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"Federal funds" and the Puerto Rican economy: Myths and realities
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“Federal funds” and the Puerto Rican economy: MYTHS AND REALITIES

EMILIO PANTOJAS-GARCÍA

ABSTRACT

Federal expenditures in Puerto Rico between 1975 and 2000 grew at an accelerated pace creating the perception of an economy dependent on federal welfare. An analysis was conducted disaggregating federal disbursements into three categories, expenditures of federal agencies, transfer payments and grants. Further analysis was conducted by analyzing the components of each category: unilateral transfers, transfers for paid or earned benefits, priorities of federal government agencies expenditures, etc. The analysis showed that: (1) the level of federal transfers grew dramatically during the 1970s but remained stable since the 1980s; (2) the greater portion of federal transfers to residents of Puerto Rico came from pensions or benefits earned for services rendered to the federal government or paid for by individuals while they were active in the workforce (social security, pensions, veterans benefits); (3) changes in the operating expenditures of federal agencies in Puerto Rico follow primarily the changing priorities of the United States government in Puerto Rico; and (4) federal subsidies to Puerto Rico benefit directly greatly U.S. corporations. [Key words: economic development, welfare, subsidies, federal government, transfer payments, fiscal incentives, tax policies, U.S.- Puerto Rico relations]
In the 1970s federal transfer payments to Puerto Rican residents experienced a sharp increase, averaging 25.6 percent per year. Since then the sustained flow of "federal funds" to the Puerto Rican economy has led to the construction of important myths about the degree of dependency of the island economy and population on federal funds and about the one-sided nature of these expenditures and their benefits. The most important of these myths is that "all" Puerto Ricans live off federal transfers and that the island constitutes an unfair and unjustifiable burden to the American taxpayers (Odishelidze and Laffer 2004). This myth is primarily based on the fact that since the decade of the '70s, Puerto Rican families that fall below the poverty line—about half of all families on the Island—receive federal food subsidies (food stamps, nutritional assistance payments, etc.)

As usual, reality is more complex than popular perception. This essay examines the trends in federal disbursements in Puerto Rico between 1975 and 2000. The data were collected from the Puerto Rico Planning Board's Informe Económico al Gobernador (Annual Report to the Governor), which publishes data on federal disbursements. The Planning Board presents the data in three categories: (1) net operating expenditures of federal agencies in Puerto Rico; (2) transfers between Puerto Rico and the federal government (mostly payments to individuals through federal programs such as food stamps, Pell Grants, Medicare, veteran benefits and social security benefits); and (3) federal transfers received by the government sector for joint projects and operational expenses (mostly grants to government corporations and municipal and insular agencies).

The analysis of the trends in federal disbursements in Puerto Rico during the last quarter of the twentieth century revealed that (1) the level of federal transfers grew dramatically during the 1970s but has remained stable since the 1980s; (2) the greater portion of federal transfers to residents of Puerto Rico come from pensions or benefits earned for services rendered to the federal government or paid for by individuals while they were active in the workforce (social security, federal employees pensions, veterans benefits); (3) changes in the operating expenditures of federal agencies in Puerto Rico follow primarily the changing priorities of the United States government in Puerto Rico, rather than the priorities of local agencies; and (4) federal subsidies to Puerto Rico directly benefit U.S. corporations operating in Puerto Rico.

Background
In the early 1970s the Puerto Rican economy was adversely affected by three events: devaluation of the U.S. dollar, the end of oil import quotas in the United States and the sharp increase in oil prices. The restriction on oil imports to the United States by a system of quotas between 1959 and 1973, and the concession of special import quotas to American oil refineries operating in Puerto Rico since 1965, had stimulated the development of a petrochemical complex on the island. Oil refining and petrochemical production became the leading industrial sector in the Puerto Rican economy. The ability to import cheaper oil from Venezuela and the Middle East under the quota system provided a cost advantage for U.S. oil refineries operating in Puerto Rico (Phillips, Sun Oil, Gulf and CORCO) over competing companies operating in the Eastern United States. By the early 1970s Puerto Rico had become an export platform for intermediate petrochemical products. The elimination of the oil import quotas by the Nixon Administration in April 1973, the oil embargo declared by OPEC in October 1973 and the devaluation of the U.S. dollar, also in 1973, compounded by a recession in the U.S. economy, unleashed a series of processes that brought to a screeching halt the sustained growth of the Puerto Rican economy.
Between 1973 and 1975 the real growth rate of the gross national product (GNP) fell sharply—from 5 percent to -1.8 percent. The real GNP growth rate would never recover to pre-1970s levels (see chart 1). The ’70s became a decade of fiscal adjustment and economic restructuring for both Puerto Rico and the United States.

