Wealth Extraction, Governmental Servitude, and Social Disintegration in Colonial Puerto Rico

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After ten years of economic contraction, many of the citizens of Puerto Rico find themselves watching the secular decomposition of a reality that in its heyday was painted by many as one of relative socio-economic welfare. The latest economic downturn of the island, which predated the so-called global "great recession" by two years, has confirmed that the current colonial economy could not achieve certain objectives of the economically more advanced economies.

When compared to its own historical record and that of the United States, the performance of the economy of Puerto Rico is not an example of socio-economic convergence or of a process leading to "developed capitalism":

• Economic growth capacity is declining. Compared with the so-called golden period of 1947-1973, when growth averaged 6 percent per year, average growth was 1.6 percent per year after the first oil shock during fiscal years 1976-2014. From 2000 to present, the average annual rate is -0.5 percent, and with the onset of the current crisis in 2006, average economic growth is down to -1.5 percent per year. Preliminary forecasts for growth in fiscal years 2015, 2016, and 2017 are negative. The length and depth of the downturn are those of a depression and not a simple cycle.

• Job creation capacity has declined dramatically. Even during the golden years, full employment was never attained. Unemployment of 10.3 percent during 1969-1970 was the lowest yearly average from 1947 to date. Currently, the participation rate is around 40 percent, more than 20 percentage points lower than in the United States. Unemployment hovers around 12 percent, while the U.S. state with the highest unemployment rate, West Virginia, experiences 7 percent unemployment. The Puerto Rican employment rate stands at 36 percent.

• Median household income, in 2013 inflation-adjusted dollars, was 37 percent of U.S. median household income ($19,183 versus $52,250). Per capita income in Puerto Rico is not quite half that of Mississippi, the poorest state. Around 46 percent of the population lives in poverty, compared to about 15 percent of the United States. Puerto Rico is second to none of the 50 states regarding inequality of income distribution. The island's Gini index (a measure of income inequality) was 0.547 in 2013, higher than those of Washington DC (0.532) and New York (0.510). The U.S. average is 0.481.

• Emigration to the United States is reaching record levels. Between 2010 and 2014, the average number of people leaving the island each year was 53,020. For the period between April 2014 and March 2015, the number reached 86,654. (During the first massive waves of emigration in the 1950s, the yearly average was 47,400.) Combined with lower birth rates, this has led to a significant decrease in and aging of the population.

• The island's total public debt is more than 100 percent of its Gross National Product ($72 billion), not counting net liabilities of the public pension system at $43.4 billion. Government faces increasing debt-service burden, a liquidity crisis, creeping default, and tax-backed bonds that are at near-default status.

• The economy has seen nine years of austerity policy, increased tax burden on consumption, attrition and firing of thousands of government employees with reduced fringe benefits for those remaining, big privatization projects, and market liberalization policies.

The roots of this unfolding drama are found in an obsolete economic model once thought of as successful and which the two major political administrations insist on perpetuating, albeit with differences in tonalities. It is a failed model that, combined with regressive neoliberal structural reforms imposed by both administrations, intensifies the economic depression and fiscal crisis, securing Puerto Rico's membership within a group of countries squeezed and looted by austerity policies. While the cost of the adjustment is shared by workers, poor people, and many small businesses, the share of the pie going to the top of our society and external partners increases with the crisis and the adjustments vainly imposed to appease global financial capital and local intermediaries' thirst for more. No wonder some consider the country to be the Greece of the Caribbean.

In this article we provide a general overview of how the decade-long depression in Puerto Rico is connected to the enforcement of an outdated economic model and structural adjustment policies with regressive and procyclical consequences. The search for a new way to organize economic activity is not a technical issue for well-paid advisors; it is a matter of power relations.

