

CHAPTER 1

Island Paradox: Puerto Rico in the 1990s

PERHAPS nowhere else in the Western Hemisphere do the sharply different economies and societies of Latin America and the United States encounter one another as closely as in Puerto Rico. Halfway between North and South America, this Caribbean island of three and a half million people is literally situated between two worlds. But it is history, culture, and politics—more than geography—that account for Puerto Rico's present situation.

Puerto Rico was a Spanish colony from the early sixteenth century until the end of the nineteenth century, by which time it had a Spanish-speaking population of about one million made up of a mixture of races and ethnicities, with African, European, and Taíno/Arawak components. In 1898, after the Spanish-American War, the island became a territory of the United States. Subsequently, Puerto Rico's economic, social, and political ties with the United States became stronger than the ties between the United States and any other country in Latin America. Even Mexico's relationship with the United States in the aftermath of the North American Free Trade Agreement pales by comparison.

The island's current political status was forged in the 1940s by the Puerto Rican leader Luis Muñoz Marín and his Popular Democratic Party. In 1952, Puerto Rico became the Commonwealth of Puerto Rico, or, as officially referred to by the government, a "free state associated with the United States" (*Estado Libre Asociado*). Under the commonwealth formula, Puerto Rico is neither a state of the American union nor an independent country. It has a popularly elected governor and legislature, but its residents are exempt from federal taxes, have no voting representatives in Congress, and may not vote in national elections. Puerto Rico uses the U.S. dollar as its currency, and its foreign

and immigration policies are controlled by Washington. Persons born in Puerto Rico hold U.S. citizenship and may move freely between the island and the mainland. This has led to massive population flows in and out of Puerto Rico. Slightly over three and a half million persons now reside on the island, but close to three million Puerto Ricans live in the continental United States. Of these, almost one million reside in New York City, about the same number as live in the island's capital, San Juan, and its greater metropolitan area.

The historical interplay of Spanish and American involvement in Puerto Rico has resulted in a population that shares many cultural attributes with Latin America yet is heavily influenced by American social and economic forces. Nowhere else in Puerto Rico are the close ties between the island and the United States in greater evidence than the Luis Muñoz Marín International Airport in San Juan. From this bustling compound there are daily departures of Puerto Ricans to all parts of the mainland United States. During holidays, the airport bursts with Puerto Ricans arriving from all parts of the continental United States.

Despite the heavy influence of the United States on the Puerto Rican population, its Latin American and Caribbean heritage is still evident. The Hispanic and Afro-Caribbean cultures are deeply embedded. Spanish remains the primary language of nearly the entire population. San Juan reminds the visitor of other Latin American cities in the Caribbean—of Santo Domingo or Cartagena—not Boston or Chicago.

Puerto Rico has maintained its cultural contacts with other Latin American nations, and with Spain. The proximity of Puerto Rico and the Dominican Republic, for example, has resulted in a long history of migratory movements between the two nations, movements that continue to the present. Currently, thousands of undocumented Dominican immigrants arrive on the deserted beaches of Puerto Rico's west coast every year. Most of them make the perilous trip in flimsy boats. Some stay in Puerto Rico, part of a growing community of undocumented immigrants. Many, however, end up at the Muñoz Marín airport, where the ease of movement between Puerto Rico and the mainland allows safe travel to the United States (see Rivera-Batiz 1995).

Nearly fifty years have passed since Puerto Rico and the United States entered into their present political and economic relationship. What fundamental demographic shifts have occurred during this period? How has the integration of Puerto Rico's small, developing economy to the much larger and economically industrialized economy of the United States affected social and economic conditions on the island? Despite having made substantial socioeconomic progress, Puerto Rico currently confronts serious social and economic problems. How have the intimate social, economic, and political ties of Puerto Rico to

the United States contributed to the crisis confronting the island in the 1990s?

The information presented in this volume is based largely on U.S. census data, primarily from the 1970, 1980, and 1990 censuses of population and housing. The decennial census represents the most exhaustive count of the Puerto Rican population and the most detailed survey of its characteristics. The margin of error of the data provided by the census is much smaller than for other surveys on the Puerto Rican population carried out by the Puerto Rican government. (See appendix 1 for information on the design of the census for Puerto Rico and how this census differs from the one for the mainland United States.)

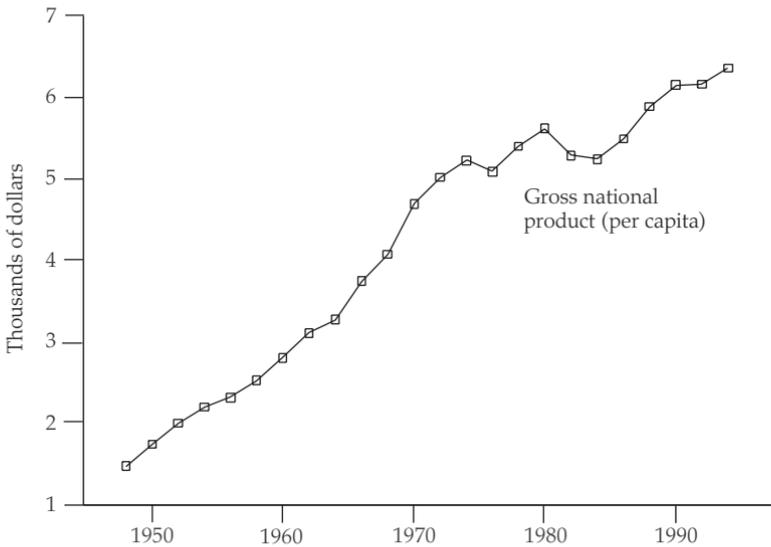
This monograph focuses on the demographic and social changes that occurred in Puerto Rico during the decade of the 1980s and the early 1990s, when the sustained decline of a series of socioeconomic indicators reached alarming levels. A disturbing rise in the unemployment rate, high poverty rates, sustained social inequities, and a sharp increase in substance abuse and crime were characteristic of the period. These transformations and their policy implications can only be understood in their historical context.

