

## Current pains and the Tobin Report

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There was great pain last week in Puerto Rico as more than 16,000 public employees got their notice of dismissal. Thousands of families were hurled into a chaos of uncertainty. Thousands of workers in anguish are looking for employment in a private sector which, instead of creating jobs, is shedding jobs. The pain of these families is the pain of Puerto Rico.

We were headed for this moment of truth a long time ago. Puerto Rico enjoyed 28 years of uninterrupted economic growth—in real terms about 7%—during the hegemony of the Popular Democratic Party. Twenty-eight years of a coherent vision and strategy for economic development that provided, in the prosperous post-WWII economic environment, the continuity of policies necessary to achieve sustained growth.

This continuity came to an end with the victory of the New Progressive Party in 1968. At that time, the government of Puerto Rico began to alternate between the New Progressives and the *populares*. This brought about a discontinuity in policies regarding our economy and our finances. It also ushered in 40 years of electoral promises and spoils of victory that, on a cumulative basis, became unsustainable. These 40 years also brought profound changes in the international economic environment.

When I was elected governor in 1972, I would face a crisis that none of my predecessors—Muñoz Marín, Sánchez Vilella or Luis A. Ferré—had faced. Henry Kissinger described it this way:

“No crisis of the second half of the 20th century fell on a world less prepared for it than the one triggered by the quadrupling of oil prices in the fall of 1973. Within the space of three months, the global political and economic system found itself faced with a series of stark challenges threatening its very foundation.”

As Puerto Rico headed for the worldwide recession triggered by the quadrupling of oil prices, I realized we needed an in-depth analysis of our economic and fiscal policies to meet the challenges that lay ahead. To that end, in early 1974, I recruited a blue-ribbon committee headed by Dr. James Tobin, professor of economics at Yale University. In 1978, Tobin would receive the Nobel Prize in economics.

I charged them with the mission of examining our capital needs for development and our capacity to float our bonds in light of the changes that were beginning to occur in the economic environment. The committee labored for almost two years and, in December 1975, presented a seminal report that came back to my mind as I watched and listened on television to the desperate stories of the public employees who received their letters of dismissal.

The report of the committee headed by Dr. Tobin came to be known as the Tobin Report. The report, which was addressed to me as governor, began by stating the following:

*“Your appointment of this committee nearly two years ago reflected some concerns over the economic and financial prospects of the island. You wondered, quite rightly, whether the economic and financial strategies of the past two decades could be successfully continued without modification and innovation. But none of us foresaw how rapidly and drastically the national and international economic climate would deteriorate. Nor did we foresee at that time the severe impact of a U.S. recession on the finances of state and local governments and of the Commonwealth, and the sharp decline in investors’ confidence in tax-exempt bonds. You and your colleagues won’t be surprised that our report is more somber than we expected when we began.*

*“Puerto Rico’s difficulties today are partly due to circumstances beyond the island’s control. These include the sharp increase in world petroleum prices, a severe blow for an island economy dependent on imported fuel, and the relative increases in prices of agricultural and mineral products, costly to a country that makes its living mainly by manufacturing. In addition, federal anti-inflationary policies and the deep recession to which they contributed have damaged Puerto Rico’s economic and fiscal position....*

*“The island’s problems, however, also reflect economic and fiscal developments in Puerto Rico since 1969. It would be a mistake to blame the island’s current problems wholly on the U.S. recession and to expect U.S. recovery would solve them. The trends of government expenditure, government-enterprise deficits, Puerto Rican debt, and costs of production weren’t sustainable even with favorable economic weather overseas. Your government, beginning in 1974, has taken important steps to arrest these trends, and we must recommend intensification of your efforts...*

*“As Puerto Rican leaders have long recognized, the only durable basis for prosperity is to develop and maintain economic activities on the island that are internationally competitive, in [U.S.] mainland, world and local markets. Competitiveness is especially critical right now and, for this reason, a number of our recommendations concern productivity and cost.*

*“Puerto Rico faces several years of fiscal, financial and economic austerity. Drastic adjustments are required; especially painful because they involve the postponement of expectations deeply entrenched in the economic and political life of the island during the era of rapid industrial growth and abundant external finance. The adjustments are necessary to lay the basis for renewed growth. They must be made. The only question is whether they are made in a timely, orderly and equitable manner, or whether they are deferred until the exigencies of a financial crisis compel them to be made in haste. Fortunately, you and the officials of your government concerned with economic and financial management recognize the urgency of the situation. This has been demonstrated by the measures already taken to increase tax revenue, to control government outlays and limit the Commonwealth’s debt issues. Measures of this kind will have to be resolutely pursued in the coming years.”*

My State of the Commonwealth message delivered in January 1976 resolutely endorsed the recommendations of the Tobin Report. We came out of the recession and our fiscal house was put in order. However, I lost the election in November of that year. Romero Barceló, who succeeded me, decried the Tobin Report. Since then, there has been no continuity with regard to the report's recommendations. Although I left a surplus in the 1992-'93 budget, Rosselló promptly overcommitted our resources particularly with health reform, and eliminated a major source of funds for our banks and jobs for our people by doing away with Section 936. The Calderon and Acevedo Vila administrations contributed their share to the structural deficit generated by the health reform. So, the day of reckoning finally came last week. The exigencies of a financial crisis, as the Tobin Report had predicted, finally compelled our government to make the adjustments in haste.

The painful experience we are undergoing could yield a fruitful lesson that would take our politics to another level. There are certain things that require the parties who alternate in governing Puerto Rico should agree upon so continuity of policy is provided for an extended period. Economic and fiscal policies can't change every four years. Our economy is vulnerable to these changes and this has consequences regarding our budget and our capacity to borrow. In advanced democratic societies, the principal political parties agree about the basic premises that sustain the countries' vital interests and they place policies on these matters beyond electoral considerations.