In the first section, we examine the characteristics of an *obsolete* economic model that outlived its "successful" period by four decades. We then explore how the crisis of 1974-1975 was tackled and use that context to then analyze the current decade-long depression, one that to a certain extent is structural and self-inflicted. Finally, we indicate where we think our analysis leads in order to tackle the crisis and possible solutions.

An Outdated Economic Model

Puerto Rico's current economic model has its roots in the postwar transition from a rural and agricultural economy to an urban and industrial one. This transformation was based on export-led industrialization dependent on foreign, primarily U.S., direct investment, which was attracted by a host of economic, legal, and political incentives to operate in the island. This process, sometimes referred to as "Operation Bootstrap," involved various phases of industrialization, from light industries (apparel), to heavy industries (refining and petrochemicals), and then to the current high-tech sector (pharmaceuticals and electronics among others). Throughout this process the basic characteristics of the development model have remained unchanged, namely:

• An ideology based on the notion that Puerto Rico's lack of development capacity is due to its small size, overpopulation, absence of natural resources, and very low income, therefore requiring external capital flows and export-led industrialization and now services;

• A fundamental role for governmental promotion of economic activity in an ad-hoc fashion, attracting foreign investment with various incentives and no clear objectives attached to them, for instance giving multiple tax credits and exemptions; environmental subsidies; subsidized public utilities; an abundant, educated, and cheap labor force; and industrial peace through anti-union policies; and

• The contradictory goal of maintaining low absolute costs of doing business to attract investment, regardless of productivity gains and expected personal income gains from growth and development processes.

Between 1947 and 1973, Operation Bootstrap and the ensuing industrialization process promoted relatively high growth rates averaging 6 percent yearly. However, economic growth did not lower unemployment rates to single digits or increase labor participation rates to first-world standards. Migration to the United States was substantial, yet poverty remained extremely high, encompassing 62.8 percent of the population in 1970. Whatever room to maneuver the Puerto Rican government had in negotiating terms for the country was lost: The general attitude of those promoting industrialization was based on the impossibility of endogenous development and a primeval belief in a sort of trickle-down effect. In essence, Operation Bootstrap was a neoliberal endeavor from its inception. When the crisis struck and options were discussed in the new scenario of economic liberalism's rebirth, public strategists were out of options.

Flawed Historical Responses

With the onset of the early 1970s crisis, expansion of oil refineries and petrochemical complexes came to an abrupt halt. The onset of neoliberal globalization brought new third-world competitors into the world economy. It was clear that Puerto Rico had lost attractiveness for certain fractions of capital. Competing against low costs in newly industrializing countries was not an option as they gained more access to U.S. and global markets within the new international division of labor. Instead of changing the model in place since 1947, those in power preserved it, and more aggressive subsidies were offered, especially tax breaks, low real wages, cheap infrastructure, and environmental laxity. Vested interests' resistance to change, lack of institutional agility, and determination were the order of the day. Dependency was to remain untouched and growing.

To start the chronology of the early-1970s crisis with the oil embargo and its consequences for the Puerto Rican economy obscures the fact that signs of the economic model's exhaustion were present before that event. Economic growth in the late 1960s and early 1970s was maintained with expansionary fiscal policy. Public debt increased by around 90 percent during 1969-1973. Debt financing grew larger as the government increased public spending to create 40 percent of new jobs in those years.

The process of industrialization, supposed to be the main driver of growth and development, had and still has major flaws. First there is the problem of *improvisation:* The absence of a development strategy and corresponding industrial policy resulted in "taking advantage" of conjunctural opportunities without a long-term, integral, and dynamic vision of the economy, the relationship among its sectors, and major development goals. This lead to the formation of an industrial enclave dominated by subsidiaries of multinational firms, with no substantial connection with the rest of the economy, a policy that used the country as an assembly platform for the export of goods and for global money-laundering. This enclave model limited the benefits usually associated with industrialization, such as increased employment and income, transfer of technology, endogenous capital formation, domestic entrepreneurial development, and so on. This also applies to other industrial sectors like tourism, with the proliferation of resorts and cruise-ship activity poorly integrated with the rest of the economy.