The Tarnished Showcase

In the early 1970s, Puerto Rico was held up as a showcase of economic development, as a shining example of how political stability, democracy, and open-market economic policies lead to economic growth. This image has been tarnished by the island's disappointing and painful social and economic experiences of the last twenty years. What happened? What accounts for the sharp turnaround of the Puerto Rican economy and the accompanying breakdown of social structures?

By any measure, Puerto Rico has undergone dramatic changes in the last fifty years. From a largely rural, agricultural economy, it has become a nation of urban dwellers mostly employed in manufacturing and service activities. In 1940, two-thirds of all Puerto Ricans resided in rural areas; now, two-thirds live in urban areas. In the 1940s, close to 45 percent of the labor force was engaged in agricultural activities; by 1990, this number had dwindled to 3.7 percent.

These changes were accompanied by substantial economic growth and social gains. In 1948, gross national product per capita in Puerto Rico was \$1,478, in 1990 dollars; by 1994, GNP per capita had increased more than four times, to \$6,361, in 1990 dollars (see figure 1.1). Associated with these improvements in income were impressive advances in the standard of living. Consider the area of health, for example. In 1940, there was one physician for every 3,763 persons in Puerto Rico; by 1990,

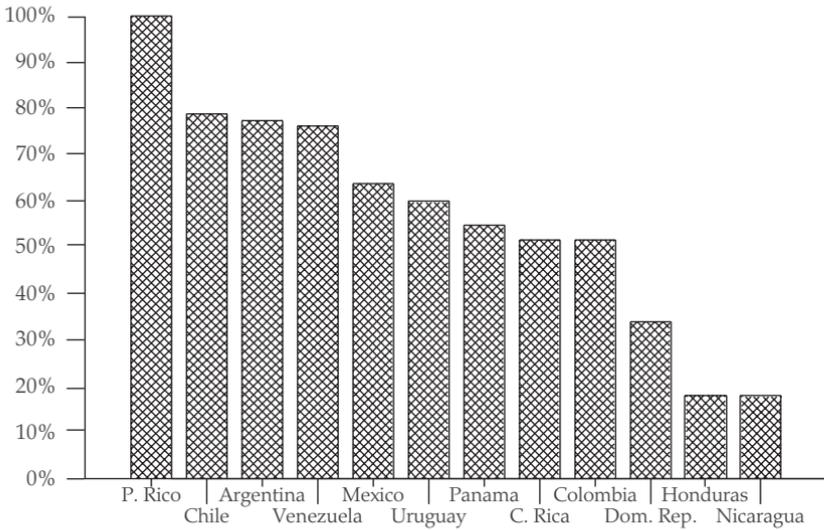
Figure 1.1 Economic Growth in Puerto Rico, 1948–94

Source: Puerto Rico Planning Board, *Economic Report of the Governor*, various years.

there was one physician for approximately every 350 persons. The improvement in health facilities has led to sharp increases in life expectancy. In 1940, life expectancy was 46 years; by 1990 it was 75 years. The infant mortality rate has been drastically curtailed, from 109.1 infant deaths per thousand births in 1940, to 14.3 in 1990. Educational attainment is another area of major progress. In 1950, only 7 percent of the Puerto Rican population 25 years of age or older had a high school diploma; by 1990, this proportion had risen to approximately 50 percent. While in 1940, 31.5 percent of the population 10 years of age or older were able to read and write in any language, by 1990, this proportion had risen to well over 90 percent (Rivera-Batiz 1992a).

The substantial economic growth of Puerto Rico over the last fifty years is also reflected in the island's per capita GNP, which is higher than that of any other Latin American nation. This was not the case fifty years ago. Indeed, in 1940, per capita income was significantly lower in Puerto Rico than in Argentina, Chile, and Panama (Puerto Rico's per capita income was a third of Argentina's). By 1993, the Latin American nation with the highest per capita GNP relative to Puerto Rico's was Chile, whose per capita GNP was 79 percent of Puerto Rico's

Figure 1.2 Per Capita GNP in Latin America Relative to Puerto Rico, 1993



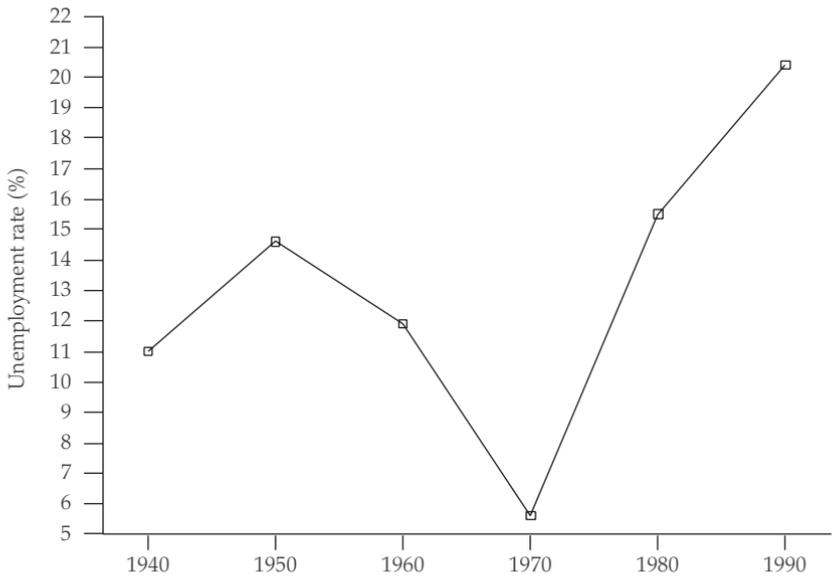
Source: World Bank (1995).

Note: GNP adjusted for purchasing power differences between countries.

(see figure 1.2). The per capita GNP of the poorest countries in Latin America, Nicaragua and Honduras, was less than 20 percent of Puerto Rico’s. The World Bank ranks Puerto Rico among the middle-income countries worldwide. Within this group of countries, Puerto Rico’s per capita GNP ranks slightly higher than that of Greece and South Korea, but somewhat below that of Ireland, Portugal, and Spain.

