

## The Puerto Rican Economy in Transition\*

Since the inauguration of a well-conceived development program in the late forties, Puerto Rico has undergone a dramatic transformation from a stagnant, predominantly agricultural area to a more fully diversified and rapidly growing economy. Despite the island's limited resource availabilities and high population density, the rate of economic growth in Puerto Rico has been substantially higher than growth rates typically encountered in developing countries and, during recent years, has exceeded those of a number of industrially advanced countries as well. Between 1947 and 1963 gross insular product in real terms increased at an average annual rate of 6.3 per cent, and in 1964 advanced by 8.5 per cent.<sup>1</sup> Over the same period, real yearly income per capita—a measure that allows for the effect of population growth—increased at an average annual compound rate of 5.5 per cent and by 1964 amounted to \$706 (at 1954 prices), about two-and-one-half times its level in the early postwar period.<sup>2</sup> (In terms of current prices, annual per capita income amounted to \$830 in 1964, compared with \$253 in 1947.) The growth in per capita income in Puerto Rico has to some extent been aided by a high rate of emigration from the island. But, with the rapid growth in income and employment opportunities on the island, emigration has dwindled in recent years.

The island's extraordinary growth has derived much of its momentum from a sustained increase in the level and rate of investment in industries oriented largely toward export markets. And with the increase in the pace of de-

velopment the economy's center of gravity has shifted from the production and export of sugar toward industry. Indeed, the Commonwealth Government's development program—known familiarly as Operation Bootstrap—has been based primarily on the promotion of nonresident direct investment in industrial activities. While industrialization has played a leading role in the transformation of the whole economic structure, it is only one element, though an important one, of the broader problem of lifting the level of productivity and achieving better utilization of the labor force. The high rate of industrial investment has directly or indirectly facilitated the transfer of workers newly entering the labor force from rural areas, where there appears to have been substantial "underemployment", into industrial activities in which productivity is appreciably higher and has thus helped to raise output per employed worker for the economy as a whole. And the increasing diversification of production and the resulting reallocation of labor have substantially reduced the island's vulnerability to the wide seasonal and cyclical swings in employment and income that had resulted from its extreme dependence on sugar.

### THE CRUCIAL ROLE OF CAPITAL FORMATION

Both the increase in the over-all rate of Puerto Rican growth and the expansion of industrial activities reflect to a large extent a substantial increase in investment. Of course, a host of other factors—the availability of a growing labor force with appropriate training and skills, the emergence of a managerial group, and the efficiency with which both labor and capital are utilized—have also exerted an important influence upon the growth of income and output. Even though capital formation alone by no means adequately explains the success of the Puerto Rican development effort, the very acceleration of investment has tended to call forth many of the technological, structural, and other influences required to overcome the inertia of underdevelopment and propel the economy forward. The extensive mechanization of agriculture and industry has resulted in substantial increases in the productivity of labor by increasing the volume of capital

\* Martin Barrett had primary responsibility for the preparation of this article.

<sup>1</sup> Unless otherwise noted all annual data are for the fiscal year ended June 30.

<sup>2</sup> The growth of per capita income is, of course, only an imperfect indicator of possible advances in the "standard of life", a measurement of which should also allow for such factors as life expectancy and degree of literacy. Since 1940, life expectancy on the island has increased from 46 to 70 years and the death rate has declined from 18.4 to less than 7 per thousand. With a rapid increase in school enrollment, literacy increased from 68.5 per cent in 1940 to 83 per cent in the early 1960's.

equipment per worker, thus increasing output directly or releasing labor for use elsewhere in the economy. Moreover, the introduction of more up-to-date and efficient equipment, which is virtually inseparable from the level of investment, has helped to raise the level of manual, technical, and managerial skills on the island.

Except for a brief pause in 1950 and again in 1953 gross real investment—including both private and public investment—has increased steadily throughout the postwar period, not only in absolute terms but also in relation to gross insular product. Throughout the postwar span gross investment rose at an average annual rate of almost 11 per cent, and during the early sixties the growth in fixed investment in Puerto Rico was faster than in many developed countries. Moreover, investment rose more rapidly than any other component of demand and, in the past three years, has amounted to about 25 per cent of gross insular product as compared with 16 per cent in the early postwar period (see Table I).

Private investment has increased more rapidly than public investment. Nevertheless, the Commonwealth Government has played an important role in the promotion of private investment by providing the basic transportation and power facilities, which were an essential prerequisite for the effective participation of private capital in the development process. Thus public policy was basically designed to provide a general framework in which private investment could be fostered.