Between 1973 and 1976, the government of Puerto Rico found itself in the peculiar situation of not having fiscal incentives to attract new U.S. investment in manufacturing. The crisis of the ’70s thus resulted in a sharp increase in unemployment. From 1955 to 1970 unemployment had steadily declined from 15.3 percent to 10.7 percent. This trend was abruptly reversed with a jump in unemployment to 18.1 percent in 1975. The ascending trend in unemployment peaked in 1985, reaching 21.8 percent, and would not come down to the 1960s levels until the second half of the 1990s (chart 2).

Real average weekly wages will follow a similar pattern. Wages improved steadily until 1972, reaching a peak of 153 dollars per week. After that, average wages would stagnate, declining to an average of 124 per week in 2000. The gender gap in wages, however, would narrow noticeably in the 1980s (Acevedo 1999). In 2000, both men’s and women’s wages had declined to their lowest point since the 1970s—124 and 122 dollars, respectively. Yet the wage gender gap was only two dollars (Chart 3).

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**Chart 1: Real GNP growth rates**

![Chart 1: Real GNP growth rates](image1)

**Chart 2: Unemployment rate**

![Chart 2: Unemployment rate](image2)
Table 1 presents the annual average growth rates in the real GNP, real wages and federal transfers and the annual rate of unemployment and migration for the last three decades of the twentieth century. This table suggests that federal transfers in the 1970s supported GNP growth and moderate wage growth and influenced a reduction in migration rates. In the subsequent decades, as federal transfers leveled, GNP lagged, wages declined and migration rates increased to levels comparable to the 1950s and 1960s. The data presented in charts 1 to 3 and in table 1 suggest that the Puerto Rican economy never fully recovered from the crisis of the 1970s and that federal transfer payments have not played a major role in the economy other than subsidizing families below the poverty level. The question remains, What is the role of federal funds beyond transfer payments?

**Table 1**

<table>
<thead>
<tr>
<th>MIGRATION</th>
<th>REAL GNP</th>
<th>REAL WAGES</th>
<th>FEDERAL TRANSFERS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ANNUAL GROWTH</td>
<td>ANNUAL GROWTH</td>
<td>ANNUAL GROWTH</td>
</tr>
<tr>
<td>1970–79</td>
<td>4.2%</td>
<td>1.2%</td>
<td>25.6%</td>
</tr>
<tr>
<td>1980–89</td>
<td>1.8%</td>
<td>-0.7%</td>
<td>6.2%</td>
</tr>
<tr>
<td>1990–99</td>
<td>2.8%</td>
<td>-0.7%</td>
<td>7.2%</td>
</tr>
</tbody>
</table>


Federal funds in the last quarter of the 20th century

There are two salient events in the policy response of the United States federal government to the economic crisis of Puerto Rico in the mid-1970s. First, the increase of Puerto Rico’s share in the food stamps program by the U.S. Congress; and second, the enactment of Section 936 of the Internal Revenue Code. Both events occurred in
1976. The inclusion of Puerto Rico in the food stamps program had been negotiated by Governor Luis A. Ferré, of the pro-statehood Partido Nuevo Progresista (PNP—New Progressive Party). Its original intention was not to ameliorate an economic crisis but to provide equity to the Puerto Rican poor who were the poorest of the poor American citizens. It was fortuitous that the beginning of the food stamps program in 1974 coincided with the economic recession of the 1970s.

This was not the case with Section 936 of the IRC, which had been negotiated by the Puerto Rican government in Congress after a commission headed by Nobel laureate economist James Tobin had recommended measures to stimulate U.S. corporations to reinvest their federal tax-free profits in Puerto Rico. Section 936 allowed U.S. companies operating in U.S. possessions (Puerto Rico, Guam or the Mariana Islands), and incorporated as possession corporations, to invest or deposit profits in financial instruments (government bonds, special bank deposits) that would stimulate financial and economic expansion in the possessions. Possession corporations (also known as “936 corporations”) could repatriate profits to the United States free of federal taxes after certain stipulated conditions were met or by paying a “tollgate tax” to the possession’s government (Pantojas-García 1990: chap. 5). It could be said that food stamps and section 936 ended up being two sides of the same coin, with individual and corporate welfare becoming the means used to stabilize the Puerto Rican economy.