This glittering image of economic growth has an ugly underside, however. Although by some measures Puerto Rico has shown great progress since the 1940s, in recent years it has suffered from the effects of deep economic and social malaise. The unemployment rate, which had declined steadily during the 1950s and 1960s—the golden age of Puerto Rican economic development—to a low of under 6 percent, began to rise sharply after 1970 (see figure 1.3). By 1990, the unemployment rate had increased, to over 20 percent, nearly double what it was in 1940.

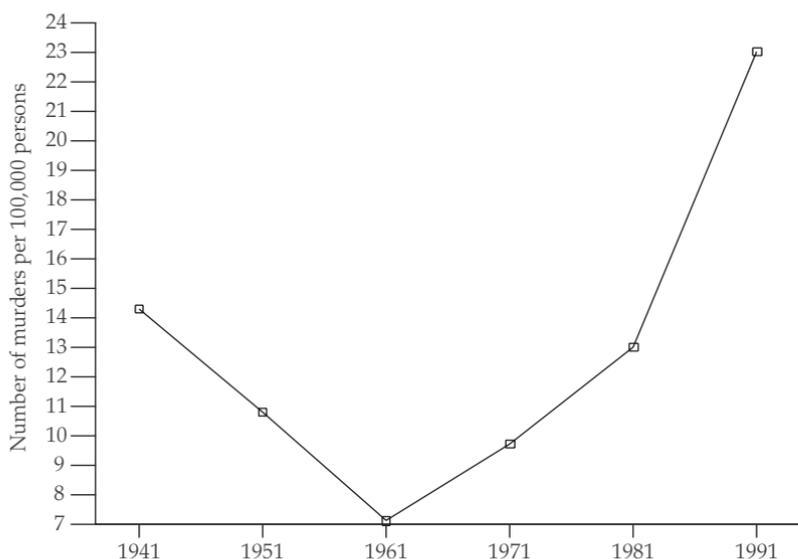
The crash of the labor market in Puerto Rico since the 1970s has had severe repercussions, particularly in the young. According to census data, in 1970, young men between the ages of 16 and 19 had an

Figure 1.3 Unemployment Rate in Puerto Rico, 1940–90

Source: U.S. Census of Population, Puerto Rico: Detailed Characteristics, various years.

unemployment rate of 17 percent. By 1990, the unemployment rate for this group was 54 percent. The unemployment rate for men aged 20 to 29 rose from 7 percent to 24 percent during this same period. Among young women, the rise in unemployment was just as dramatic. In 1970, females aged 16 to 19 had an unemployment rate of 21 percent; by 1990, the rate was 62 percent. Among women aged 20 to 29, unemployment went from 8 percent in 1970 to 29 percent in 1990.

Unemployment rates of 30 to 60 percent are indicative of a severely depressed labor market: consider that, in 1933, at the height of the Great Depression, unemployment in the United States was 25 percent. The social distress such a situation causes is bound to be severe. Indeed, the rising unemployment rate in Puerto Rico has been accompanied by disturbing social trends, the rise in the crime rate being the most visible. As the statistics on murder, rape, robbery, and theft show, crime in Puerto Rico has reached crisis levels. In the early 1990s, carjacking became a dangerously common crime all over the island. In 1992, there were 8,669 carjackings in Puerto Rico, or 2.4 carjackings per one thousand persons, the highest rate in the world at the time (Navarro 1994). By comparison, the rate in Los Angeles was 2.0 carjack-

Figure 1.4 Murder Rate in Puerto Rico, 1941–91

Sources: Data for 1941 through 1971 are from Silvestrini de Pacheco (1980), 273. Data for 1981 and 1991 are from U.S. Federal Bureau of Investigation, *Crime in the United States*, various issues.

ings per thousand. Although carjackings declined sharply after the taking of a vehicle with the use of a firearm became a federal crime in 1992—with penalties ranging up to life in prison—the paranoia caused by this crime spree persists. Expressing the feeling of powerlessness present in most of the population, one San Juan resident admitted, “My wife and I don’t go out at night, out of fear. . . . We don’t even like to go to the shopping center any more. The only place you can feel safe is where entry is controlled and there are guards there. It’s an absurd situation” (Rohter 1993a, A13).

The murder rate, which had declined sharply between 1941 and 1961, started to go back up in the 1960s and early 1970s, rising gradually thereafter until it began to skyrocket in the early 1990s (see figure 1.4). In 1990, there were 17 murders per 100,000 persons; by 1992, the murder rate had climbed to 24.1. By comparison, the average murder rate in the United States in 1991 was 9.8. Only in large urban centers was the murder rate in the United States equal to or higher than the murder rate in Puerto Rico. In New York City, for example, in 1991 it was 29.3.

The rising level of crime on the island led Governor Pedro J. Rossello in 1993 to the unprecedented use of the national guard in raids on public housing projects and to patrol beaches and high crime areas. Although there was some worry about the possible militarization of the island and civil rights violations, most of the residents in areas ravaged by crime welcomed the initiative. One woman, who lived with her four children in the Vista Hermosa housing project in San Juan, said, "Now we can finally enjoy some peace. . . . Before the Guard came in, there were gun battles all over the place and you didn't dare stick your head out the window. But now I can let my kids play outside after dark. God bless them! As far as I am concerned, they can stay here forever" (Rohter 1993b, A10).

The rise of unemployment and its associated social ills occurred during a period of slowdown in economic growth. On average, real per capita GNP grew by 1.6 percent each year between 1970 and 1990. This constitutes a sharp drop from the 1950s and 1960s, when it grew by an average of 8.4 percent per year. What caused the deceleration of economic growth and the fourfold rise of unemployment in Puerto Rico between 1970 and 1990? How has the island's population adjusted to these changes? And, what is in store for Puerto Ricans in the coming years? In order to answer these questions, we must first consider Puerto Rico's economic history of the last fifty years.

Public Policy and Economic Change from 1947 to 1995

There have been three stages in Puerto Rico's development strategy over the last fifty years.¹ The first stage—Operation Bootstrap—lasted from 1947 to the early 1960s. The economic strategy pursued during this period led to the industrialization of the island.