Table I  
GROWTH AND COMPOSITION OF REAL GROSS INSULAR PRODUCT  
Annual average

Gross insular product and its components	Rate of growth				As percentage of gross insular product	
	1948-64	1948-52	1953-58	1959-64	1947-49	1962-64
Private consumption .....	6.0	5.3	4.7	8.0	90.2	84.9
Government current expenditure .....	7.6	6.1	7.7	8.8	12.5	14.1
Gross investment (public and private) .....	10.6	14.2	6.6	11.5	16.0	25.3
Exports of goods and services .....	8.1	8.6	7.0	8.7	40.7	55.2
Less: Imports of goods and services* .....	8.2	6.2	7.9	10.3	-39.4	-79.5
Gross insular product .....	6.4	7.6	4.3	7.6	100.0	100.0

Note: Because of rounding, figures do not necessarily add to totals.

\* Goods and services produced abroad and imported must, of course, be deducted from total expenditure in order to arrive at a measure of production within Puerto Rico.

Source: Puerto Rico Planning Board.

In the early stages of the industrialization program the government went beyond the provision of social overhead capital and established and operated a number of manufacturing plants. However, it soon became clear that the Commonwealth authorities had neither the financial nor the managerial resources to launch the many industries required for a sustained expansion of industrial activity. Moreover, while the provision of social overhead capital was a crucial factor in stimulating private investment, it was not in itself sufficient to assure a higher level of private investment. Accordingly, the emphasis in policy shifted in the late forties toward the adoption of more specific measures designed to promote private investment. In 1948 Puerto Rico began to exempt almost all new manufacturing firms from all insular income and property taxes for periods up to ten years. However, since the period of exemption provided in the 1948 law was fixed to expire fully in 1962, its effectiveness as an incentive declined as the remaining period for exemption grew shorter. To deal with this situation, the Industrial Incentive Act of 1954 provided that the ten-year exemption period for new firms would begin when the firm started the operation. Furthermore, under a 1963 amendment, tax exemption is now available for periods of as much as seventeen years, depending on the location of the new plant.<sup>3</sup> These extended tax holidays resulted in a substantial increase in net profits and thereby sharply reduced the payback period and thus the initial risk inherent in the investment.<sup>4</sup> At the same time tax incentives focused attention on investment opportunities in Puerto Rico that might otherwise have gone unnoticed and also aided in the internal financing of the expansion of the exempt enterprises.

Apart from the provision of certain strategic facilities and the adoption of tax and other incentive measures by the Commonwealth Government, perhaps the most important influence on the level of investment is the Puerto Rican investment climate—that elusive constellation of factors which makes the island an attractive area for investment. External as well as local private capital is welcome to engage in any legitimate business activity. No special spheres are reserved for local capital, and the only field that the government has dominated is electric power.

<sup>3</sup> Essentially, the less industrialized the zone of establishment of a new manufacturing facility, the longer the available tax-exemption period.

<sup>4</sup> For a discussion of the tax-exemption program and other measures designed to promote investment, see "Private Investment and the Industrialization of Puerto Rico", this *Review*, April 1960, pages 68-74.

Moreover, the commitment of the Commonwealth Government to rapid industrialization along with the island's political stability undoubtedly provided a significant impetus to private investment.

Following the introduction of the tax-incentive program there was a sharp increase in the rate, as well as a change in the composition, of total investment. In 1947-49 public investment accounted for about 44 per cent of gross fixed investment, but that proportion has declined to less than one third in recent years. The decline in the relative importance of public investment has its counterpart, of course, in a sharp increase in the level of fixed private investment, which (in current dollar terms) rose from \$97 million in 1954 to \$410 million in 1964—equivalent to an average annual increase of almost 16 per cent. The greater part of the increase in private investment in plant and equipment undoubtedly represents investment by publicly "promoted" plants, most of which are subsidiaries of mainland firms engaged in manufacturing operations.

Since tax exemption has been one of the principal factors in the rapid expansion of new industrial investment, the question arises how permanent such industries may be once a specific firm's exemption period expires, as it eventually will for all and already has for some.<sup>5</sup> Although many plants may indeed have originally been attracted by tax exemption, pre-tax profits of new firms in Puerto Rico have been twice as high in relation to equity investment as for companies in the same asset-size classes on the mainland. Moreover, Puerto Rican corporate income taxes are on the average only slightly more than half the Federal corporate tax. As an added incentive, Puerto Rico allows taxpayers to depreciate fixed assets at their own discretion so that, as a firm's income becomes taxable, depreciation accruals can be materially increased and taxable income reduced. Although a few firms have begun to retrench in their operations on Puerto Rico, this tendency has been counteracted by the successful drive to attract new plants. In 1964 alone, some 175 new factories were established.