If we examine federal disbursements in Puerto Rico as an undifferentiated category, it is easy to appreciate why there is a perception that the Island is totally dependent on federal transfers. Chart 4 presents a pattern of sustained growth in aggregate federal disbursements between 1970 and 2000, both in current and real prices. In the last three decades of the twentieth century, federal spending in Puerto Rico grew at an annual rate of 10.2 percent in current prices and 5.7 percent in real prices. In 1970, total federal disbursements at current prices amounted $720.9 million dollars growing to $10,833.1 million dollars in 2000. The fastest growth rates, however, took place during the 1970s, when federal spending on the island grew at an annual rate of 20.1 percent at current prices.

Even when we disaggregate the total amount into the three major categories defined by the Puerto Rican government—operating expenditures, transfers to individuals and grants and payments to the government for joint projects—the picture remains one of acute dependence on federal transfers by Puerto Ricans. Chart 5 seems to confirm the image of growing dependence on federal transfers. This graph confirms the growing tendency of transfer payments as a share of total federal spending. Indeed, in 1975 transfer payments represented 58.9 percent of total federal disbursements, and in 2000 this share grew to 71.4 percent.

It could be said that food stamps and section 936 ended up being two sides of the same coin, with individual and corporate welfare becoming the means used to stabilize the Puerto Rican economy.
Rico’s GNP that the image of absolute dependence on federal funds takes a different perspective. Chart 6 presents aggregate federal spending, total transfers to individuals, net transfers, and food subsidies as a percentage of the Island’s GNP between 1975 and 2000. The top curve indicates that aggregate federal expenditures as a share of GNP peaked in 1980, at 38.4 percent, and slowly but steadily declined to 26.2 percent in 2000. Transfer payments to individuals followed a similar pattern. However, if we look at the category of net transfers (the third curve from the top), the actual amount of federal funds received by the Puerto Rican economy grows from less than 10 percent in 1975 to 15 percent in 1977 and hovers just below that figure, declining to 12 percent in 2000. Net transfers are calculated by subtracting transfers from Puerto Rico to the United States from federal transfers to Puerto Rico. Typically these are payments by Puerto Rican workers and employers to social security, federal retirement plans, Medicare, and unemployment insurance. Finally, it can be clearly observed that there is a constant and sharp decline in the share that federal food subsidies represent in regard to the Puerto Rican GNP, from a high of 10 percent in 1976–78 to a low of 2.4 percent in 2000.

Clearly, food subsidies lead the way to the increase in federal spending in Puerto Rico.
Rico after 1975 (federal spending on food stamps nearly doubled from 388.4 million dollars in 1975 to 754.8 million dollars in 1976). However, food subsidies have declined more than any other transfer. Moreover, as we shall see, much of what is considered transfers are not giveaways but earned benefits for which Puerto Rican workers and employers have paid or rendered services.

A breakdown of federal transfer payments
A breakdown by program of “transfer payments” reveals that six categories or types of expenditures accounted for most of the growth in this category of expenditures: (1) Social Security; (2) veterans benefits; (3) Medicare; (4) basic education grants (BEOG and Pell Grants); (5) food subsidies (foodstamps and nutritional assistance program); and (6) housing subsidies (“Section 8” and FHA). These categories constitute around 90 percent of all transfer payments since 1975. Chart 7 presents the fluctuation patterns of federal expenditures in these areas.

Social security is clearly the program with the largest share of expenditures and shows a pattern of sustained growth. Medicare and housing also exhibit sustained growth patterns. Educational assistance grew until the mid-’80s and leveled off after that. Conversely, the share of expenditures in nutritional assistance and veterans benefits declined steadily, vis-à-vis the other four categories. It is important to note that Puerto Rican employees and Puerto Rico-based employers contribute to Social Security and Medicare; hence, these are not unilateral transfers. In 1975, for example, contributions to Social Security by employees and employers from Puerto Rico represented 78 per cent of the total Social Security payments to Puerto Ricans. Since the 1980s the contribution to social security by Puerto Rican employers and employees represents between 55 and 65 per cent of payments, but there is a tendency for Puerto Ricans living on the mainland to retire to Puerto Rico. This shift may account for the reduction in the proportion of payments to benefits moving to and from the Island. In the case of veterans’ benefits, these are not paid for in cash contributions but services rendered and do not represent, as such, a grant or a gift.