Operation Bootstrap

Operation Bootstrap, a set of government policies aimed at fostering private-sector investment by U.S. firms in Puerto Rico, essentially replaced earlier initiatives to expand local employment through public investment. A new government agency, the Economic Development Administration (FOMENTO) was created. According to the economist Harvey Perloff, an early architect of this development strategy, "promoting industrial development . . . centered on the attempt to attract mainland industries and capital to the island through tax exemption,

1. On Puerto Rico's economic history, see Santiago (1992a), Pantojas-García (1990a), Dietz (1986), DeJesús Toro (1982), and Ruíz (1982).

industrial services, the provision of factory buildings, loans, and special assistance in various forms" (1950, 51).

Such incentives were necessary to attract U.S. capital to the island, even though manufacturing wages were four or five times lower than those on the mainland United States and the island enjoyed political stability and the free movement of goods, capital, and people with the United States. This was because the comparatively lower productivity of labor in Puerto Rico and the island's lack of infrastructure offset any cost advantages of locating there.² As a result, the government decided to undertake massive public investments in infrastructure, including the construction of physical plant facilities tailored to foreign investors. A "tax holiday" law was passed in 1947, and later amended in 1963, that provided income and property tax exemptions for U.S. investments in new manufacturing establishments. This, in combination with section 931 of the Internal Revenue Code of 1954, under which income earned by U.S. manufacturing firms in Puerto Rico was exempt from federal taxes, gave these firms a strong incentive to locate on the island.

Operation Bootstrap generated rapid growth of manufacturing production and employment. In 1950, there were 96 manufacturing plants promoted by the government. By 1963, there were 910. Most of these were in light manufacturing, many in the garment and small consumer-goods industries. The plants were labor-intensive and relied on unskilled, low-wage labor. They were also comparatively small (with an average of 80 or fewer employees per establishment). Many of them were assembly operations: raw materials and parts were shipped from the mainland, and the assembled goods were exported back to the mainland. The absence of tariffs or other barriers to trade between Puerto Rico and the mainland was critical to the success of these operations and gave Puerto Rico a cost advantage over other low-wage locations outside the United States.

Despite the island's rapid economic growth during this period, the situation was not entirely rosy. Puerto Rico's almost total dependence on the U.S. market for its exports left it hostage to sustained U.S. economic growth. This, combined with the *enclave* nature of its budding manufacturing industry, was worrisome. As economists Lloyd Reynolds and Peter Gregory noted: "Should the processing op-

2. The lack of foreign investment in Puerto Rico may also have been related to a failure of single investors to recognize the potential profits of a coordinated, large-scale investment on the island. As Rodrik (1994, 80) observes: "Market prices reflect the profitability of different activities as they are currently undertaken; they do not provide any signals about the profitability of activities that would require a large-scale reallocation of resources within the economy (which, after all, is what economic development is all about)."

erations performed by these plants ever become unprofitable, they can be closed down at little cost to the parent company. Workers can be dismissed, the rented factory building turned back to FOMENTO, and the simple machinery in use shipped home or abandoned" (Reynolds and Gregory 1965, 23).

The Rise and Fall of Petrochemical Development

The potentially disastrous cyclical sensitivity of the employment generated by American capital in Puerto Rico moved the government to support the diversification of production. As a result, in the mid-1960s a new development strategy—the so-called petrochemical (capital-intensive) development strategy—emerged. Based on the theories of the economist Albert Hirschman (1958), the idea was to attract industries to the island whose output could be used as an input by other industries. These industries were also expected to make considerable capital investments in Puerto Rico and to be able to withstand a downturn in the business cycle. The government promoted huge petrochemical complexes, for example, in the hope that pharmaceuticals and other chemical companies, which use derivatives of the oil refining process, would also locate in Puerto Rico. The public sector's large subsidies for capital-intensive production engendered optimism and hopes that, in combination, the labor-intensive and capital-intensive industries would lead to astounding growth rates.

The boom of the 1950s and 1960s, however, became a bust in the 1970s and 1980s. In 1973, the sharp increase in the price of oil was associated with the start of a major recession in the United States. The old saying, "when the United States sneezes, the rest of the world catches cold," applied only too well to Puerto Rico. The demand for Puerto Rican manufactures collapsed and, as a result, between 1972 and 1976 unemployment almost doubled.

The U.S. economy recovered in the late 1970s, but Puerto Rico's did not. The island's GNP increased at a sluggish rate and the unemployment level, which stood at 5.6 percent in 1970, reached 15.5 percent in 1980. The increases in international oil prices had signaled the demise of the local petroleum refining industry. Puerto Rico had been importing cheap crude from Venezuela for processing on the island. As Venezuelan oil prices rose according to the guidelines set by the Organization of Petroleum Exporting Countries (OPEC), importers began to seek other, less expensive, sources of refined oil and to circumvent Puerto Rico's refineries, many of which closed their doors. The abandoned facilities can be seen today throughout the island, a ghostly reminder of this failed development strategy.

However, the crash of Puerto Rico's petrochemical industry was not the only reason its labor market failed to recover in the 1970s and 1980s. Under Operation Bootstrap, Puerto Rico had been at the forefront of a worldwide movement to open local markets to direct foreign investment. But by the 1970s and 1980s, many other industrializing and newly industrialized nations had begun to follow suit. This meant that U.S. firms now had a wide array of alternative sites in Asia and Latin America—where wages were as low or lower than those in Puerto Rico—from which to choose. At the same time, a worldwide movement to reduce tariff and nontariff barriers to trade meant that Puerto Rico lost its advantage in this area as well. Many U.S. firms were now locating their assembly plants in these low-tariff countries or in duty-free zones elsewhere.