#### TRADE AND INVESTMENT

Since Puerto Rican exports have duty-free access to the United States market and since the internal market is relatively small, new investments have been oriented

<sup>5</sup> A total of 1,100 plants have been established in Puerto Rico since the adoption of tax exemptions, and such plants account for an estimated 60 per cent of income generated in the manufacturing sector.

largely toward the mainland market. One indication of the export orientation of Puerto Rican development has been an increase in the relative importance of exports, which rose from 41 per cent of gross insular product in the early postwar period to an annual average of 55 per cent in 1962-64. To a large extent the growth in commodity exports reflected substantial increases in exports of textiles and apparel, electrical equipment, processed foods, and petroleum products, as well as a wide range of other manufactured goods. Exports of sugar and sugar-related products, such as rum and molasses, which accounted for more than half of total export receipts as recently as 1950, now represent less than 15 per cent.

The growth in exports of manufactured products has also exerted an important influence on the level of investment and the over-all rate of growth by helping to finance the increasing import requirements generated by rising industrial activity. Whether new production is oriented primarily to the mainland market or to the internal market, the realization of a rising volume of investment has called for an increased flow of resources, a large part of which must be imported since the island produces few industrial raw materials and, in the virtual absence of local capital goods industries, heavy reliance must also be placed on imports of capital equipment from the mainland. The very growth of manufacturing activities has led to some substitution of local production for imported goods—notably furniture, fuel oils, and certain processed foods. On balance, however, the spread of industrial activities has intensified the demand for imports—particularly capital goods, raw materials, and other intermediate goods. As a result the trade deficit has risen, and the ratio of merchandise imports to gross insular product has advanced from 53 per cent in the late forties to about 70 per cent in recent years.

#### THE FINANCING OF INVESTMENT

In Puerto Rico, as in most economically less developed areas, the rate of capital formation required to launch a rapid and lasting increase in income has been substantially higher than the local capacity to mobilize domestic resources either through voluntary savings or through increased taxes. In view of the close financial links between Puerto Rico and the mainland, the Commonwealth has been able to have recourse to the mainland capital market and to promote successfully direct nonresident investment. Capital inflows have enabled the Puerto Rican economy to realize a higher rate of growth than would otherwise have been possible and to avoid the resource bottlenecks and inflationary pressures that frequently accompany pro-

grams of rapid industrialization.

The net inflow of external capital—whether in the form of direct investments or of an increase in financial claims on Puerto Rico—has been reflected in, and has been accompanied by, increased imports and current account deficits in the island's balance of payments. In 1947-49, the net use of external capital funds—as measured roughly by the current account deficit plus unilateral transfers from abroad—amounted to an annual average of \$67 million, equivalent to almost 65 per cent of gross investment during the period (see Table II). The use of outside funds dropped considerably in the early fifties, but during the later years of the past decade there was a steady increase in both the amount and proportion of investment financed

externally as nonresidents responded to the tax and other incentives provided by the Commonwealth Government. However, with the growth of Puerto Rican income, domestically generated savings have also increased substantially, and in the process Puerto Rico has stabilized the extent of its reliance on external sources of capital.<sup>6</sup> Since 1959, the proportion of total investment financed directly or indirectly by nonresidents has leveled off at about 50 per cent—substantially below its level in the early post-war period.

Among the internal sources of savings, there has been some decline in the relative importance of savings generated by the public sector—the combined budgetary surpluses of the Commonwealth and municipal governments and the net revenues of public corporations. Savings at all levels of government, including those made possible by direct grants-in-aid from the United States Government, almost tripled since the end of the war to as much as \$112 million in 1964, despite the increasing demands for public services generated by rapid urbanization. Yet as a proportion of total investment, government savings declined from an annual average of about 19 per cent during 1947-49 to less than 15 per cent in 1962-64. On the other hand, internally generated private funds—which include depreciation allowances, retained corporate earnings and other private savings—have increased from about 16 per cent of total savings in 1947-49 to an annual average of 38 per cent during 1960-64. Depreciation allowances showed a large absolute increase—rising from an annual average of \$26.9 million in 1947-49 to almost \$200 million in 1964—but, as a proportion of gross capital formation, increased only from 26 per cent to 31 per cent during the same period. Corporate savings (other than depreciation allowances) and other private savings—which has been assisted by Federal transfers—have tended to rise more rapidly; in 1947-49 these two components combined were negative, as they were again in 1964. Nevertheless, during the past five years they have averaged about \$26 million, or about 5 per cent of gross investment.

