**Puerto Rico: Double Crisis and Political Status**

Arthur MacEwan\*

January 2019

 At the beginning of 2019, Puerto Rico had receded from the headlines in the U.S. media. It had been more than a year since hurricanes devastated the island in September of 2017, and the hurricanes along with Puerto Rico’s long recession and its government’s debt crisis have become “old news” for media in the states.

 In Puerto Rico, however, the double crisis of the hurricane damage and the recession damage continues. And the critical issue behind this double crisis, *the issue of the island’s political status*, remains not only unresolved, but virtually invisible in Washington.

 To be sure, the fact that two major hurricanes hit Puerto Rico in September 2017 cannot be attributed to the political status of Puerto Rico as an “unincorporated territory of the United States.” This status, however, means that, in spite of Puerto Ricans electing their own governor and legislature, the island is under the control of the United States government. Puerto Ricans on the island, though citizens of the United States, are not able to vote in U.S. presidential elections nor do they have any voting members in the U.S. Congress.[[1]](#footnote-1) This status, this lack of formal power to affect matters in Washington, has undoubtedly been a major factor in the delays and insufficiencies in the aid Puerto Rico has received in the wake of the hurricanes.

 Furthermore, the extent of the hurricane damage and the resulting hardships experienced by the Puerto Rican people were certainly exacerbated by the poor condition of the economy—especially the poor power grid. The poor condition of the economy, in turn, is largely attributable to the island’s territorial status. While formally a “territory” of the United States, Puerto Rico is, by any reasonable definition of the term, a colony of the United States. Colonial status, with some exceptions, is not a good basis for economic progress. (While the status issue is, as stated, critical in understanding Puerto Rico’s economic troubles, this does not mean that Puerto Rican officials—especially those who have advocated indefinite continuation of the current status—do not share responsibility for the situation.)

**Status and Economic Performance**

Since 1980s, the economy of Puerto Rico has been falling further and further behind the U.S. economy. The Puerto Rican economy had grown quite rapidly in the 1950s, 1960s and on into the 1970s. This experience generated an illusion that lasted for many years—the illusion that the economy was doing quite well.[[2]](#footnote-2) Yet, from 1980 onward, economic growth in Puerto Rico lagged behind that in the United States. With the still-existing recession that began in 2006, by fiscal year 2017 (before the hurricanes), GNP in Puerto Rico was smaller compared to U.S. GNP than it had been in 1950. (See the table below.)[[3]](#footnote-3)

Economic Growth in Puerto Rico and the United States, 1950 – 2017

 Puerto Rico United States

Growth of Real GNP

 1950-2017 589% 693%

 1950-1980 364% 197%

 1980-2000 59% 92%

 2000-2017 -6.7% 39%

Population Growth

 1950-2017 50% 116%

Growth of Real GNP per capita

 1950-2017 356% 269%

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Sources: Real GNP data for Puerto Rico, 1950-1980, James L. Dietz, Economic History of Puerto Rico, Princeton University Press, 1986, Table 5.1; 1990-2017, Informe al Governador Puerto Rico, various years. Real GNP data for the United States, St. Louis Fed, <https://fred.stlouisfed.org/series/GNPC96#0>. All population data from the U.S. Census.

*Outward Orientation*

 Ironically, an important element in the weakness of the Puerto Rican economy was generated by the success of the rapid growth in the post-World War II decades. That success, in large part, was generated by U.S. government tax policies that attracted many U.S. light manufacturing firms to establish operations in Puerto Rico. Compounding the irony, these policies were dubbed “Operation Bootstrap,” implying that the spur to economic activity was based in the actions of Puerto Ricans themselves.[[4]](#footnote-4) In addition to the economic growth success of these years, that experience established an outlook on economic policy that has been maintained to this day: a continually looking outward, to businesses based in the states and to favors from Washington as the drivers of economic growth. This outlook, of course, was a manifestation of the island’s status.