Disaggregating the category “transfer payments” and analyzing its evolution by
programs reveals that the majority of transfer payments are not unilateral transfers to Puerto Rican individuals. The majority of transfer payments are not welfare benefits but earned benefits. Between 1980 and 2000, the combined shares in food assistance, housing subsidies and educational grants or scholarships declined from 35.8 to 23 percent of all transfer payments. Conversely, during the same period, the combined shares of social security and veterans benefits grew from 47.7 to 56.7 percent of total transfer payments.

**Grants for joint projects**

The category of grants for joint projects between the federal government and the government of Puerto Rico or its agencies declined as a share of total federal expenditures. From representing nearly one-third of all expenditures in 1975, grants decline to nearly one-fifth in 2000. The decline began in 1982, when the Reagan Administration cut down expenditures in social and health services (see chart 7). As chart 8 demonstrates, the main beneficiary of federal grants is the Puerto Rico is
the Department of Education. Grants include not only teaching and educational development but also school transportation and nutrition programs. Health programs have increased their share of grants significantly given the surge in programs for drug treatment and prevention as well as prevention and treatment of new epidemics such as HIV/AIDS. Universities are also major recipients of federal grants for research and higher education development.

Operating expenditures of federal agencies
The operating expenditures of federal agencies in Puerto Rico represent the smallest share total federal disbursements on the Island. Between 1975 and 2000, the expenditures of federal agencies fluctuated between 10 and 7 percent of total federal disbursements. Before 1975, however, operating expenditures amounted to nearly 20 percent of total federal disbursements. The lion's share of these expenditures came from the Defense Department, which in 1970 accounted for 65.4 percent of all agencies expenditures. This share went down to 40.6 percent in 1975, reaching a low point in 1980 at 27 percent of all federal agencies expenditures. During the Reagan Administration, defense spending went back up to 46.7 percent of all expenditures in 1985 but fell to an all-time low of 25.7 percent in 2000, as shown in chart 9.5. This tendency continued into the twenty-first century with the closure of the Roosevelt Roads naval base and its practice range in Vieques in 2003.

Chart 10 shows a different pattern for the Veterans Administration's expenditures. Contrary to direct military expenditures, the Veterans Administration expenditures experienced a substantial increase between 1975 and 2000. In the latter year, the Veterans Administration's expenditures surpassed those of the Defense Department by nearly ten million dollars ($241.2 million dollars vs. $231.6 million dollars).

The other agencies that increased their expenditures significantly were the Department of Justice and the Department of the Treasury. Between 1990 and 1995, the Justice Department more than doubled its operating expenditures from $23.7 to $45.5 millions. In this same period, the expenditures of the Treasury Department soared from $24.5 to $59.8 millions. By 2000, the expenditures of the Justice Department were nearly three and a half times what they were in 1990 ($81.2 million) and the expenditures of the Treasury Department amounted to over two and a half
times the 1990 expenditures ($62.8 millions).

These changes in the operational expenditures of federal agencies in Puerto Rico reflect the new strategic priorities of the United States government, particularly in the Caribbean. The war on drugs, illegal immigration control and control of money laundering were the responsibility of the Justice and the Treasury Departments until the creation of the Department of Homeland Security. The Drug Enforcement Administration (DEA), the Federal Bureau of Investigations (FBI), the U.S. Custom Service, the Immigration and Naturalization Service (INS) and the Secret Service were under these departments and account for the increases in expenditures of federal agencies in Puerto Rico. In spite of the recent closures of military facilities in Puerto Rico, such as the Roosevelt Roads Naval Base and the Vieques target range, the Island continues to play an important role in U.S. strategic interests.

At this point, it should be noted that the operating expenditures of federal agencies in Puerto Rico represent a declining share of total federal disbursements (see chart 6). This relative decline in the operating expenditures of federal agencies is a reflection of increased transfer payments, especially in earned benefits such as social security pensions and veteran benefits.