Table II  
INVESTMENT AND ITS FINANCING IN PUERTO RICO

Item	1947-49 (annual average)	1960	1961	1962	1963	1964
	Millions of dollars					
<b>Gross capital formation:</b>						
Inventories .....	12.7	39.4	37.2	72.7	79.4	62.5
Fixed private investment .....	51.6	220.7	241.5	305.3	342.2	409.6
Fixed public investment .....	41.1	129.8	132.0	139.9	139.8	171.8
<b>Total .....</b>	<b>105.5</b>	<b>390.0</b>	<b>410.7</b>	<b>517.9</b>	<b>561.4</b>	<b>643.9</b>
<b>Financing:</b>						
Public sector surpluses .....	19.0	63.5	56.6	59.3	85.9	111.6
Depreciation allowances .....	26.9	131.3	144.5	160.9	181.9	199.8
Other corporate and private savings .....	-7.3	-0.4	39.3	30.7	68.4	-9.5
Current account and uni- lateral transfer deficit .....	66.9	195.6	170.3	267.0	225.2	342.0
<b>Total .....</b>	<b>105.5</b>	<b>390.0</b>	<b>410.7</b>	<b>517.9</b>	<b>561.4</b>	<b>643.9</b>
	Percentage of total					
<b>Gross capital formation:</b>						
Inventories .....	13.5	10.1	9.1	14.0	14.1	9.7
Fixed private investment .....	48.2	56.6	58.8	58.9	61.0	63.6
Fixed public investment .....	38.3	33.3	32.1	27.0	24.9	26.7
<b>Total .....</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Financing:</b>						
Public sector surpluses .....	19.1	16.3	13.8	11.4	15.3	17.3
Depreciation allowances .....	25.5	33.7	35.2	31.1	32.4	31.0
Other corporate and private savings .....	-9.4	-0.1	9.6	5.9	12.2	-1.5
Current account and uni- lateral transfer deficit .....	64.7	50.2	41.5	51.6	40.1	53.1
<b>Total .....</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Note: Because of rounding, figures do not necessarily add to totals.  
Source: Puerto Rico Planning Board.

#### COMPOSITION OF OUTPUT

The progressive increase in aggregate output and the changing pattern of final demand have been accompanied by a major increase in the size of the industrial sector

<sup>6</sup> For a discussion of the role of the Puerto Rican banking system in mobilizing domestic savings, see "Financing Economic Development in Puerto Rico", this *Review*, May 1961, pages 78-83.

**Table III**  
**INDUSTRIAL ORIGIN OF GROSS DOMESTIC PRODUCT**  
 Amounts in millions of dollars at 1954 prices

Sector	1947		1955		1963	
	Amount	Per cent of total	Amount	Per cent of total	Amount	Per cent of total
Agriculture .....	125.8	20.1	152.1	14.8	191.5	9.9
Industry .....	173.2	27.6	342.2	33.2	749.4	38.8
Manufacturing .....	112.7	18.0	202.0	19.6	439.7	22.7
Contract construction .....	13.2	2.1	49.3	4.8	134.5	7.0
Transportation and public utilities .....	47.3	7.5	90.9	8.8	175.2	9.1
Services .....	328.0	52.3	534.0	51.9	992.3	51.3
Commerce .....	150.9	24.1	222.4	21.6	379.7	19.6
Finance, insurance, and real estate .....	67.9	10.8	125.5	12.2	237.7	12.3
Other services (including tourism) .....	41.6	6.6	70.9	6.9	161.8	8.4
Government of Puerto Rico .....	67.6	10.8	115.2	11.2	213.1	11.0
<b>Total gross domestic product .....</b>	<b>627.0</b>	<b>100.0</b>	<b>1,028.3</b>	<b>100.0</b>	<b>1,933.2</b>	<b>100.0</b>

Note: Because of rounding, figures do not necessarily add to totals.  
 Source: Government Development Bank for Puerto Rico.

relative to agriculture. One measure of the change in the composition of output is provided by the relative contributions of each sector to gross domestic product at constant (1954) prices (see Table III). While agricultural output has continued to increase, its share in total product has receded from about 20 per cent in 1947 to less than 10 per cent in 1963—only slightly higher than in the United States. Incomes generated in the industrial sector—here defined to include transportation and public utilities as well as construction and manufacturing production proper—rose so much faster that this sector accounted for almost 39 per cent of total output in 1963, compared with roughly 28 per cent in 1947. The share of income generated by service activities—wholesale and retail trade, financial enterprises, as well as health, education, and other public services—has remained virtually unchanged and still accounts for about half of gross domestic product.