 In a prescient critique of Operation Bootstrap in her college thesis, now U.S. Supreme Court Justice Sonia Maria Sotomayor summed up the situation. She recognized that Operation Bootstrap allowed the Puerto Rican economy to improve in absolute terms, but argued that it failed because it “. . . was based on a negation of self-sufficiency and an acceptance of utter dependency on the colonial master, the United States. Manufacturing firms in Puerto Rico were almost completely export oriented to the mainland market . . . Puerto Rico was also dependent on the United States for its investment capital.”[[5]](#footnote-5)

 The success of this early period, as soon became apparent, was not simply the favorable U.S. tax treatment and the actions of firms based in the states. In addition, it depended on the low-wage labor in Puerto Rico and on the privileged, free access of products from Puerto Rico into the U.S. market. As these conditions changed, as wages rose in Puerto Rico and other, even lower-wage, parts of the world gained access to the U.S. market, the success in Puerto Rico faded. Yet, the policy outlook did not change, and it was an outlook that neglected the actions that were so important in regions of the world that have attained lasting economic growth.

The economist James Dietz usefully explains the essence of this neglect: “…Puerto Rico’s strategy of development lacked a focus on the systematic support or fostering of local entrepreneurs and local sources of finance, unlike the more successful East Asian path of industrial growth and development.” As a consequence “the central role of domestic entrepreneurs, skilled workers and technological progress that underlies sustained economic progress” has been weaker in Puerto Rico than in sovereign nations where sustained economic progress has proceeded more rapidly.[[6]](#footnote-6)

 An aspect of the neglect of actions that would have created a more successful development program is the failure of the Puerto Rican governments to give attention to economic sectors beyond manufacturing. Manufacturing has been not only the core of U.S. tax support, but was also central to the hyper-industrialization ideology that prevailed in Puerto Rico, as well as in many other parts of the world, in the post-World War II era. Once the low-wages and privileged access to the U.S. market were gone, Puerto Rico had no special advantage in manufacturing activity other than federal tax provisions coupled with tax favors by the Puerto Rican government. Yet, the governments’ focus continued to be fixed on manufacturing, and it virtually ignored other activities—agriculture and tourism stand out. Furthermore, the social infrastructure of broad-based economic success—education, in particular—was given insufficient support.[[7]](#footnote-7)

*Section 936*

 Puerto Rican governments’ view of Section 936 is a prime illustration of their misguided outward-oriented approach to economic development. This feature of the U.S. tax code, established in 1976, gave special favorable tax treatment to U.S. firms operating in Puerto Rico. Governments in Puerto Rico viewed 936 as a center-piece of their development program. When it was phased out in the 1996 to 2005 period, the governments—and many commentators—saw the demise of 936 as the cause, or at least the catalyst, of the long recession that began soon after 936 ended. Yet, 936 cannot be credited with success when it was in operation, and its cessation cannot be blamed for the recession.

 To begin with, the years of 936’s full operation, 1976 to 1996, were the years of slowdown in Puerto Rico’s economic growth. Moreover, in spite of the fact that 936 included employment-creating provisions, it was a remarkably poor and costly means of job creation. Unemployment in the 1976 to 1996 years averaged over 17% (though it was coming down toward the end of the period). On average in the midst of the 936 period, it cost the U.S. Treasury $26,725 each year to maintain a job that was paying an annual salary of $17,725.[[8]](#footnote-8)

 Much has been made of the 27.5% decline of jobs in Puerto Rico’s manufacturing sector as 936 was phased out in the 1996 to 2005 period, but ignored is the fact that employment declined in this period by only 1.1% in those four sectors of manufacturing where 936 firms played a major role (pharmaceuticals and medicines, chemicals, computers and electronic goods, and medical equipment and supplies). The 936 firms could switch to Controlled Foreign Corporation (CFC) status, giving them virtually the same federal tax advantages as had 936. CFC status, however, did not include the employment provisions of 936. For pharmaceutical firms, in subsequent years, exports expanded substantially though employment fell substantially. While some pharmaceutical firms did depart Puerto Rico, the causes do not seem to have been the elimination of 936.

 Nonetheless, in spite of the lack of positive impact by 936 on the island’s economy, governments’ have been beseeching (without success) the U.S. Congress to establish new, 936-like programs as a major solution to their economic problems. Once again, it is the combination of investment from off the island and favors from Washington that are at the center of Puerto Rican economic policy.