The Expansion of Tax Breaks as Industrial Policy

The reaction of policymakers to the crisis of the 1970s was to generate a new round of tax breaks that would keep U.S. firms from leaving Puerto Rican soil and revive the incentives for greater foreign investment in the island.³ This strategy, which began in 1976, constitutes the third, and latest, stage of industrial policymaking in Puerto Rico over the last fifty years. The legislative basis for the new strategy was section 936 of the U.S. Internal Revenue Code, as amended by the Tax Reform Act of 1976. Section 936, which superseded the previously mentioned section 931 of the U.S. tax code, in essence allowed subsidiaries of U.S. companies located on the island to repatriate income generated from their investments in Puerto Rico to their parent companies on the mainland free of federal taxes, but only if these funds were deposited in Puerto Rico for at least six months before repatriation. Such funds had to be used for investment purposes on the island or in the other countries of the Caribbean Basin. The so-called 936 funds in Puerto Rico's financial system grew quickly—from \$7.4 billion in 1980, to close to \$10 billion in 1992. These funds (which accounted for 18.6 percent of all commercial bank deposits in 1992) have become one of Puerto Rico's most important sources of private investment. Most of the money has been used to finance commercial loans, mortgages, and government loans (Daubón 1989; Escobar 1982).

The new tax laws perpetuated the tradition of relying on American direct investment to stimulate the local economy. In 1970, close to 80

3. Puerto Rico's development strategies are discussed by Bofil (1987), del Valle-Caballero (1994), Dietz and Pantojas-García (1993), Meléndez (1988), Curet (1986), Villamil (1983), Heine and Passalacqua (1983), Long (1988), and Freyre (1979).

percent of all manufacturing employment in Puerto Rico was in plants operating under the governmental incentive program; by 1989, this number had risen to 87 percent. The strategy suffered from two major shortcomings, both of which had surfaced under the previous strategies in the early 1970s. First, the tax and other incentives offered by Puerto Rico to American employers were aimed at reducing the relative cost of investing capital on the island, and they thus led to capital-intensive, rather than labor-intensive, investments. As a result, they were not able to generate a sustained boom in employment (Gutiérrez 1977). Indeed, the firms that were attracted under the 936 incentives plan produce capital-intensive pharmaceuticals, electronics equipment, and scientific instruments (Colón 1994; Marqués Velasco 1993). Second, the export-oriented plants established as a result of this strategy are highly sensitive to U.S. business cycles, and this contributed to increased variability of employment (Meléndez 1988; Alameda 1979; Baer 1960). The pattern of economic activity in Puerto Rico during the last three decades mirrors that of the United States, except that the booms and busts are magnified. As a result, recessions in the United States lead to massive social and economic dislocations on the island. This pattern was very evident in the 1980s and early 1990s.

A Time of Turbulence

The 1980s and early 1990s were a tempestuous period in Puerto Rico's history, and the sharp economic fluctuations of these years hit the island with the impact of a hurricane. Not even the hugely destructive hurricane Hugo, which blasted the island in September 1989, left such devastation in its wake as the economic turbulence of this period.

In 1982, the U.S. economy moved into a sharp recession, which led to American unemployment rates of close to 10 percent. The recession's repercussions in Puerto Rico were severe. By 1986, as many as 282 plants that had operated under government incentive programs had closed, with a loss of over 13,000 jobs. Unemployment soared to over 22 percent in 1986.

The U.S. economy rebounded quickly from this recession, and its recovery was strong and sustained. By 1989, the average unemployment rate in the United States had dropped to about 5 percent. In some states, unemployment fell below 4 percent. Although Puerto Rico also experienced brisk increases in production in the second half of the decade, unemployment rates remained high, exceeding 20 percent in 1990.

Economic activity in the United States slowed down once more between 1991 and 1993, with unemployment rising to over 7 percent in 1992. Again, Puerto Rico felt the impact of the U.S. economic slow-

down. According to government figures, the unemployment rate on the island climbed an additional four percentage points between 1989 and 1993. Only in 1995 did the high unemployment levels in Puerto Rico begin to subside, a turnaround associated with the increased U.S. economic growth of the mid-1990s.

This economic hurricane did not affect Puerto Rico's population uniformly, however. Just as an actual hurricane may leave in its wake some areas less damaged than others, the effects of the economic and social crises of the last fifteen years have not been felt equally by all. While part of the population was becoming immiserized, part of it was substantially improving its socioeconomic status.

The divergent fortunes of different groups in the Puerto Rican economy are seen most clearly in the labor market. Although the average unemployment rate in Puerto Rico in 1990 was over 20 percent, the overall unemployment picture was uneven. In urban San Juan, for example, the unemployment rate was 15.5 percent, and in the urbanized *municipio* (county) of Guaynabo, located next to San Juan, unemployment was under 13 percent. On the other hand, in the *municipio* of Guayama on the sparsely populated southern coast of Puerto Rico, the unemployment rate exceeded 38 percent. In Jayuya and Utuado, located in the mountainous center of the island, the unemployment rates were 34 percent and 29 percent, respectively.

These regional differences in unemployment rates are reproduced in income levels. The *municipios* with the highest per capita income in Puerto Rico are Guaynabo, San Juan, and the bordering *municipios* of Carolina, Bayamón, and Trujillo Alto. Among the *municipios* with the lowest per capita income are Jayuya, Utuado, and others in the rural, central region of the island.

In addition to regional inequities, Puerto Rico's economic landscape is uneven in other respects as well. While unemployment rose to alarming proportions between 1980 and 1990, the earnings of those who were employed grew significantly (by close to 20 percent) during the same time period, especially in the second half of the decade. This suggests that the recessionary periods in the economy left a more lasting imprint on unemployment than on the pay of those who were employed. This was particularly devastating for young workers entering the labor market for the first time. Older, experienced workers and highly educated employees made substantial economic gains. What caused these inequities?

A significant part of the employment generated by the Puerto Rican economy in the 1980s was associated with U.S. direct investment. As we have noted, these investments were capital-intensive and provided comparatively high-paying jobs, but did not supply a boost to employment relative to the growing labor force (Santiago 1987a).