The changing structure of the island's economy has also been accompanied by changes in the composition of output within sectors. In the agricultural sector, the production of sugar and tobacco—Puerto Rico's traditional export products—has declined in both absolute and relative terms, while production of other agricultural foodstuffs, notably meat and dairy products, has increased substantially. There have also been considerable changes within the service sector. While income derived from wholesale

and retail trade has increased in recent years, the proportion of income derived from such activities has declined somewhat since 1947. On the other hand—and partly as a result of vigorous efforts by the Commonwealth authorities to promote tourism—income from “other services” rose at a faster than average rate.

The process of industrial development has also entailed significant shifts within the manufacturing sector. As industrialization gained momentum, there has been a progression from relatively simple types of manufacturing—textiles, clothing, and food processing—to more complicated types of consumer durables and producer goods, such as electronic equipment, chemical products, and certain household appliances. In the most recent years, the whole constellation of industries that fall under the general heading of engineering and chemicals has been the most dynamic.

But it is not only in the pattern of output that industrialization now differs from its early development. At first, the types of plants established depended little on other plants or industries for either materials or markets. Raw materials were derived largely from the agricultural sector, and products were sold directly to final consumers or exported to the mainland. More recently, the interrelation among plants has become more complex. Such industries as metals, petroleum, and machinery and transport equipment tend to depend on a varied supply of components from other plants and industries. Although a large proportion of these components are still imported, the emergence of heavy industries has also led to ancillary activities such as synthetics and plastics within Puerto Rico. Thus, the character of industrial growth has shifted toward the organic development of whole complexes of interdependent plants.

Both the shift in output from agricultural to nonagricultural activities and the changing composition of industrial output itself reflect in part the changing pattern of final demand in response to increases in real incomes. Thus, the decline in the share of the agricultural sector is related to the fact that the demand for foodstuffs tends to increase less than proportionately to increases in per capita income. Moreover, consumer demand tends to shift from relatively simple fabricated nondurables to more highly fabricated durable and nondurable goods. Therefore, changing Commonwealth consumption patterns may have contributed to the relatively rapid growth of the chemical, metal, machinery, and transport industries. However, the relationship between changes in the structure of manufacturing production and the growth in insular demand is certainly a loose one: a considerable part of the increase in manufacturing activities has consisted of the expansion

of production for the mainland market.<sup>7</sup>

Between the late forties and the early sixties the shifts in the industrial origin of income were broadly paralleled by similar changes in the occupational pattern of employment, but there are nevertheless significant differences. The proportion of the employed labor force engaged in agricultural activities is substantially greater than that sector's contribution to output. In the construction industry, which is also relatively labor-intensive, the percentage of income generated was generally less than the proportion of manpower absorbed, while in the capital-intensive transport and public utilities sectors the absorption of labor was considerably less than the share of income generated. In the manufacturing sector, the relationship between the share of income generated and the percentage of labor absorbed has changed with the shift in the composition of manufacturing output and with the extensive mechanization of certain traditional branches of manufacturing production. The home needlework industry, for example, which at one time employed thousands of women has virtually disappeared. Moreover, the emergence of capital-intensive industries has tended to reduce the overall ratio of employment to income generated in the manufacturing sector. The manufacturing sector's share of income has thus become substantially greater than its relative absorption of labor.

These differences between the industrial origin of income and the occupational pattern of employment reflect, of course, underlying differences in output per employed worker, which in turn have their roots in differences in labor productivity, in the amount of capital per worker, and in the efficiency of utilization of both labor and capital. Given the differences in output per worker between sectors, the rate of growth of productivity for the economy as a whole depends not only on the rise in output per

worker in each sector of activity but also on the effects of faster expansion in some branches than in others—i.e., on changes in the structure of the economy. Although output per worker in agriculture has increased considerably since the late forties, largely as a result of the extensive mechanization of farm production and the shift in output to dairy, meat, and other year-round products, both the level and the rate of increase in such output were lower in agriculture than in industrial activities. The continuous transfer of labor out of agriculture has thus contributed to the growth of the economy as a whole. Even though output per worker in service activities has grown less rapidly than in the agricultural sector, output per worker in service activities was considerably higher than in agriculture prior to the start of the transformation of the Puerto Rican economy. Therefore, the continuing reallocation of employment toward service activities has also had a favorable effect on the over-all increase in labor productivity.

