1950 to 1970, that Puerto Rico's strategy of "industrialization by invitation," dubbed Operation Bootstrap, was presented to other poor nations as a formula worthy of emulation. Per capita income figures

such as these, which show significant gains in Puerto Rico's income compared to the United States and a tendency toward income convergence, often were noted as evidence of the wisdom of a Puerto Rican-type path of growth for other less-developed economies, one based on attracting foreign direct investment (FDI) to speed up the growth process.<sup>4</sup>

This story line of growth and income convergence by FDI did not continue unabated, however. By 1980, though Puerto Rico's income per person had risen in absolute terms to \$4,549, income per capita in the United States remained 2.7 times larger at \$12,226. The same was true in 1990; average income in Puerto Rico had grown to more than \$8,713, but the average U.S. income per person of \$23,215 remained 2.7 times as large. The gap between U.S. and Puerto Rican income thus remained virtually unchanged for more than two decades, from 1970 to 1990, with income in the United States averaging nearly three times that in Puerto Rico. The trend toward income convergence observed in the first two decades of industrialization failed to be maintained by the subsequent income growth that occurred from 1970 to 1990.

Since 1990, the tendency toward income convergence with the United States has reemerged. In 1995, GDP per capita in Puerto Rico rose to \$11,713. It was \$28,131 per person in the United States, or now just 2.4 times larger. In 2000, U.S. income of \$36,174 per person was 2.3 times larger than Puerto Rico's GDP per person of \$16,065 (Junta de Planificación 1988: A-1; 1999: A-1; 2002: A-1; U.S. Bureau of the Census 2001: 422). Interestingly, this trend toward convergence of income reappeared during the 1990s precisely when the federal tax law governing U.S. corporations in Puerto Rico was undergoing its most fundamental change and the Puerto Rican economy was being forced to find its own path of economic development with less federal intervention and more local initiative, as Chapter 5 will detail.

The relative income gap between the United States and Puerto Rico actually is worse than painted by the above statistics, however. The data used for comparing incomes were GDP figures, which shed the best possible light on the level of income in Puerto Rico. From 1950 to 2000, Puerto Rico's total GDP has grown faster—9.3 percent per year—than gross national product (GNP), which grew 8.3 percent per year over the same period. As a result, aggregate GDP is now nearly 50 percent larger than total GNP (Junta de Planificación 2002: A-1), the difference being due primarily to the large outflow of income repatriated to U.S. corporations by their subsidiary operations in Puerto Rico.<sup>5</sup>

If GNP per capita figures are used as the basis of comparison between the United States and Puerto Rico, then in 1970 the U.S. GNP per person of \$5,101 was 2.95 times larger than Puerto Rico's income of \$1,729 per person. In 2000, U.S. GNP per person of \$36,158 was 3.32 times larger than Puerto Rico's GNP per person of \$10,906, though this ratio had declined slightly over the 1990s.<sup>6</sup> Using GNP as the income measure for comparison reveals an even wider income gap between the United States and Puerto Rico, a divergence that again only began to be moderated somewhat in the 1990s.

In effect, almost all of the gains in income relative to the United States were made over the first two decades of Operation Bootstrap's efforts to promote growth and industrialization. It is quite likely that much of this gain in income was due to a onetime shift of low-productivity agricultural workers to higher-productivity industrial and service jobs as part of the fundamental structural change that takes place in the transformation of agricultural economies into industrial societies.<sup>7</sup> Once that shift in the labor force had taken place, further gains in income did not take place as quickly. As a result, from 1970 to the 1990s, the development strategy failed to maintain the income convergence of the first two decades of transformation.<sup>8</sup>

Whether the tendency toward some mild income convergence observed in the 1990s continues, only time will tell. What is of interest in terms of this study is that the reappearance of relative income convergence occurred precisely when the federal tax advantages for U.S. corporations operating within Puerto Rico underwent their most drastic changes and at the same time that new efforts to strengthen the local economy began to be implemented in an effort to counteract the expected negative effects of the changing federal tax laws.

Table 1.1 compares Puerto Rico's personal income per person with the two richest and the two poorest U.S. states in 1980 and 2000. In 2000, Puerto Rico's per capita personal income was equal to less than one-quarter of that in the richest U.S. state, Connecticut, and was less than one-half the income per person of Mississippi. Since 1980, Puerto Rico's personal income has not shown any tendency to close the gap with Mississippi, the poorest U.S. state. In fact, the relative difference in income was marginally greater in 2000 than in 1980, as Puerto Rico's personal income per person was only 47.2 percent of Mississippi's in 2000 compared to a slightly more favorable 48.8 percent in 1980. Relative to Connecticut, the richest U.S. state in 2000, income divergence also is evident between 1980 and 2000.