A second explanation for the rising average pay—and the growing unemployment—is the sharp increase in minimum wages during the period. Minimum wages in Puerto Rico are established under a combination of federal and Puerto Rican statutes. The 1938 Fair Labor Standards Act (FLSA) first set minimum wages both for the mainland and for Puerto Rico. However, a few years later, the U.S. government allowed Puerto Rico's minimum wages to be set below the federal standards. In addition, the minimum wage covered only limited sectors of the island's economy. This changed in the late 1970s and the 1980s, when amendments to the FLSA extended coverage widely in Puerto Rico.

One of the ideas behind a minimum wage is to make sure that unwitting workers are not exploited by unscrupulous employers who offer wages much below the prevailing market rate. In Puerto Rico, however, prevailing market wages have traditionally been much below those on the mainland. The federal minimum wage has thus often exceeded the wages offered by many employers. Although some firms have been able to raise their salaries to the federal minimum wage level, becoming more productive in the process, others have found it extremely difficult to do so. Puerto Rico first felt the full force of the federal minimum wage in the 1980s. As this study shows, the widespread application of the minimum wage contributed significantly to the higher earnings obtained by employed Puerto Ricans in the 1980s but, at the same time, by making it more expensive to employ labor, it also contributed to the island's unemployment problem.⁴

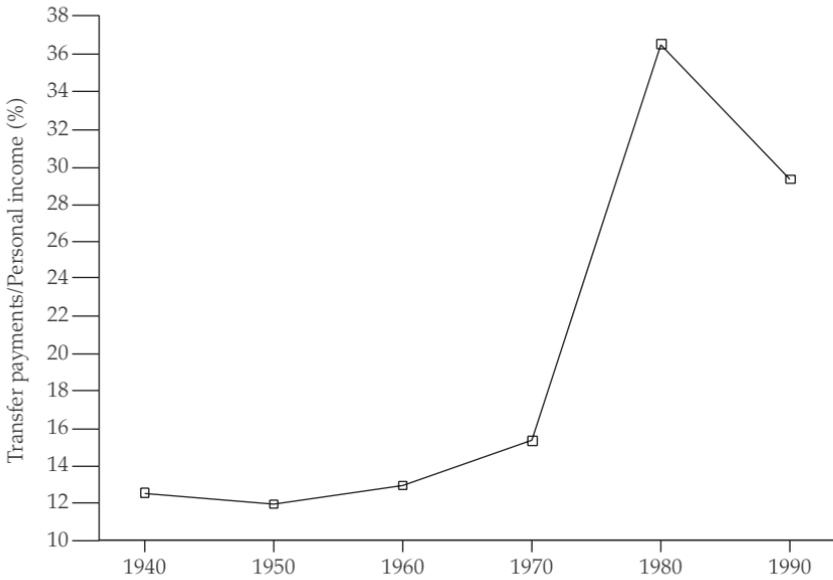
Shifts in U.S. Government Policies

The federal government has made itself increasingly felt in the Puerto Rican labor market and in other areas as well. Federal transfers to Puerto Rico increased sharply between 1970 and 1990. Payments made by the U.S. government to persons in Puerto Rico rose from just over \$500 million to over \$6 billion annually, and the proportion of personal income accounted for by these transfer payments nearly doubled, from 15 percent to 29 percent (see figure 1.5).

The increase in federal transfer payments ameliorated the social impact of the climbing unemployment rate and the sluggish economy. Many of the poor in the population were able to sustain minimum consumption levels and maintain their living standards in spite of the economic crisis. Since a large share of the transfer payments was spent on local consumer goods and services, the rise in federal entitlements led to a surge in the service and commerce sectors of the economy.

4. Our findings are consistent with those of Castillo-Freeman and Freeman (1992). See also Santiago (1987a, 1989).

Figure 1.5 Federal Transfer Payments as a Fraction of Personal Income in Puerto Rico, 1940–90



Source: Puerto Rico Planning Board, *Economic Report of the Governor*, various years.

Indeed, in the economy as a whole, services and commerce were the only two sectors to show a substantial gain in employment between 1970 and 1990, by which time they accounted for close to half of the employment on the island.

One of the most important federal welfare programs applied to Puerto Rico in the 1970s was the Food Stamp Program, which was extended to the island in 1971 but effectively introduced only in 1974. The following year, \$388 million in food stamps were issued to the population (Choudhury 1977, 1978). In 1982, the program was phased out and replaced by the Nutritional Assistance Grant (NAG) program, under which individuals receive checks instead of coupons. In 1993, grants to Puerto Rico under this program amounted to \$1 billion.

The broad participation of Puerto Rico’s population in the food stamp and NAG programs has had a double-edged impact on the island’s economy. On the one hand, the program has clearly succeeded in ensuring minimum nutritional levels for the poor. As the economist Richard Weisskoff (1985, 60) notes: “The largest single federal program ever directed to the people of Puerto Rico, food stamps were intro-

duced quickly throughout the island from September 1974 to January 1975, 'like a hurricane relief expedition,' according to one federal official. Seen in historical perspective, the food stamp program in Puerto Rico arrived at a critical juncture in the island's development. . . . Food stamps have served as the rescue operation for the entire Commonwealth economy."

At the same time, some social scientists believe that the wide application of the food stamp and NAG programs to the low-income economy of Puerto Rico has created a ghetto-style economy there. They argue that the easily available transfer payments encourage labor market participants to scale upward the wage offers at which they are willing to accept employment. They are thus more likely to remain unemployed, searching for high-paying job offers that may never surface. This generates a vicious cycle in which the programs that were intended to alleviate a short-term problem discourage work, promote long-term dependency on transfer payments, and create long-term poverty. As the Puerto Rican economist Elías Gutiérrez (1983, 127) points out, "The problem with the level and nature of the welfare system, or the transfer payments system, is that payments are such that it keeps the recipients in poverty. Their poverty in turn tends to reinforce itself because of the social and psychological impact of poverty on the poor or the dependent" (see also, Weisskoff 1985). Some critics (Murray 1985; Chavez 1991) of public assistance programs in the United States have further claimed that such welfare programs as food stamps and Aid to Families with Dependent Children (AFDC), increase poverty among women by inducing them to have more children out of wedlock and to form single-headed households in order to qualify for higher benefits.