Furthermore, during the early 1970s a widening gap between Gross National Product and Gross Domestic Product started, one that has grown currently to the equivalent of 50 percent or more of GNP.* The collapse of Bretton Woods opened the gates for the thus-far restricted flow of financial capital worldwide. Puerto Rico became a focal point for investors' global financial strategy when Section 931 of the U.S Internal Revenue Code was replaced by Section 936, providing greater

flexibility to capital flows. Numerous tax breaks and the use of transfer pricing for income shifting around the world allowed for a substantial amount of money—over $30 billion in total and more than 75 percent of manufacturing's GDP currently—to be transferred out of Puerto Rico yearly, limiting capital formation and enhancement of economic activity.

The government budget experienced its first (unconstitutional) deficit in 1974, and debt rose to 74 percent of GNP in 1976. Risk classification of government's general obligations was downgraded, and the first contemporary fiscal crisis was born. The Commonwealth of Puerto Rico commissioned a study of the country's public finances in 1974, often referred to as the Tobin Report (1975), named for economist James Tobin.

Tobin's report emphasized the problems of poverty, inequality, and dependence and highlighted the erosion of Puerto Rico's attractiveness to foreign capital, but it also put forward a series of recommendations, many of them typical of neoliberal adjustment programs imposed by the International Monetary Fund principally in third world countries from the 1970s onward. Among its recommendations were: limiting public expenditures; freezing salaries of the central government, public corporations, and private sector; delaying congressional federal minimum wage increments; reducing minimum wages for workers under age twenty; eliminating fringe benefits that increased labor costs; providing direct industrial incentives to firms that invest and create employment in Puerto Rico; and responsibly marketing government bonds.

Current Political and Economic Crisis

From the time of the Tobin report until 2006, the economy of Puerto Rico had undergone an intermittent structural adjustment process with varying degrees of intensity. A detailed account of more than three decades of on-and-off structural adjustment is beyond the scope of this essay. However, as affirmed by Tobin, the early-1970s crisis was not merely a conjunctural problem to be solved by a repertoire of anti-cyclical policies. It was a structural problem that required more fundamental responses.

The disastrous effects of the first postwar crisis in 1974 and the second great recession of the early 1980s, when unemployment in Puerto Rico surpassed 20 percent, were contained through a sizable increase in the flow of federal funds and migration. However, Operation Bootstrap remained unchanged. Thus, the problems of 40 years ago remained latent and made their reappearance in 2006.

Puerto Rico's economy never regained capacity for growth comparable to that of the 1947-1973 period. Public indebtedness remained at 60 percent of GNP during 1977-2000. The labor market continued its mediocre performance, and migration and federal transfers kept conflicts and tensions at bay. After the 2001 recession, growth capacity further weakened, and public debt picked up again. Risk assessment of Puerto Rico's public debt was a notch above non-investment grade in 2006, or Baa3 according to Moody's assessment. At play were the combined effects of an outdated economic structure, the lack of an industrial policy, and new federally mandated parameters—a higher minimum wage and changes in the IRS code affecting Puerto Rico—in a more competitive and globalized economy.

This is the context in which the administrations of the Popular Democratic Party and the New Progressive Party have governed during the last decade of depression and fiscal crisis, applying structural reforms without questioning how this context came to be. The neoliberal discourse adopted by ruling extractive elites in Puerto Rico has had four main components: the excessive size of government; living beyond our means; the need for an adjustment in which all sectors of society must sacrifice; and the need to keep costs of doing business low in order to maintain

competitiveness.

The size and role of the government has become one of the principle issues of the debate, with various groups offering often contrasting views on the subject. Both governing parties have adopted the idea that the excessive size of government as one of the main reasons for the Puerto Rican economy's woes. While standard economic measurements do not support the thesis that Puerto Rico's government is "too big," the recent history of the island puts the role of the government at center stage, particularly regarding U.S.-Puerto Rico relations, the origin of the crisis, as well as local government capacity to negotiate with the federal government on possible strategies to solve the crisis.