**Federal funds and U.S. corporations**

During the 1990s, the U.S. Department of the Treasury officials claimed that Section 936 of the U.S. Internal Revenue Code (IRC) allowed 936 corporations (Possessions Corporations) to avoid paying federal taxes legally. Put another way, Puerto Rico had become a tax haven for American transnational corporations, particularly for the pharmaceutical, medical equipment and electronics industries. This was not a new allegation; Treasury officials had raised it since 1959 (U.S. Department of the Treasury 1989: 19). Indeed, Section 936 of the federal tax code had made Puerto Rico into the most profitable tax haven in the world (Pantojas-García 1990; Suárez 2000).

Between 1954 and 1975 Section 931 of the IRC regulated taxation for American corporations operating on the Island. Section 931 exempted Possessions Corporations, as they were designated, from paying federal income taxes as long as profits were not repatriated from Puerto Rico to the United States. Repatriated income or profits were only tax exempt when the corporation liquidated its assets on the Island. In 1973,
at the height of the fiscal crisis created by the recession, the Commission for the Study of the Finances of Puerto Rico revealed that under section 931 companies were engaging in financial speculation. The Commission was chaired by Nobel laureate economist James Tobin. The report described how Possessions Corporations were investing “unrepatriated” profits, deposited in transnational U.S. banks operating on the Island (such as Citibank and Chase), in the European petrodollars market using financial subsidiaries in U.S. possessions in the Pacific. This increased profits by generating additional financial or “passive” income, not related to productive activities in Puerto Rico (Informe Tobin 1976: 80–1).

As part of the 1976 federal tax reform, section 931 was replaced with section 936 of the IRC. The new section on Possessions Corporations was intended to end the legally dubious financial practices, encourage capital repatriation to the United States and allow the government of Puerto Rico to collect some revenue from American companies. Section 936 allowed the annual repatriation of income free of federal taxes provided that a tollgate tax of between 5 and 10 percent be paid to the government of Puerto Rico. The difference in taxation rates for repatriated profits depended on whether the companies deposited the money on special accounts in banks in Puerto Rico or repatriated them immediately. The objective was to encourage investment and reinvestment on the Island.

But instead of stimulating capital formation and investment, section 936 became a major and unique tax haven. Companies began to use transfer pricing mechanisms to funnel profits to the Island from all over the world (Buttles 1978). The uniqueness of Puerto Rico as a tax haven was that, instead of using paper or “hollow” international foreign companies, as in other tax havens like the Bahamas or Bermudas, companies had to own and operate manufacturing plants (Pantojas-García 1990: 153–5; Suárez 2000: 60–2). Table 2 shows that by 1996 (the year section 936 was repealed by Congress) Puerto Rico generated the largest amount of income on U.S. direct investment abroad, 13.8 percent. To understand clearly the financial nature of this income, not having investment figures for Puerto Rico as they are not revealed by the companies, we can compare the proportion of income (profits) generated by Puerto Rico as a percentage of gross domestic product (GDP) with those of the other two large sources of

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American companies’ global income, the United Kingdom and Canada.

In 1996 Puerto Rico’s GDP was $45.3 billion, the United Kingdom’s was $1,180 billion and Canada’s was $601.6 billion. That is, Puerto Rico’s GDP in 1996 amounted to 3.8 percent of that of the United Kingdom and 7.5 percent of that of Canada. Put another way, the economy of the United Kingdom was 26 times bigger than Puerto Rico’s and Canada’s was 13 times bigger. Notwithstanding these asymmetries, Puerto Rico produced nearly twice as much income as Canada and
The Internal Revenue Service of the Treasury Department (IRS) inferred that this income was not generated from the manufacturing activities of 936 corporations. According to an IRS study, tax benefits (avoidance) by 936 corporations between 1983 and 1995 range from $2 billion in 1983 to a peak of $4.6 billion in 1993. A conservative estimate would place tax avoidance of Section 936 benefits between 1983 and 1995 somewhere between $26 billion ($2 billion per year) and $32 billion ($2 billion per year between 1983 and 1989 and $3 billion per year between 1990 and 1995) (Miller 1995: 169; U.S. Department of the Treasury 1989: chapter 4).

In the book *Does Business Learn?*, a U.S. corporate tax lawyer is quoted: “Ireland, Hong Kong, and Singapore—all of the tax havens combined did not come close to what Section 936 represented to these companies” (Suárez 2000: 19). Puerto Rico was not simply a tax haven but the greatest tax haven for U.S. transnational corporations producing knowledge intensive and patented products such as pharmaceutics, medical equipment, electronics and beverage syrups.