After the Reagan administration tightened eligibility requirements for welfare programs and lowered benefits, food stamp/NAG transfers to Puerto Rico declined, from \$896 million in 1982, to \$780 million in 1985. However, this drop was only temporary and, by the early 1990s, NAG transfers exceeded \$1 billion annually.

There have also been significant changes in federal policies with respect to 936 funds. In 1982, the Reagan administration changed the rules so that half of the income generated by U.S. firms in Puerto Rico would be subject to the 46 percent federal corporate income tax. Up to that point, all such income had been exempt from federal corporate taxes under section 936. The resulting increase in tax revenues collected by the U.S. Treasury did not end the controversy surrounding these tax breaks, however. Periodically, both the U.S. Treasury and Congress threaten to eliminate section 936. In May 1992, the General Accounting Office released a report documenting the huge tax benefits received by some U.S. corporations in Puerto Rico, feeding speculation that the tax

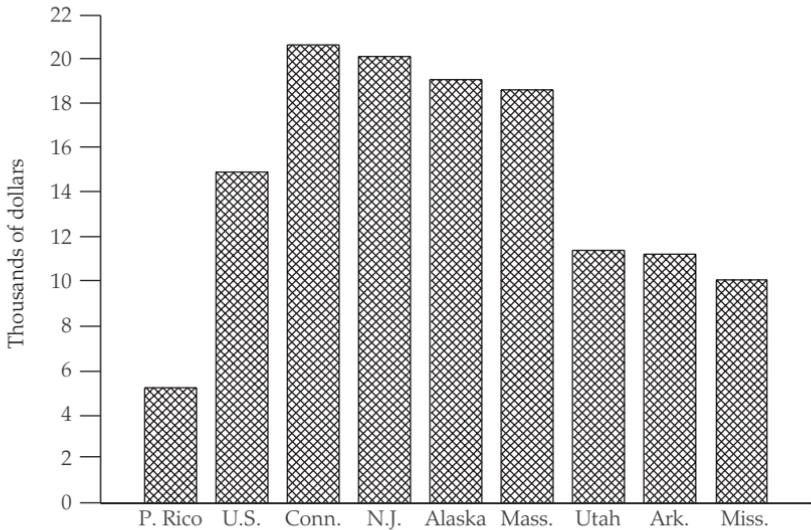
breaks would soon be gone. Moreover, the periodic plebiscites to determine Puerto Rico's political status have eroded investor confidence, which undermines section 936's effectiveness. The outcome of the latest plebiscite, in 1994, favored continued commonwealth status, but this did little to remove the underlying uncertainty, especially given the general antagonism among the American public toward any form of "corporate welfare."

Island Paradox

The relationships between Puerto Rico and the United States have led to a paradoxical situation. Overall, the integration of Puerto Rico into the U.S. economy has been associated with substantial income growth in the island. At the same time, the tight links with the United States have led to increased economic volatility, and, during the last twenty years, to growing unemployment and widespread social malaise. In some ways, Puerto Rico is no different from any other economic region of the United States. But there is one major difference between Puerto Rico and almost all other regions of the United States: by comparison with almost any part of the United States, Puerto Rico has much lower per capita income. Disposable income per capita in the United States in 1990 was \$14,948, while in Puerto Rico it was \$5,215 (see figure 1.6). Even the state with the lowest per capita income, Mississippi, had close to twice that of Puerto Rico. Richer states, like New Jersey and Connecticut, had per capita incomes close to four times that of Puerto Rico. Furthermore, the per capita income of every ethnic and racial group within the United States—including mainland Puerto Ricans—was substantially above the average for Puerto Ricans living in Puerto Rico. On this account, Puerto Rico remains a developing economy, more akin the rest of Latin America than the United States.

The differences in standard of living between Puerto Rico and the United States, combined with the freedom of movement between them, have given rise to massive migration flows. There were over a million persons who were born in Puerto Rico residing in the mainland United States in 1990. This constituted 26 percent of all native-born Puerto Ricans. In terms of its impact on the source country, Mexican migration to the United States pales in comparison. In 1990, only about 5 percent of all persons born in Mexico were residing in the United States.

The impact of migration flows on Puerto Rico's economy and society runs deep. Historically, emigration has served as a safety valve for the island, as evidenced by the Commonwealth's own policies, which fostered migration to the mainland by aiding in the recruitment of Puerto Rican labor. Between 1940 and 1970, 835,000 Puerto Ricans emigrated to the mainland United States on a net basis, constituting one of the

Figure 1.6 Per Capita Personal Income in Puerto Rico and the United States, 1990

Sources: For Puerto Rico, the data are from Commonwealth of Puerto Rico, Planning Board, *Informe Económico al Gobernador, 1991*, statistical appendix, table 1. For the United States, the data are from U.S. Bureau of the Census, *Statistical Abstract of the United States, 1991*.

most massive emigration flows occurring anywhere in this century. Although most of this population settled in New York City, in recent years, Puerto Rican migration to the United States has become more geographically dispersed. From California to Connecticut, from Florida to Massachusetts, Puerto Rican communities now exist all over the country. This other Puerto Rico maintains its intimate ties with the island. Reinforced by constant flows back and forth between the two communities, the Puerto Rican population on the mainland continues to exert a serious political, economic, and social influence on Puerto Ricans on the island.

The fact that migration flows between Puerto Rico and the mainland are not just one-way flows to the mainland is significant. Between 1980 and 1990, there was a net emigration of 116,571 persons from Puerto Rico, but this number hides the massive gross flows of people moving back and forth between the two places. In the 1980s, 432,744 persons left the island to reside in the mainland and 316,172 persons emigrated from the mainland to reside in Puerto Rico. Many of the latter were

return migrants, although a significant number were Puerto Ricans born and raised in the United States. In fact, close to one in ten Puerto Ricans residing on the island in 1990 had moved from the mainland to Puerto Rico in the 1980s. The Puerto Rican migration process is studied carefully in this book since it embodies the paradoxical nature and consequences of the relationships between Puerto Rico and the United States.

