

When All Else Fails: Deficit and The Limits of Public Debt as Economic Driver – The Puerto Rico Case

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Abstract

In 1950, in the context of the Cold War, the U.S. Congress approved Public Law 81-600 for the unincorporated territory of Puerto Rico, which would redefine the legal relationship between the U.S. and its territory. One of the most important clauses of this law was the extension of "fiscal autonomy" powers, which would allow the territory certain capacities to design its fiscal policy in terms of its own tax system, budget, and public spending, but above all, the ability to issue public debt. This tool was supposed to enable Puerto Rico to advance its industrialization process as a first step in its economic development and modernization of its agrarian economy. For the first 25 years of this dual process – industrialization and development – Puerto Rico's economy, driven by industrialization, public spending, and debt issuance, reached historic levels of economic growth. The growth path abruptly stopped in 1974 due to external shocks brought by the oil embargo, plunging the economy into a recessionary spiral from which it barely recovered, mainly on the basis of strong fiscal policy measures and debt. This manuscript proposes to present how the trajectory of Puerto Rico's public debt as the main tool of fiscal policy with a dangerous trajectory – and the budget deficits to which it led – resulted in government facing debt default and a complex bankruptcy process. It also aims to present the complex interactions between politics, the limits of economic and fiscal policy, and the economic development of the territory.

Keywords: bankruptcy; budget deficit; credit; debt restructuring; fiscal policy; public finance