

**Richard Weisskoff**  
**International Studies Department**  
**University of Miami**

**Angel Ruiz**  
**Faculty of Economics and Business Administration**  
**Inter American University of Puerto Rico**

**The Economy of Puerto Rico: Restoring Growth**, edited by Susan M. Collins, Barry Bosworth, and Miguel A. Soto-Class. 2006. Washington: The Brookings Institution Press and San Juan, Puerto Rico: Center for the New Economy. 607 + xiii. ISBN 0-8157-1554-4, \$59.95; ISBN 0-8157-1553-6, \$29.95.

The dilemma of Puerto Rican development, as framed in this Brookings Institution study, is “how to return us to growth.” Since the 1970s, the Puerto Rico economy, together with the development strategy that has guided it, has stagnated. How to get growing again?

The book presents a collection of studies, incomplete in their coverage and partial in their explanations and solutions. Cosponsored by Brookings and the recently founded Center for the New Economy in San Juan, Puerto Rico—it consists of 10 chapters on selected economic topics, limited to growth, labor and human capital, business climate, taxes, financial structures, and trade. There is no theme, other than growth, that holds the chapters together, and even the people of Puerto Rico are an elusive factor. However, each chapter is meticulously researched by its principal authors, and each is followed by a frank, gloves-off critique by two commentators. The result: a free-for-all debate on a restricted set of topics by 32 different academic and research economists, 10 of whom are working in Puerto Rico.

Despite the book’s title, it is no review of the Puerto Rican economy at all, or even an attempt to grapple with a comprehensive approach. Despite many of the authors’ pleas for a new strategy, none is presented here! An earlier Brookings study of the island’s economy, *Porto Rico and Its Problems* (Clark et al., 1930), was intended as a landmark report and did document the problems of the first quarter of the twentieth century, the transformation from the small-holder peasant society under the Spaniards to the sugar–tobacco–coffee plantation economy under the Americans. But the postwar world has swept away that economy, and Puerto Rico became the pioneer of the prototype for the footloose factory, manufacturer and exporter, manipulator of financial incentives (tax holidays), and public investor in the infrastructure (ports, roads, power, and water) needed for this new mode of “development.” By the early 1980s, it was clear that the

## BOOK REVIEWS

economy had maxed out on this strategy, as other nations, ranging in size from Grenada to China, also discovered the new path. This has left Puerto Rico, with four million U.S. citizens, a hollowed-out economy, a countryside of abandoned factories, its streams and aquifers contaminated, and two functioning parallel economies: the “modern” glitzy sector of finance and government services, and the “popular” sector of families, workers, and workers who “dropped out” of the labor force.

Nevertheless, the new book makes a number of methodology breakthroughs and smashes several taboos. In chapter 2, “Economic Growth,” for example, authors Barry Bosworth of Brookings and Susan Collins of the University of Michigan adjust the estimate of Puerto Rico’s GDP by some 17–31 percent (depending of the stringency of the assumptions, pp. 27–28) due to “substantial income shifting [to Puerto Rico] by U.S. corporations operating in Puerto Rico under section 936 [of the Tax Reform Act of 1976]” (p. 24). They write, “We are only arguing that much of what is recorded as production in Puerto Rico is a simple paper transaction in which income is transferred to Puerto Rico and then taken back as dividend payment to mainland corporations” (p. 28). Despite the reduction, Bosworth and Collins still find that “for Puerto Rico, labor productivity in industry is twice that for services,” in contrast to the “mainland” where estimates of labor productivity in industry and services are “nearly equal” (p. 35). But Bosworth and Collins reach conclusions about total factor productivity through the methodology of growth accounting and use of the perpetual inventory method to estimate capital stock (p. 69). Despite their careful efforts, it must be noted that the Puerto Rico Planning Board (the source of their data) has never estimated the capital stock for the island, so that any inference using this method to measure capital must be, at best, a rough approximation pending an official estimate. Furthermore, the distortion of transfer pricing probably affects only some of the manufacturing sectors, such as pharmaceuticals, and should not be applied to the other manufacturing sectors or to agriculture, construction, and services. Moreover, measures of labor productivity in Puerto Rico are made on the basis of the number of production workers, not man-hours.

Bosworth and Collins ask, “Why is Puerto Rico’s labor force participation rate so depressed?” (p. 40), and then they suggest the reasons are the distorted relative wage structure (p. 45), the absence of linkages of the sector benefiting from tax incentives to the local economy (p. 57), and the cushion offered by the underground economy (pp. 58–63). But Gary Burtless of Brookings and Orlando Sotomayor of the University of Puerto Rico argue in their chapter 3, “Labor Supply and Public Transfers,” that the labor participation rates fell in the late 1970s due to the earlier recession (which knocked out demand) and the introduction of food stamps in 1974, which improved living standards without requiring work. “By 1980, about 60 percent of Puerto Rico’s population was collecting benefits, and the program provided 7.5 percent of Puerto Rico’s personal income” (p. 97). By 2003, the share of participants had fallen to 30 percent of the population after the “stamps” were replaced by cash grants to families and the program was capped. In 2003, the nutrition programs accounted for only 3 percent of personal income (graph, p. 98). But other federal programs were being extended to Puerto Rico’s poor. The sum of all transfers from nutritional assistance, social security, and unemployment altogether provided 15 percent of personal income in 2002 (p. 115).