As industrialization has lifted the level of labor productivity, wage and salary income has increased as a proportion of total net internal income. Thus the share of wages and salaries rose from 56 per cent in 1940 to almost 70 per cent in 1964. Since incomes generated in the form of payments to employed labor is a much lower share of total factor payments in the agricultural sector, the increase in the ratio of wage and salary income to total income reflects to some extent a decline in the importance of the agricultural sector. Moreover, some of the increased share of labor income may simply be a reflection of the reduced importance of income from self-employment (classified as nonwage income), which may well be related to the relative decline of the agricultural sector where self-employment was relatively high. Furthermore, a part of the increase in labor's share of income received within Puerto Rico reflects the fact that payments received from abroad—including those made by the United States Government—consist largely of wages and salaries. Payments to the rest of the world, on the other hand, include a large component of property income, and, in addition, have been rising more rapidly than receipts. Since these payments are of course not income received within Puerto Rico, the relative importance of nonwage income on the island itself is correspondingly reduced.

One of the most encouraging aspects of Puerto Rico's growth has been a substantial and sustained decline in unemployment. Although the current rate of unemployment in Puerto Rico—at about 11 per cent of the labor force—remains high, it is nevertheless lower than it was in the early fifties, and a decrease in the number of underemployed (those who are nominally employed but contribute very little to output) has no doubt also taken place.

<sup>7</sup> Both the spread and the changing character of industrial activity also reflect the nature of the island's resource availabilities. Although natural resources are relatively scarce, there is an abundant supply of skilled and unskilled labor. Indeed, absorption into productive activity of the large numbers of unemployed or underemployed persons was and remains a major objective of Operation Bootstrap. In the initial stages of the industrialization program, many plants established were concentrated in industries such as cotton textiles, which require large amounts of relatively unskilled labor. By now, the very process of industrialization has lifted the level of skills and technical expertise and generally improved the quality and efficiency of productive resources throughout the economy. This factor has undoubtedly contributed to the development of the electronics industry, which calls for a high degree of technical and professional expertise. The increasing availability of skilled personnel, together with Puerto Rico's close proximity to Venezuelan oil, has facilitated the emergence of the petroleum and petrochemical industries.

Moreover, the average duration of unemployment is relatively short. In recent years about 90 per cent of the unemployed have been without work for less than fifteen weeks a year and about 60 per cent for less than five weeks. Thus, a considerable part of the unemployment is short term in nature. This fact, in all likelihood, largely reflects the individually temporary, but continuing, dislocations caused by the steady movement of the population from rural to urban areas and by the shifts within the labor force from unskilled to more skilled work.

#### CONCLUDING REMARKS

Puerto Rico's Operation Bootstrap owes much of its extraordinary success to the island's status as an integral part of the mainland economy—a position which has removed many of the risks ordinarily associated with foreign investment and thereby facilitated the flow of external capital to the island. Puerto Rican government obligations are traded in the United States on the same tax-free basis as the obligations of state and local authorities, and private Commonwealth borrowers may enter the United States market for long-term funds on the same basis as mainland borrowers. In addition, the high rate of net emigration from Puerto Rico mitigated the island's unemployment problem, especially during the early stages of industrialization. Moreover, since the island shares a common cur-

rency with the mainland, Puerto Rican trade with the United States is entirely free of foreign exchange problems. However, most nonresident direct investment is export oriented. As a result the Puerto Rican economy is vulnerable to changes in business conditions on the mainland, with respect to both the demand for Puerto Rican exports and the supply of nonresident investment. Each of the postwar recessions in the United States was reflected in a more or less concurrent slowdown in the growth of investment and income in Puerto Rico.

Puerto Rico's experience thus provides neither a panacea nor a blueprint for other developing areas. Nevertheless, that experience is by no means irrelevant. The island's unique status hardly explains the success of its postwar development drive. Puerto Rico's progress clearly owes much to the energy, imagination, and the success with which the island's government and public authorities have tackled the problems of raising the level of education, providing basic public facilities, and making the island attractive for the effective participation of private mainland capital in economic development. Planned capital inflows continue to play an important part in the government's development strategy. However, the very process of growth has enabled the island to reduce the extent of its reliance on external sources of capital, and in this and many other respects Puerto Rico appears to be making the transition to fully self-sustained economic growth.