**An Unlevel Playing Field**

Puerto Rico’s status as a territory has placed it on an unlevel playing fields with the states. In several federal programs that provide funding to the states or supply supports directly to the residents of the states, Puerto Rico and Puerto Ricans are not included or are included only on less favorable terms. Major examples of these programs are the federal Earned Income Tax Credit (EITC), the Child Tax Credit (CTC), Medicare, Medicaid, and Nutritional Assistance.[[9]](#footnote-9)

The exclusion of Puerto Ricans from the federal EITC and CTC has large negative consequences for low-income Puerto Rican families as compared to their counterparts in the states with identical earnings and family structure. For example, consider two families whose members are all citizens of the United States. One family is in the states and one in Puerto Rico. Each consists of two parents and two young children. Both families had earned income of $24,000 in 2018. Each family pays $1,488 in Social Security taxes and $348 in Medicare taxes. Neither family has any federal income tax liability, the Puerto Rican family because it is not covered by federal income tax requirements and the family in the states because its income is so low.

On the basis of 2018 tax regulations, the family in the states, however, receives an EITC of $5,716 and a CTC of $2.800. Thus, after federal taxes and credits, this family has income of $30,680. The family in Puerto Rico, not eligible for the EITC and CTC, after federal taxes and federal credits (i.e., none) has an income of $22,164. The family in Puerto Rico, earning the same as the family in the states and having the same family composition, has an income $8,516 less than the family in the states after both families’ tax and credit interactions with the federal government. (In percentage terms, the family in the states has a 38% greater income than the Puerto Rican family after federal taxes and credits.)[[10]](#footnote-10)

Furthermore, were these two programs fully implemented in Puerto Rico, they would lead to an annual inflow of funds from the federal government to Puerto Rico of approximately $1.4 billion. This would be a significant stimulus to the island’s economy.

The fact that Puerto Ricans island residents do not pay federal income tax has sometimes been cited to justify their exclusion from the EITC and the CTC. In fact, many (perhaps most) current recipients of EITC and CTC do not pay any federal income taxes simply because their incomes are too low. Also, the EITC was established in part to offset the regressive payroll taxes—the Social Security and Medicare taxes—for low-income families. Puerto Rican residents pay these federal payroll taxes at the same rates as do residents of the states. Moreover, both the EITC and CTC were put in place and then expanded in order to alleviate poverty by supplementing earned income and thus providing an incentive for people to draw a paycheck. The poverty rate in Puerto Rico is substantially higher than on the mainland, with about 45% of Puerto Ricans living below the poverty line.[[11]](#footnote-11)

The other federal programs listed above—Medicare, Medicaid, and Nutritional Assistance—all have upper limits for Puerto Rico that do not apply for the states. If these Puerto Rican limits were eliminated (i.e., with Puerto Rico treated the same as the states), the island would receive approximately $1,650 billion in additional federal funds.[[12]](#footnote-12) Thus, the impact of treating Puerto Rico and Puerto Ricans the same as the states and residents of the states for these five programs would bring approximately $3 billion additional federal funds to the island each year, providing both direct benefits and a substantial economic stimulus. With a moderate multiplier effect, the total impact could be as large as $4.5 billion, an amount equal to over 6% of the fiscal year 2017 GNP.[[13]](#footnote-13)

**The Generous Support Myth**

 It is often argued, however, that Puerto Rico already receives excessively generous funding support from the federal government. The data, however, show something rather different. Unfortunately, the relevant data, those showing the amount of federal expenditures in various categories going to the individual states and territories, have not been available since 2010. But the pattern of 2010 data is consistent with the pattern of earlier years, and there is no reason to think that pattern has changed significantly in the period since 2010.[[14]](#footnote-14)

 In 2010, in terms of federal expenditures per capita, Puerto Rico ranked below all of the states and the District of Columbia; expenditures to Puerto Rico were half the average for the states. Even when compared to per capita personal income, seven states ranked higher than Puerto Rico. Perhaps most telling, however, is the comparison of Puerto Rico to the states in terms of net federal expenditures per capita—that is, federal expenditures less federal taxes. In 2010, net federal expenditures to Puerto Rico per capita were less than that going to seventeen states and the District of Columbia. If the federal support for Puerto Rico is “generous,” it is even more generous for those seventeen states.[[15]](#footnote-15)

Federal fund disbursements are designed to serve multiple functions, and there is no reason that the expenditures in a state or region should equal the tax payments from that state or region. Those various functions range from providing income and employment in relatively low-income regions to building infrastructure (e.g., highways), to establishing military bases and purchasing military equipment. Because of an implicit federal commitment to support regional income convergence, it is to be expected that low-income regions would have relatively large receipts. Yet, Puerto Rico, certainly a low-income area relative to all the states, is not treated especially “generously” by any of these measures.