The Tobin Report (1976: 24, 26), called attention to the growing gap between the gross domestic product (GDP) and the gross national product (GNP). The former accounts for the total product of the economy, while the latter accounts for the share of that product that “stays” in the local or domestic economy. The difference represents the share of the GDP used to pay external factors of productions in the form of profits, interests, royalties, etc. Between 1975 and 2000, the GDP / GNP gap grew from 7 percent to 37 percent. (Chart 11). This growing gap has had the effect of reducing the share of net income to local factors of production.

According to a study of the U.S. General Accounting Office (GOA), between 1982 and 1996 the share of net income paid to local property owners and labor in Puerto Rico declined from 69.3 percent to 59.8 percent of GDP (GAO 1997: 8). This growing loss in net income ($3,800 billion in 2000, Chart 12) would have had a devastating impact on any economy. However, federal transfers and expenditures on the Island had a “cushioning effect,” curbing the negative effects of the increasing “loss” of

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**TABLE 2:**

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>INVESTMENT</th>
<th>INCOME</th>
<th>PROFIT</th>
<th>RATE</th>
<th>GLOBAL SHARE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Puerto Rico</td>
<td>N/A*</td>
<td>15,423</td>
<td>N/A</td>
<td></td>
<td>13.8%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>142,560</td>
<td>13,862</td>
<td>9.7%</td>
<td>12.4%</td>
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</tr>
<tr>
<td>Canada</td>
<td>91,587</td>
<td>8,642</td>
<td>9.4%</td>
<td>7.7%</td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>44,667</td>
<td>7,991</td>
<td>17.9%</td>
<td>7.1%</td>
<td></td>
</tr>
<tr>
<td>Switzerland</td>
<td>35,751</td>
<td>4,685</td>
<td>13.1%</td>
<td>4.2%</td>
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</tr>
<tr>
<td>Germany</td>
<td>44,259</td>
<td>4,286</td>
<td>9.7%</td>
<td>3.8%</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>39,593</td>
<td>3,950</td>
<td>10.0%</td>
<td>3.5%</td>
<td></td>
</tr>
<tr>
<td>Brazil</td>
<td>26,166</td>
<td>3,879</td>
<td>14.8%</td>
<td>3.5%</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>34,000</td>
<td>3,322</td>
<td>9.8%</td>
<td>3.0%</td>
<td></td>
</tr>
<tr>
<td>Bermuda</td>
<td>29,980</td>
<td>3,305</td>
<td>11.0%</td>
<td>3.0%</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>796,494</strong></td>
<td><strong>111,989</strong></td>
<td><strong>11.9%</strong></td>
<td><strong>61.9%</strong></td>
<td></td>
</tr>
</tbody>
</table>

Sources: U.S. Department of Commerce, Survey of Current Business, September 1997; Junta de Planificación, Balanza de pagos; * There are no reliable figures on private investment for Puerto Rico since 1986.
potential capital and income. Although a share of the GDP loss can be attributed to
global price transferring practices by transnational corporations, the transformation
of Puerto Rico into a tax haven supported by federal funds created a weak economy
sustained by government that does not produce enough jobs. The Puerto Rican
economy registers very low labor participation rates and a growing informal economy
(Collins, Bosworth and Soto-Class 2006: 7–9, 32–40).

To gage this “cushioning effect” of federal transfers we compared the
evolution of GDP “losses” with the evolution of federal transfers and expenditures
in Puerto Rico. Chart 13 compares the annual percentage changes in total federal
expenditures (federal funds) vis-à-vis the same changes in the percentage annual
GDP “outflows.” The result is two graphs that are the mirror image of one another.
The annual percentage changes of total federal expenditures in Puerto Rico are lower
but similar to the percentage changes in GDP outflows.

This tendency was sustained over the last quarter of the twentieth century. It is as
if there was a formula whereby a share of GDP outflows would be covered by federal inflows (transfers, grants and expenditures). However, this is not the result of a deliberate policy. Rather, it is the outcome of a federal policy that treats Puerto Rico equally to states in some programs, differently in others, and excludes the Island from yet others. This differential treatment in federal programs accounts for the fluctuations in federal disbursements.