**Table 1.1 Income per Capita: Puerto Rico Versus Richest and Poorest U.S. States, 1980 and 2000**

	1980		2000
Alaska	\$14,807 (23.3)	Connecticut	\$40,702 (24.2)
Connecticut	12,439 (27.8)	Massachusetts	37,704 (26.2)
Arkansas	7,586 (45.5)	West Virginia	21,738 (45.4)
Mississippi	7,076 (48.8)	Mississippi	20,900 (47.2)
Puerto Rico	3,455	Puerto Rico	9,870

*Sources:* U.S. Bureau of Economic Analysis, Regional Accounts data available at [www.bea.gov/bea/regional/spi](http://www.bea.gov/bea/regional/spi); Junta de Planificación 1990: tab. A-1; Junta de Planificación, tab. 1 at [www.prsdclead.gobierno.pr](http://www.prsdclead.gobierno.pr).

*Note:* Numbers in parentheses show Puerto Rico's per capita personal income as a percentage of each state's per capita personal income.

The weakness of relative income convergence with the United States also can be observed more closely by examining the evolution of wages over time. Hourly wages for all Puerto Rican workers in 1979 equaled 53 percent of the U.S. level. By 1989 the relative wage relation had declined to 47 percent, as U.S. wage levels had risen faster than those in Puerto Rico. This declining relationship was observed regardless of education level, age, gender, or sector of the economy except in communications, which showed a 1 percentage point increase in relative wages compared to the United States. Interestingly, though troubling from a perspective of economic development and economic theory, the relative wage losses for Puerto Rican workers compared to U.S. workers actually increased at higher levels of education and human capital accumulation, so that those with postgraduate educations actually suffered the largest relative wage losses compared to U.S. wages over time.

For example, whereas a postgraduate degree in 1979 provided U.S. workers with a wage 50 percent larger than was received on average in Puerto Rico, by 1989 the U.S. wage per hour was twice as large as in Puerto Rico, effectively doubling the wage differential. Overall, Puerto Rican wages relative to the United States would have fallen even further if Puerto Rico's average education level had not increased relative to that of the average worker in the United States (Sotomayor 2000: 109–110, 125–126).<sup>9</sup>

Nonetheless, despite the slowdown in relative income growth from the 1960s to the 1990s compared to incomes in the United States, Puerto Ricans undeniably have enjoyed an improving quality of life since the industrialization program was introduced in the late 1940s. Absolute incomes—that is, the sum of dollars received each week or month—have grown rapidly, expanding the choices available to virtually every family. Most ended their dependence on agriculture for their livelihood and began to enjoy lives quite similar to those in other modern economies.

In many respects, Puerto Rico manifests the characteristics of more developed economies, especially on key social indicators as well as in terms of the apparent level of industrialization in contributing to total income. Homeownership is widespread. More and more cars are on the road as traditional ways of transportation more associated with low incomes (e.g., *publicos*) slowly disappear due to lack of demand. Leisure activities such as spending the day at the mall and eating at the food court have become as typical as they are in the United States or elsewhere. Nonetheless, there remain significant gaps and weaknesses in the economy that threaten future development progress if the cracks that have appeared in the underlying economic foundation are not addressed correctly.

## Social Progress and Its Origin

A few key social indicators illustrating some of the central advances achieved in overall well-being are shown in Table 1.2, measures that confirm the substantive social progress attained since the 1940s and the beginning of the industrialization program. For the sake of comparison, the values for the same indicators for the United States are shown in parentheses when comparable data are available. The first two columns, crude birth rate (CBR) and crude death rate (CDR), show that by 1990 (actually by 1985 if individual years are examined) Puerto Rico had completed the demographic transition—that is, there had been a reduction of both the CBR and the CDR to below 20 per 1,000 of population. As a result, the natural rate of population growth  $[(\text{CBR} - \text{CDR}) / 10]$  fell from a very high 3.02 percent per year in 1950 to 1.15 percent in 1990 and to just 0.81 percent in 2000.<sup>10</sup> Completion of the demographic transition often is considered to be one indicator of a relatively high level of human development, capturing underlying desir-

**Table 1.2 Selected Social Economic Statistics, Puerto Rico, 1940–2000**

	CBR	CDR	IM	LE	PPP	UN	LFP
1940	40.1 (19.4)	18.4 (10.8)	109.1 (47.0)	46 (62.9)	—	15.0 (14.6)	52.2 —
1950	40.1 (24.1)	9.9 (9.6)	68.3 (29.2)	61 (68.2)	—	12.9 (5.3)	53.0 (55.7)
1960	33.5 (23.7)	6.7 (9.5)	43.7 (26.0)	69 (69.7)	1,139	13.1 (5.5)	45.2 (59.2)
1970	25.8 (18.4)	6.6 (9.5)	28.6 (20.0)	72 (70.8)	759	10.3 (4.9)	44.5 (59.4)
1980	22.8 (15.9)	6.4 (8.5)	19.0 (12.6)	73 (73.7)	539	17.0 (7.1)	43.3 (63.8)
1990	18.9 (16.7)	7.4 (8.6)	13.4 (9.2)	74 (75.4)	349 <sup>a</sup>	14.3 (5.6)	45.5 (66.5)
2000	15.6	7.5	—	—	—	11.0 (4.0)	46.2 (67.2)

*Sources:* Junta de Planificación 1981: A-26; 1989: A-61; 1994: 4, 7–10; 1999: A-36, A-37; 2002: tabs. 31–32; U.S. Bureau of the Census 1999: 874, 879; 2001: 367.