**The Options for Puerto Rico**

 Some of the economic problems identified here as stemming from Puerto Rico’s political status could, in theory, be dealt without status change. Yet, the history of Puerto Rico’s treatment by the U.S. government, and the practices that have been followed by Puerto Rican governments with regard to their economic policies make it highly unlikely, if not inconceivable, that significant and lasting progress could be attained without status change.

 There are, then, two options. Puerto Rico could become the fifty-first state or Puerto Rico could become an independent, sovereign county. For economic reasons taken alone, it would seem that statehood is preferable. Puerto Rico would be automatically treated in the same manner as the states with regard to federal programs; the outward orientation of policy in Puerto Rico would be altered; and, most important, Puerto Rico would have two senators and four or five representatives in the House and would fully take part in presidential elections.

 As an independent country, Puerto Rico would have the authority to chart its own economic path, which could include different social programs than those of the U.S. government[[16]](#footnote-16) and different economic relations with other countries. There are, however, few examples of small, island countries that have had substantial economic success. Also, such countries tend to maintain the same outward looking, dependent approach to policy that has characterized policy in Puerto Rico.

 There are, of course, non-economic issues that are involved. Most prominent is the issue of U.S. citizenship, which would of course remain the same under statehood but which is, at least, uncertain under independence. Also, for many Puerto Ricans, cultural and language issues are important.

 While the status issue is formally under the authority of the U.S. government, the desires of the Puerto Rican people are central to any decision regarding the choice between statehood and independence. Recent polls show far more support for the former. The polls, however, also show considerable support for the current status (though not as much as for statehood), and it is not clear how the groups supporting current status would shift—for statehood or independence—if the current status were excluded as a choice.

 Certainly, from a human rights perspective, the continuation of the current status should not be a choice. Whether Puerto Rico is called a “territory” or a “colony,” the people living in Puerto Rico are denied basic rights that the U.S. people, the U.S. government, and much of the world’s people and governments have long viewed as essential components of freedom. Aside from economic issues, continuation of Puerto Rico’s current status cannot be justified.

**Conclusion**

The current status of Puerto Rico is central to an explanation of the island’s economic woes. Yet, even while the approach to economic policy by authorities in Puerto Rico have been greatly affected by status, those authorities are not absolved of responsibility. Some have embraced the current status, and others who have opposed the current status have nonetheless followed the same sorts of policies. Moreover, it is widely believed, and in some instances established in court, that there has been considerable corruption in Puerto Rico’s governments, which, of course, has generated economic damage.

Regarding excessive, unpayable debt that has been taken on by the government, the responsibility of Puerto Rican authorities has been substantial. Even if the poor growth performance is attributable to status, continually taking on more debt amounted to an irresponsibility from which crisis was the virtually certain outcome. Of course, the financial firms that both served as underwriters in the selling of this debt and those who gladly purchased the debt share responsibility. But both sides have been culpable.[[17]](#footnote-17)

While it is useful to understand how the current crisis has developed, blame per se is not the issue. The focus needs to be on the solution of Puerto Rico’s economic problems. Resolving the status issue is not a magic pill, which alone would place Puerto Rico on the path to prosperity. But the argument here is clear: A change in Puerto Rico’s status is a necessary and important step in creating a new economy.

1. \* Professor Emeritus of Economics, University of Massachusetts Boston.