A review of charts 13 and 6 and table 2 provides support to the notion that “federal funds” act as a macroeconomic cushion and a social safety net in the Puerto Rican economy. Federal funds sustain the viability of the Puerto Rican economy, enabling the repatriation of global profits to U.S. transnational corporations while maintaining socioeconomic stability. It can be said, however, that the main beneficiary of the huge amounts of federal expenditures are U.S. corporations and that federal transfers to Puerto Rico are a disguised form of “corporate welfare.” During the last quarter of the twentieth century (the “936 era”) American tax payers subsidized not only Puerto Rico and Puerto Ricans but also U.S. corporations operating and realizing global profits using the “tax advantages” of the Island.

Conclusions
A detailed and disaggregated analysis of the composition of federal funds assigned to Puerto Rico demonstrates that:
1. Although a large share of the Puerto Rican population relies on federal transfers to sustain a living standard over the poverty threshold, these funds also play a major role sustaining the viability of Puerto Rico as a tax haven for U.S. transnational corporations.
2. The major beneficiaries of federal largess in Puerto Rico are “936” or possessions corporations, which receive billions of dollars in tax breaks. During the life of Section 936 transfer payments serve to maintain economic stability in the largest tax haven under U.S. jurisdiction.
3. After the ’70s, an increasing share of federal transfers to individuals represent payments for earned benefits or benefits for which Puerto Ricans pay a contribution, such as veteran benefits, Medicare and Social Security pensions.
4. The disbursements of federal funds in Puerto Rico reflect the policies and interest of the U.S. government and U.S. transnational corporations, rather than simply the
needs of the Puerto Rican government and population.

The reliance of the Puerto Rican population on federal transfers is not simply a function of the persistent of poverty and unemployment in Puerto Rico but, rather, the increasing integration of Puerto Rico into the economy of the United States, as reflected in the analysis of the GDP / GNP gap. Transfer payments are not charitable donations but the result of lobbying by the Puerto Rican government and American corporate and political interests such as “936 corporations.”

Section 936 of the IRC was repealed in 1996 and its phase-out period expired on December 2005. “Corporate welfare” is “out,” and trade liberalization and government retrenchment are “in.” The debate over federal transfers and federal economic incentives to Puerto Rico in the twenty-first century will take place in a radically new intellectual and political context. It is likely that this debate will also be intersected by the traditional debate on Puerto Rico’s political status. In any case, the debate over the future of Puerto Rico and the Puerto Rican economy must be framed in the context of hemispheric and global economic restructuring. Free trade agreements such as NAFTA (North American Free Trade Agreement), DR-CAFTA (Dominican Republic-Central American Free Trade Agreement), the FTA with Chile and the Free Trade Area of the Americas will shape the terms of this debate.

NOTES

1 All of the figures in this essay, unless otherwise indicated, are official figures or calculations based on the figures from: Junta de Planificación, Informes anuales al gobernador; Departamento de Recursos Humanos, Series estadísticas de empleo y desempleo y series de salarios; and U.S. Bureau of Census, Population Census.

2 The Puerto Rican government uses 1954 as its base year to calculate real prices; we have adhered to it for consistency, except in cases otherwise specified as in chart 3 on wages.

3 The high point in this period was 1999, with disbursements totaling 11,569.7 million dollars. Unless otherwise indicated, all figures in this sections come from Junta de Planificación, Informe económico al gobernador, 1983, 1989, 1996, 2000, statistical appendix.

4 The Gross Domestic Product (GDP) is a measure of total production in an economy, while the Gross National Product (GNP) is a measure of the part of the product that “stays” in an economy after payment to external factors (i.e., repatriated profits, royalties and dividends). The difference between the GDP and the GNP is greater than 30 percent. This represents an unusual economic distortion, reflecting financial maneuverings of U.S. transnational corporations. Hence we use GNP, which reflects the “net product” of the Puerto Rican economy. Later on we discuss the implications of the GDP / GNP gap.

5 These major shifts in operating expenditures of Federal agencies were induced by the introduction of the food stamps program as well as the end of the Viet Nam war.


7 Calculated using figures from Junta de Planificación, Informe económico (1988, 2000):
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______. 2000. Congressional Testimony, 2000; Statement by Michael S. Vigil, Special Agent in Charge of the San Juan Field Division, DEA, USDOJ, before the House Government Reform Committee. 4 January.

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