However, denying the relative fiscal autonomy of the Commonwealth of Puerto Rico is a grave mistake. It can be argued that much of the crisis is *self-inflicted*. The lack of an industrial policy with effective oversight and the extension of subsidies to most of the foreign investors in sectors other than manufacturing, as well as to local capitalists, has eroded the tax base and contributed to depressed salaries, wealth and income inequality, poverty, environmental degradation, and the expansion of the informal economy. Despite the fiscal crisis and the lack of evidence supporting the effectiveness of the multitude of subsidies, both governing parties continued granting tax exemptions, wage subsidies, and other inducements for business to invest. In 2004 there were 40 tax exemption laws. As we write, the number of these laws exceeds 80. Furthermore, every instance of tax reform from the mid-1980s until 2010 involved lowering taxes in order to promote economic growth—a failed supply-side strategy for growth but a very effective tool for income and wealth redistribution to the top.

Intensive and indiscriminate use of tax exemptions has made of Puerto Rico a free-for-all fiscal paradise, eroding the tax ethic and tax base of the system. A growing sense of unfairness permeates public opinion. Some events that highlight Puerto Rico's lack of fiscal control are:

• More than 20,000 businesses did not submit income tax reports in April 2014, which meant a loss of revenue on the order of $400 million.

• Big businesses in manufacturing, retail, and other sectors report minimal profits, losses, or breaking even, hiding their revenues through "profit-stripping" strategies with transfer pricing and income shifting.

• Real estate investment trusts siphon hundreds of millions of dollars out of Puerto Rico without paying taxes or being authorized to do business on the island.

• Government bailout payments for debt service of luxury hotels amounted to $400 million during 2012 and 2013.

• Four billion dollars in tax debts went uncollected in 2015. The overall rate of evasion is close to 30 percent of potential revenues.

• Eighty tax exemption laws together cost over $1 billion in lost revenues yearly.

• Dwindling resources at the Treasury Department for tax enforcement has led to the loss of personnel, intellectual expertise, and technological know-how.

• Tax subsidies at the municipal level, granted by central government, result in $850 million per year in revenue losses for cash-strapped towns.

• Waste of public funds amounts to 10 percent of the budget according to past comptrollers

(equivalent to $900 million of the general-fund-backed budget and $2.9 billion of the consolidated budget). Corruption has mounted to almost $900 million of public funds per year, according to FBI figures.

All of these examples of contradictory economic behavior, and more, happen amidst a major fiscal crisis and depression. This is precisely why we see this crisis as self-inflicted and also question the discourse of the adjustment burden being shared by all. So far, the burden of the adjustment has been falling on the working class, the poor, and many small businesses. The tax system—with its complexity, lack of integral connection, and regressive bias—and the use of public funds—reflecting lack of planning, absence of controls, corruption, political cycles, and politicians' whims—are both common problems in the allocation of resources that are *locally determined*.

Although budget deficits are explicitly forbidden by Puerto Rico's constitution, using public debt to finance recurrent expenditures, declaring certain amounts of debt as "extra constitutional," and issuing debt without specific sources for its service have been common practices. However, as the imbalance grows, as the economy contracts, and as less revenue accrues to the treasury, solvency is compromised and risk assessment becomes increasingly negative. As this vicious cycle continues, a cash-flow crisis emerges with incremental default taking place.