 Puerto Ricans do elect one non-voting member to the U.S. House of Representatives. Also, when Puerto Ricans move to the states, as U.S. citizens they have full voting rights in the states. [↑](#footnote-ref-1)
2. In a 1996 article, two well-known U.S. economist suggested that Puerto Rico might well be similar to the economic success experience in several East Asian countries. See William J. Baumol and Edward N. Wolff, “Catching Up in the Postwar Period: Puerto Rico as the Fifth ‘Tiger’?” *World Development*, Vol. 24, No. 5. 1996. [↑](#footnote-ref-2)
3. With population in Puerto Rico growing slower than in the United States during the 1950 to 2017 period, largely due to migration from the island, real GNP per capita growth over the period was greater in Puerto Rico than in the United States—see table. In the discussion of Puerto Rican economic issues, it is important to keep in mind that the official Puerto Rican economic data are not good. For example, for aggregate data—GNP and related aggregates—real values are computed and presented using 1954 as a base year. This is unreasonable and makes the accuracy of the reported figures highly suspect. See, Arthur MacEwan and J. Tomas Hexner, “Establishing Reliable Economic Data for Puerto Rico,” Paper submitted to the Congressional Task Force on Economic Growth in Puerto Rico, August 2016, [https://www.finance.senate.gov/imo/media/doc/Arthur%20MacEwan%20and%20J.%20Tomas%20Hexner%20(Submission%201).pdf](https://www.finance.senate.gov/imo/media/doc/Arthur%20MacEwan%20and%20J.%20Tomas%20Hexner%20%28Submission%201%29.pdf). [↑](#footnote-ref-3)
4. In Spanish, the program of this period was called *Operación Manos a la Obra,* a title with different implications. [↑](#footnote-ref-4)
5. Sonia Maria Sotomayor. *La Historia Cíclica de Puerto Rico: The Impact of the Life of Luis Muñoz Marín on the Political and Economic History of Puerto Rico, 1930-1975*. Princeton University, Senior Thesis, Department of History, 1976, p. 98. [↑](#footnote-ref-5)
6. James L. Dietz, *Puerto Rico: Negotiating Development and Change*, Lynne Rienner Publishers, Boulder and London, 2003, pp. 79. [↑](#footnote-ref-6)
7. See Arthur MacEwan, “Puerto Rico: Suffering the ‘Dutch Disease’ in Reverse,” *Social and Economic Studies*, Vol. 66, No. 3&4, 2017. [↑](#footnote-ref-7)
8. For elaboration and sources for these statements and those in the following paragraph regarding 936, see Arthur MacEwan, “The Effects of 936,” paper submitted to the Congressional Task Force on Economic Growth in Puerto Rico, August 2016, [https://www.finance.senate.gov/imo/media/doc/Arthur%20MacEwan%20and%20J.%20Tomas%20Hexner%20(Submission%206).pdf](https://www.finance.senate.gov/imo/media/doc/Arthur%20MacEwan%20and%20J.%20Tomas%20Hexner%20%28Submission%206%29.pdf). While it does not appear that Section 936 did much for Puerto Rico’s economic growth or employment, it did a great deal for the profits of firms based in the states and operating subsidiaries in Puerto Rico. While some of those profits arose from production in Puerto Rico, they also arose form transfer prices within the firms and from the firms locating ownership of valuable patents with their Puerto Rican subsidiaries. While profit data per se for these firms is not available, the large share of the value added in their Puerto Rican operations that the firms obtained indicates large profits. In pharmaceuticals, for example, proprietors’ income (profits, interest, etc.) accounted for 94% of value added. [↑](#footnote-ref-8)
9. For a full list and discussion of such programs, see Appendix 2: Federal Programs Under Which Puerto Rico Receives Differential Treatment, in *Congressional Task Force on Economic Growth in Puerto Rico: Report to the House and Senate,* December 20, 2016, <https://www.finance.senate.gov/imo/media/doc/Bipartisan%20Congressional%20Task%20Force%20on%20Economic%20Growth%20in%20Puerto%20Rico%20Releases%20Final%20Report.pdf>. [↑](#footnote-ref-9)
10. The figures here were obtained using TurboTax © for 2018. Calculations for other years are similar. Also, for elaboration on EITC and CTC issues, see Arthur MacEwan and J. Tomas Hexner, “Including Puerto Rico in the Earned Income Tax Credit and the Full Child Tax Credit,” <https://www.puertoricoreport.com/wp-content/uploads/2016/09/Including-Puerto-Rico-in-EITC-and-CTC.pdf>. [↑](#footnote-ref-10)