Outline of the Book

This book maps the socioeconomic status of the Puerto Rican population in the 1990s. In a territory of 3,420 square miles, population growth and population density have long been a matter of concern in Puerto Rico. The number of people residing in Puerto Rico boomed during this century. Between 1900 and 1980, the population more than tripled. The 1980s, however, were witness to a significant slowdown in population growth. Between 1980 and 1990, the population of Puerto Rico increased from 3,196,500 to 3,522,000, representing an annual change of about 1 percent a year. This constitutes a sharp drop compared with the rate of increase of the population in the 1970s. Chapter 2 addresses the nature of this drop in population growth, focusing on the role played by decreases in fertility. The chapter examines trends in fertility, age structure, marriage, and household composition in Puerto Rico during the 1980s. These trends are compared with those for the Puerto Rican population in the mainland. The questions we examine include: Does a drop in birth rates explain the declining population growth of the island in the 1980s? Is the average age in Puerto Rico rising? And how has household composition changed in the past decade? Did divorce rates increase among Puerto Ricans in the 1980s? Did single parenthood rise as much as it did in the mainland during the decade?

Migration to the United States also has had a major impact on the Puerto Rican population. Emigration to the mainland serves as a safety valve, releasing the local labor market from the pressures of a bulging labor force. For example, in the 1950s, when close to half a million Puerto Ricans emigrated to the United States, population growth in the island slowed down to a trickle. Chapter 3 examines the patterns of Puerto Rican migration in the 1980s, comparing them with those prevailing in earlier decades. The characteristics of the out-migrants from Puerto Rico are examined in detail in this chapter, since they have been a matter of controversy. Some analysts have argued that recent emigrants have been mostly highly educated professional and technical workers, altering the composition of the island's migratory contingent from unskilled to highly skilled. Is Puerto Rico suffering from a "brain drain" phenomenon? Chapter 3 answers this question

using 1980 and 1990 census data. Other questions examined in this chapter include: How much return migration is occurring in the island, and what are the characteristics of these migrants? Is migration between Puerto Rico and the mainland becoming circular or commuter-like, with people moving back and forth instead of staying at their place of destination for a long period of time?

In the second half of the 1980s, more than a decade of stagnant income growth came to an end, as per capita income in Puerto Rico again grew rapidly, pulled by a strong upswing in American economic activity. Chapter 4 discusses the changes in the level and distribution of income in Puerto Rico occurring in the 1980s. Household income and poverty rates are examined for the island overall, for demographic groups, and for regions of the island. The issue of whether inequality has increased or decreased is also analyzed in detail, including a discussion of how public assistance has influenced poverty and income distribution. Educational attainment is a major determinant of individual income and it is given close attention in this chapter. Other questions discussed include: Why did the increase in educational levels slow down in the 1980s? How did the educational attainment of women change relative to that of men in Puerto Rico? Has the gender gap in education declined in the island, as it did in the United States in the 1970s and early 1980s?

The Puerto Rican labor market has been the subject of tremendous turbulence during the last twenty-five years. There is, however, a disturbing long-term trend of rising unemployment rates. Chapter 5 examines changes in the Puerto Rican labor market during the 1980s. The chapter studies the changes in the unemployment rate and labor force participation rate between 1980 and 1990, by age and gender. The analysis examines the determinants of the rising unemployment rate, including a thorough discussion of the role played by the minimum wage. In addition, the chapter dissects the changes in the earnings of men and women during the 1980s, as well as the determinants of those changes. Given that earnings inequality increased substantially in the United States during the 1980s, the research presented in chapter 5 seeks to determine whether there has been a similar shift in the wage structure in Puerto Rico. Other questions examined include: Has labor market inequality on the basis of gender decreased in Puerto Rico? Have the returns to education increased in Puerto Rico, as they did in the United States over the past twenty years? And what role does labor market segmentation play in the economy?

The population of Puerto Rico in 1990 included 321,097 people born outside the island. This constitutes 9.1 percent of the population in the island, a proportion almost identical to the proportion of the population in the United States born outside the nation. Thus, Puerto Rico

hosts a foreign-born population approximately equal in proportion to that in the United States, a country famed for absorbing great numbers of immigrants. Chapter 6 examines the characteristics of persons born outside Puerto Rico, supplying a comparative profile of their socioeconomic status in 1990. The intermediate economic position of Puerto Rico, between less developed Latin America and the highly developed United States, has generated a distinct pattern of labor migration, in which Puerto Ricans emigrate to the United States as other Caribbeans (mostly from Cuba and the Dominican Republic) migrate to Puerto Rico. Chapter 6 describes the population of immigrants settling in Puerto Rico and their characteristics.

There are close to three million Puerto Ricans residing in the mainland, making it the second largest Latino population in the continental United States. This population has become increasingly dispersed over the years. While in 1960 close to two-thirds of all Puerto Ricans in the United States lived in New York City, by 1990 only one-third resided there. Substantial populations have emerged in smaller urban areas. For example, Puerto Ricans account for close to one-quarter of the population in cities such as Hartford and Bridgeport. Chapter 7 describes changes in the socioeconomic status of Puerto Ricans living in the United States during the 1980s. The chapter also describes shifts in where Puerto Ricans settle in the mainland and analyzes the geography of Puerto Rican poverty. Questions examined in this chapter include: Are Puerto Ricans the worst-off ethnic group in the United States? Is there a substantial Puerto Rican middle class sprouting in America? How has the educational attainment of Puerto Ricans changed in recent years and what impact has this had on the economic outcomes of Puerto Ricans in the United States?

Puerto Rico's experiences under Commonwealth political status provide a rich background for evaluating the consequences of the economic policies followed by Commonwealth policymakers. They also set the stage for the design of new policies that can move the island toward the twenty-first century. Chapter 8 summarizes various demographic and economic trends discussed in the book and examines the policy agenda facing the 1990s. The experience of Puerto Rico is highly relevant to countries moving toward more open trade and investment policies. The application of federal legislation in Puerto Rico also constitutes a virtual experiment into the consequences of political and economic integration of countries with widely divergent levels of development. One can only hope that the analysis provided in this book will help inform future policymaking in Puerto Rico and other developing nations.