The different adjustment programs implemented since 2006 have all targeted the size of government, its labor force, and their fringe benefits: from Acevedo Vilá's governorship imposing Puerto Rico's first sales tax and public-employment attrition, to Fortuño's plan and its iconic Law Number 7 of 2009 firing over 20,000 public employees, and then García Padilla's Law Number 66 of 2014 that reduces the budgets of public agencies, consolidates some of them, and maintains public-employment attrition. The number of public employees has decreased significantly and so has the cost of the public-sector labor force. From the beginning of the crisis in 2006 to September 2015, average government employment has experienced a reduction of 69,000 jobs. The negative multiplier effect of public-employment downsizing is considerable, contributing to a decline in private-sector activity on top of the downturn. Total non-farm wage employment dropped by 137,000 during the same period, deepening the depression, the fiscal crisis, and the precarious state of public retirement systems.

Regressive taxation has also been the order of the day. More taxes on consumption are imposed in a desperate move to shore up liquidity, while big-scale privatization projects have been undertaken by both administrations (Fortuño and García Padilla); more privatization projects are waiting, based on public-private partnerships that bring lump sums of cash to the government in exchange for the transfer of productive public assets to private hands for 40 to 50 years. Finally, more pro-business laws are being approved, reform was undertaken in granting business permits, commercial-sector operating hours have been expanded, and Sunday wages were slashed, while vast amounts of internal and external funds were injected into the economy. Notwithstanding, and with growth still nowhere in sight, government faces a liquidity crisis while gradual default has already begun and most of its debt is close to default status.

The Puerto Rican economy is like a punctured tire tube: You can pump vast amounts of resources into it, and it will not grow. From 2006 to 2015, close to $40 billion was injected into the system, for instance through sales-tax-backed bonds; Bush's 2008 stimulus; bond issuance by the central government, public enterprises, and municipalities; American Recovery and Reinvestment Act funds; Federal Deposit Insurance Corporation funds for bank consolidations; the Toxic Asset Relief Program; and Affordable Healthcare Act funds.

In spite of this considerable injection, the only positive growth value from 2007 to the present was a meager 0.5 percent in fiscal year 2012. During 2000-2005, right before the onset of the crisis,

average annual growth was just 1.82 percent. From the beginning of the century to 2014, growth has averaged 0.15 percent per year. Average growth from the onset of the crisis in 2006 till the present is at -1.5 percent. According to official estimates and forecasts, growth will remain negative during 2015 and 2016. As it is structured, the Puerto Rican economy has lost capacity for growth.

The problems of the Puerto Rican economy are certainly structural, but the necessary adjustment to solve them is not the classic IMF neoliberal package. Perfect mobility of labor is an effective escape valve whereby some, especially the young, can dodge draconian austerity policies by leaving the island. Dominant groups take advantage of the crisis to advance their own interests, lowering taxes, liberalizing markets, privatizing at a discount, claiming more subsidies, and so on. An enormous informal economy with both legal and illegal activities wraps the island. To think that the remedy lies in more taxes, privatization, budget cuts, and liberalization of markets is to deny major institutional problems not addressed by this neoliberal strategy. After nine years of structural reforms and massive injections, the Puerto Rican economy continues its downward march towards depression and default.

Conclusion: Race to the Bottom, Default, and Change

The double whip of the fiscal crisis and the economic recession that the economy of Puerto Rico faces shows no sign of abatement: Growth is nowhere in sight and government faces a cash-flow crisis with gradual default already in motion. With access to financial markets severely restrained, room for fiscal maneuver is very limited in the context here described.

The demographic situation runs counter to possible future growth and development as the population growth rate diminishes and net out-migration is reaching record levels, perhaps even greater than in the 1950s. Puerto Rico's total population is decreasing and aging fast. Furthermore, a sort of population swap is taking place, with mostly young people leaving (82 percent of migrants are 24 years old or younger) while Law 22 of 2012 (the Millionaire's Law) is attracting hundreds of well-off Americans to this fiscal paradise. Lack of opportunities has led to the growth of a sizable informal economy, which further erodes the tax base. Inequality, poverty, and social tensions have risen in this deteriorated scenario.