11. The exclusion of Puerto Ricans from the CTC is limited. If a family has three or more children, it is eligible for the CTC—but not if it only has one or two children. This has been taken into account in the estimation of the total annual inflow of funds, the $1.4 billion, noted above. Also, that Puerto Ricans do not file federal income tax returns is sometimes used as a basis for the claim that, without such filing, there is no technical way to implement the EITC in Puerto Rico. Yet, this argument is belied by the fact that Puerto Ricans with three or more children and who do not file a federal income tax form are able to claim the CTC. [↑](#footnote-ref-11)
12. The sources for these and the EITC and CTC estimates are as follows: EITC and CTC, private professional scoring; Medicaid and Nutritional Assistance, calculated from data in the *Congressional Task Force on Economic Growth in Puerto Rico: Report to the House and Senate*, pages 102 and 95, respectively; Medicare, rough estimate from information in U.S. Senate working paper “Addressing Puerto Rico’s Medicare Crisis And Implementing an Urgent Path to Recovery,” Working Paper as of November 30, 2015 (v8), [https://www.finance.senate.gov/imo/media/doc/Puerto%20Rico%20Healthcare%20Community%20(Attachment%201).pdf](https://www.finance.senate.gov/imo/media/doc/Puerto%20Rico%20Healthcare%20Community%20%28Attachment%201%29.pdf), and Puerto Rico Medicare, Coalition for Fairness, “Action Needed for Health Care in PR,” February 13, 2015. <http://nebula.wsimg.com/1bd5367a289dc65699c178818d0739a7?AccessKeyId=C2485EFE08948AE5AAE0&disposition=0&alloworigin=1>. [↑](#footnote-ref-12)
13. As noted above (see footnote 9 above), there are several other federal programs in which Puerto Rico is treated differently than the states, but they are not included in the quantitative impact estimates here. [↑](#footnote-ref-13)
14. For example, for 2004, see Arthur MacEwan and Angel Ruiz, “Washington Dollars and the Puerto Rican Economy: Amounts, Impacts, Alternatives,” *Ensayos y Monografias,* No. 135, febrero 2008, Unidad de Investigaciones Economicas, Departamento de Economia, Universidad de Puerto Rico, Recinto de Rio Piedras. On line at <http://economia.uprrp.edu/ensayo%20135.pdf>. [↑](#footnote-ref-14)
15. For details, see Arthur MacEwan and J. Tomas Hexner, “Puerto Rico: Quantifying Federal Expenditures,” Paper submitted to the Congressional Task Force on Economic Growth in Puerto Rico, August 2016, [https://www.finance.senate.gov/imo/media/doc/ Arthur%20MacEwan%20and%20J.%20Tomas%20Hexner%20(Submission%204).pdf](https://www.finance.senate.gov/imo/media/doc/%20Arthur%20MacEwan%20and%20J.%20Tomas%20Hexner%20%28Submission%204%29.pdf). The expenditure figures are from *Consolidated Federal Funds Report for Fiscal Year 2010, State and County Areas*, U.S. Department of Commerce, Economics and Statistics Administration, U.S. Census Bureau, Issued September 2011; and for personal income for the states *Statistical Abstract of the United States 2012,* and for Puerto Rico Junta de Planificación de Puerto Rico, Apéndice Estadístico, [www.jp.gobierno.pr](http://www.jp.gobierno.pr). Tax revenue from *Internal Revenue Service Data Book, 2010*, Department of the Treasury, IRS, <http://www.irs.gov/pub/irs-soi/10databk.pdf>. The seventeen states receiving more net federal expenditures than Puerto Rico in 2010 were, in order of the ranking: Alaska, Hawaii, New Mexico, Virginia, Maryland, West Virginia, Kentucky, Alabama, Mississippi, Montana, Vermont, Maine, North Dakota, South Dakota, South Carolina, Idaho, and Arizona. [↑](#footnote-ref-15)
16. The Partido Independentista Puertorriqueño advocates a social democratic approach to policy, significantly different from policy approaches of U.S. governments. [↑](#footnote-ref-16)
17. Contributing to the behavior of both the government and those pushing and purchasing the bonds are three factors of importance, the first two, at least, created by the U.S. government. (The origin of the third factor is opaque, but certainly required approval by the U.S. government.) First, Puerto Rico’s publicly issued bonds are triple tax free—free from federal, state, and local taxes. Second, Puerto Rican municipalities were excluded from Chapter 9 bankruptcy. Third, the Puerto Rican constitution provided that payment on bonds issued directly by the central government have precedent over all other government expenditures. This set of provisions made buyers view Puerto Rican bonds as especially good investments. [↑](#footnote-ref-17)