*Notes:* CBR = crude birth rate (number of births per 1,000 population); CDR = crude death rate (number of deaths per 1,000 population); IM = infant mortality rate (number of deaths of children less than age 1 per 1,000 live births); LE = average life expectancy at birth, in years; PPP = persons per physician; UN = unemployment rate; LFP = labor force participation rate. Values in parentheses are for the United States.

a. 1988.

able changes in fertility rates, improved health statistics, better nutrition, an improved income distribution, higher levels of education, and a host of other characteristics embodied in low CBRs and CDRs. Infant mortality rates (IM) also have decreased dramatically and are close to U.S. values, another indication of broader-based development than might be indicated by income alone.

Life expectancy at birth (LE) in Puerto Rico rose from an average 46 years in 1940 to 61 years by 1950 and to 74 years in 1990, rivaling life expectancy in most already-developed countries. In the early years of Operation Bootstrap, Puerto Rico's life expectancy increased rapidly, even superseding U.S. average life expectancy for a time. Since 1970, Puerto Rico's increases in life expectancy have slowed, and the U.S. level is now slightly higher, but the gains are nonetheless quite impressive. The number of physicians has risen faster than the population, allowing a decrease in the ratio of persons per physician (PPP).<sup>11</sup> All of these measures suggest broad-based gains in living standards that have contributed to a better quality of life for the great majority.

Another critical measure of success for an economy is its unemployment rate (UN), which provides some insight into the range of opportunities being provided to the population within the economy. Looking at this as an additional social indicator and not purely an economic variable, the story is more mixed than for the previous measures considered. The unemployment rate fell with the initiation of Operation Bootstrap, but it has never reached single-digit levels. The 1970s marked the greatest reduction in unemployment by Puerto Rico's standards, with the minimum of 10.3 percent being reached in 1970 (and again in 2001).

By U.S. standards, the level of unemployment in Puerto Rico has been unacceptable. Though the unemployment rate came down slightly after 1950, it bottomed out after two decades and then began to rise again until the 1990s. Surely one of the benchmarks by which a development strategy can be judged is its ability not just to create higher average income but also to generate sufficient employment and opportunities for individuals to reach their full potential through their own efforts based on applying their human capital in the workplace. When more than one in ten workers are unemployed, their potential is being wasted, with both individual and societywide effects.

Labor force participation rates (LFP) in Puerto Rico also historically have been low, certainly compared to those in the United States, with recent LFP rates even below those achieved at the beginning of Operation Bootstrap. This is perhaps not surprising given the relatively high unemployment rates, as workers either have chosen not to enter the labor force at all due to the lower expectation of actually finding employment or have left the labor force after some period of time as "discouraged workers" unable to find positions. There is also the matter of large federal transfer payments to individuals in Puerto Rico, which given their size, averaging more than 20 percent of disposable personal income, may have biased the labor force participation rate downward as earned formal-sector income assumed somewhat less importance to total income.

One component of the economic and social growth story not considered in Table 1.2, but of great importance to Puerto Rico's history, has been the exodus of potential workers to the United States in search of employment. Large-scale migration is certainly consistent with high unemployment and low labor force participation. As U.S. citizens, Puerto Ricans can move to the mainland with relative ease, and they have done so in large numbers. From 1950, at the beginning of Opera-



tion Bootstrap, when encouraging migration was actually part of official policy, to 1970, net emigration totaled 605,550 persons, or 27.4 percent of the 1950 population (Dietz 1986: 286). From 1970 to 1990, net emigration totaled an additional 182,384 persons moving to the mainland (Rivera-Batiz and Santiago 1996: 23).

This circulation of workers between Puerto Rico and the United States has been the focus of many valuable studies, and the need for this “safety valve” surely must be noted as one of the glaring weaknesses in Puerto Rico’s style of development, despite the undeniably positive progress made in the social indicators in Table 1.2 (see Duany 1999 for an excellent overview and analysis of the migration dynamic, as well as an extensive bibliography). From 1950 to 2000, more than 20 percent of Puerto Rico’s population (measured by 2000 statistics) migrated to the United States.<sup>12</sup>

## **The Foundations of Social Progress**

With the exception of weakness in the unemployment numbers and some serious concerns about labor force participation rates, important and valuable social advances have been achieved in Puerto Rico since the 1940s. These demonstrate that the period after World War II ushered in rapid and profound advances in living standards that greatly improved the lives of the average person. To what can the gains in social welfare shown in Table 1.2 be attributed? Were they due to the industrialization program begun in the late 1940s and the development it ushered in? Or were the social gains the result of local spending decisions to some extent independent of the specific path of economic development?

An argument can be made for the emergence of a particular political conjuncture within Puerto Rico beginning in the late 1930s that led to the extension of the benefits of a capitalist, albeit colonial, economic structure to a growing proportion of the population. In this interpretation, it was not solely the initiation of Operation Bootstrap and the promotion and expansion of the private U.S. manufacturing sector and any economic growth it generated that were responsible for the social advances documented in Table 1.2, though undoubtedly rising income and the larger government revenues that followed facilitated the funding that underlay this progress.