A "Fiscal Stabilization and Economic Growth Plan" was presented by the current administration in September 2015. According to the plan, by the end of 2015 the government would have run out of cash and public financing will see an estimated aggregate gap of $27.8 billion over the next five years. The plan proposes a variety of neoliberal prescriptions dating from the time of Tobin's report, while adding some new ones. Most important of all are negotiating debt restructuring with bondholders, obtaining substantial concessions from the federal government with more Medicaid and Medicare allocations, controlling minimum wages, and obtaining exemption from cabotage laws. The plan also proposes revising labor laws in order to strip the working class of many acquired benefits for the sake of competitiveness. It also proposes a local fiscal oversight board with powers not clearly limited. However, the proposal states that even with a 100 percent success rate in its implementation, only half of the public finance gap ($14 billion) could be closed by 2020.

The Puerto Rican economy has become a model of extreme capitalist wealth extraction, with over $30 billion in profits repatriated every year. Meanwhile the share of profits and interest going to local extractive elites, mostly intermediaries of global financial capital and other fractions of capital, increased 70 percent during 2005-2014, according to the functional distribution of net national income. Workers' share of net national income increased only 1.3 percent during the same period. Thus, all groups and classes of society do not equally share the crisis.

As the Federal Reserve Bank of New York's report "An Update on the Competitiveness of Puerto

Rico's Economy" (2014) stated, "The island appears to face two alternatives: either manage its own economic adjustment and put the Commonwealth on a secure fiscal basis, or wait for outmigration and the discipline of the market to force an even more painful adjustment, particularly for those unable or unwilling to leave the island."

Among the citizenry more awareness exists of how both major governing parties are responsible for the crisis and therefore incapable of adopting other approaches to the crisis than the socially disruptive structural adjustments they have imposed so far. Average citizens cannot relate to the discourse of having lived beyond their means, as the burden and hardship of daily life keeps growing upon a population already impoverished before the crisis and the adjustments. Rationing of basic public services and lack of opportunities, and increasing poverty, inequality, and migration, constitute major challenges faced by working people and the poor. How much more can they be asked to contribute toward the solution of the crisis? In spite of this, status preferences blur the shared-class nature of the main political parties and their resulting resistance to structural change within, and potentially outside, colonial capitalism.

However, talking about any future lineages of the Puerto Rican economy and society is purely speculative at the moment. A far-reaching social restructuring is taking place, and no significant resistance appears to coalesce in order to restrain it and lead it in a different direction. In Puerto Rico and among Puerto Ricans in the United States, much effort is being mustered for some form of bailout, bankruptcy, or federal oversight board for the troubled economy. Regardless of the mechanisms and amount of funds that a possible federal intervention could allocate to or impose on Puerto Rico's economy, growth will not restart and public debt obligations will last forever if the model based on vast subsidies for capital in exchange for crumbs for the Puerto Rican people is not substantially changed.

Building a new economy and society with more equitable wealth and power distribution in a colonial setting will not be possible without major political struggles, as the examples of sovereign Greece and Argentina show. In the end, the terminal crisis of Puerto Rico's socio-economic model poses imperative challenges that must be addressed head on if future sustainable development is to be considered attainable. The ways and manners this struggle will take depend on people's capacity to organize and transform a political system plagued with political investment, closed entry into the electoral arena for new parties, and centuries-old fears of grasping power and control of our own existence. This represents a formidable challenge as the groups and alliances of local and international classes extracting wealth from the island will do all that is possible to prevent change. However, as this extractive model reaches its extensive and intensive margins, incapable of growing, drained of its productive population, fiscally broke with systemic limits to budget cuts and more taxes, a compromise must come. A broad coalition of progressive forces in Puerto Rico and the United States, capable of cutting the Gordian knot of extractive-class domination, of pushing for institutional changes in Puerto Rico, and claiming for the island a fair share of the surplus extracted and sent to the United States during the last 117 years, would be a good start.

Footnotes