Why the low labor participation rates? Burtless and Sotomayor conclude: “improved public transfers” (p. 129), and add other factors: the informal sector, early retirement, discouraged workers, a high minimum wage, and the possibility of easy migration to the United States. Commentators Eileen Segarra Almestica of the University of Puerto Rico and Katherine Terrell of the University of Michigan contest these points. Terrell speculates that returning migrants, not transfers, depress the participation rate, and that remittances “help to keep the reservation wage in Puerto Rico high” (p. 149). There is no mystery, he concludes. There is not much demand for labor.

In chapter 4, “Why Don’t More Puerto Rican Men Work? The Rich Uncle (Sam) Hypothesis,” María Enchautegui of the University of Puerto Rico and Harvard’s Richard Freeman place the blame clearly on the United States. They conclude, “Puerto Rico needs to work with the U.S. government to redesign these [transfer and poverty] programs . . . to be more work friendly” (p. 182). But an analysis of the flow of funds from Washington to Puerto Rico by Angel Ruiz and Arthur MacEwan presented to the 24th Annual Association of Puerto Rican Economists in 2007 (“Washington Dollars and the Puerto Rican Economy: Amounts, Impacts, Alternatives”; Ruiz and MacEwan, 2007) reveals that over 60 percent of transfer payments are “earned” transfers, such as veterans and social security payments, as opposed to “granted” transfers. Compared to the level of transfers to persons in the states, the authors conclude that the island’s level of funding is not disproportionate and fails to justify the view that Puerto Rico “suffers” due to the largesse of the U.S. taxpayer, that is, “the rich uncle.” Federal funds, they conclude, cannot be blamed for the island’s economic problems.

Stephen Davis of the University of Chicago and Luis Rivera-Batiz of the University of Puerto Rico (chapter 6, “The Climate for Business Development and Employment Growth”) are also puzzled by the low employment rate. They argue that it is due to the “misalignment” between Puerto Rico’s industrial structure and the schooling attainment of the population (p. 270). These distortions are due to trade protection, tax subsidies, and a long list of tax breaks and professional entry barriers (p. 284). The final culprit: “a large public sector has suppressed productivity levels in Puerto Rico for decades” (p. 292). Their solution: downsize it!

James Alm of Georgia State University, in his chapter 7, “Assessing Puerto Rico’s Fiscal Policies,” concludes that “the tax system was designed for times and circumstances that are long past . . .” (p. 319). Rita Maldonado-Bear and Ingo Walter of New York University, in their chapter 8, “Financing Economic Development,” conclude, “Commercial banks appear to have failed to allocate funds to economic development . . . they have not generated sufficient asset gathering . . . to underwrite the capital formation needed . . .” (p. 454). There is no discussion of the role of foreign ownership.

But for all the discussion of employment, it is most strange that no structural analysis was undertaken as part of this Brookings project. Puerto Rico has the most complete set of independently made input–output tables, published every five years from 1963 through 1992 (the latest one). One of us (Ruiz) has mapped the decline in employment content of exports from 169 to 11 jobs per million dollars between 1963 and 1992, implying the need to increase linkages within the domestic economy. Furthermore, in chapter 9, “Trade Performance and Industrial Policy,” Robert Lawrence of Harvard and Juan Lara of the University of Puerto Rico argue against policies of import substitution (pp. 528–531). Yet, our own studies of the intermediate inputs of

both final household consumption and exports indicate the need to deepen potential “linkages” within the economy as opposed to widening the “leakages” which drain the economy of jobs, even in the pursuit of export promotion! (See Weisskoff and Wolff, 1977.) And as Ruiz continues to document, the direct labor coefficients (that is, jobs per million dollars of production), while falling dramatically across all sectors, are the lowest in the “promoted” sectors—financial services (3.0 jobs/\$million) and manufacturing (4.0 jobs/\$million), as opposed to trade (16.8), services (27.8), and government (34.2) (Ruiz, 2007). Therefore, to downsize government and streamline services while favoring finance and manufacturing would be self-defeating. In contrast to Lawrence and Lara’s reasoned stance against import substitution, Ruiz’s simulations suggest that potential employment could be created by import substituting agro-industry and competitive imports (ibid.). Weisskoff’s studies of the changes in the Puerto Rico economic structure, consumption patterns, and income distribution also give sample computations of the impact of such policy changes on employment (Weisskoff, 1985).

But none of these themes are pursued in this volume. As a minimum, the public needs but two new chapters: First, an introductory and thorough review of all the economic literature on Puerto Rico seen through a sympathetic and wide-angle lens. Second, an expansive concluding chapter giving Alternative Visions of the Puerto Rico Economy. Perhaps this is the next task for the Center for the New Economy in Puerto Rico.

## REFERENCES

- Clark, Victor S. et al. 1930. *Porto Rico and Its Problems*. Washington: Brookings Institution.
- Ruiz, Angel. 2007. “Los Multiplicadores Interindustriales de Puerto Rico, 1963–1992.” University of Puerto Rico, Río Piedras, Department of Economics, *Ensayos y Monografías*, No. 133.
- Ruiz, Angel and Arthur MacEwan. 2007. “Washington Dollars and the Puerto Rican Economy: Amounts, Impacts, Alternatives.” University of Puerto Rico, Río Piedras, Department of Economics, *Ensayos y Monografías*, No. 133.
- Weisskoff, Richard. 1985. *Factories and Food Stamps: The Puerto Rico Model of Development*. Baltimore: Johns Hopkins University Press.
- Weisskoff, Richard and Edward N. Wolff. 1977. “Leakages and Linkages: Industrial Tracking in an Enclave Economy,” *Economic Development and Cultural Change*, 25(4), 607–628. Rural Retirement Migration, by David L. Brown and Nina Glasgow, with contributions by Laszlo J. Kulcsar, Benjamin C. Bolender, and Marie-J