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Think Strategically

Puerto Rico Marks 50 Years of The Tobin Report, A Missed Opportunity

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A Nobel Laureate's Formula and a Missed Opportunity

Many Puerto Ricans have heard of **the Tobin Report**, but few realize how forcefully **it anticipated today's fiscal challenges.**

Commissioned in March 1974 by Governor Rafael Hernández-Colón, the Committee for the Study of the Finances of Puerto Rico brought together some of the most distinguished economic minds of the era:

- **James Tobin (Chair),** Sterling Professor of Economics at Yale University, was later awarded the Nobel Prize in 1981 for his pioneering analysis of financial markets and their links to spending, employment, production, and prices.
- **William Donaldson**, Dean and Founder of the Yale University School of Management and later Chairman of the U.S. Securities and Exchange Commission.
- **Kermit Gordon,** President of the Brookings Institution and former Director of the U.S. Bureau of the Budget.
- **Wilfred Lewis, Executive** Director of the National Planning Association**.**
- **Sidney Robbins,** Professor of Finance at Columbia University**.**

In its letter to Governor Hernández-Colón, the committee warned:

"The economic development and fiscal problems of Puerto Rico have increased since 1969. Although some of the current issues facing the Commonwealth are outside of their control, the current trend of the government expenses, the accumulation of deficits by public corporations, and public debt and production costs will not be sustainable even under the most favorable economic conditions".

Governor Rafael Hernández Colón's 1975 Reflections on the Tobin Report

On December 16, 1975, only days after receiving the Tobin Committee's findings *(the final printed report followed in early 1976)*, **Governor Rafael Hernández Colón addressed Puerto Ricans** in a televised conference devoted entirely to the report." Citing its key conclusions, he reminded viewers that Puerto Rico had once maintained consistent fiscal surpluses, and the Governor stated**, *"The Tobin Report says that before 1969 there were savings every year—in other words, not all revenues were spent …"***

By highlighting the years of budget savings before 1969, Hernández Colón underscored a central message of the report: Puerto Rico possessed a tradition of disciplined budgeting that needed to be restored. He spoke of reviewing capital programs, improving revenue administration, and aligning expenditures with sustainable growth—steps that closely followed Tobin's own prescriptions.

However, political change intervened. **In the 1976 general elections, Hernández Colón lost the governorship to Carlos Romero Barceló.** The change of administration meant that he could not fully implement the Tobin Report's comprehensive **reform plan, and many of its structural recommendations remained on paper.**

Historians and economists later noted that this interruption contributed to Puerto Rico's long fiscal drift. The unfulfilled elements of Tobin's blueprint—particularly more profound tax reform, multi-year budgeting, and stronger debt-management rules—would resurface decades later during the debt crisis and PROMESA negotiations.

When **Carlos Romero Barceló succeeded Rafael Hernández-Colón** in 1977**, the Tobin Report remained a reference point in public and policy discussions.** His government acknowledged the report's warnings and made limited use of it. Since **most of the report's structural reforms were not carried out.** Multi-year budgeting and the full integration of public corporations' debt into consolidated accounts—central to Tobin's plan—remained absent.

The Romero Barceló administration drew on the Tobin Report for guidance and rhetoric, but stopped short of the profound fiscal restructuring that Tobin had urged.

The report contained what Tobin himself described as a formula to prevent a large share of the fiscal and economic troubles Puerto Rico faces today. Yet much of it was largely ignored for decades.

This decision to defer difficult reforms—and the heavy costs of that delay—frames Fifty Years of Fiscal Lessons—From Early Warnings to Today's Opportunities, the story that unfolds in the pages ahead.

A Deeper Historical Prelude: Puerto Rico on the Eve of the Tobin Report

The mid-1970s closed the curtain on the long post-war boom. The collapse of Bretton Woods (1971), stagflation, and the 1973–74 oil shock punished energy importers and capital-hungry governments alike. Puerto Rico—an open, dollarized economy with limited representation in federal decision-making—absorbed those shocks just as the social demands of rapid urbanization and industrialization peaked.

Alarms were already ringing inside the island's own fiscal institutions. **On June 16, 1975, Guillermo Rodríguez, chairman and CEO of the Government Development Bank**, **sent Governor Rafael Hernández Colón a memo that read like a red-ink siren**. In just five years, he warned, **public debt had surged 233 percent while gross product grew only 47 percent**. Bond issuance planned for FY1975–77, he cautioned, would match the entire previous sixteen years combined. **Puerto Rico's share of the U.S. municipal-bond market had climbed to 2.34 percent, despite representing only about 0.5 percent of U.S. GDP**. **Moody's** was flashing yellow, **warning that deficits above $200 million could imperil the island's A1 rating**, and large dealers were already refusing to resell Puerto Rican bonds they would not buy for their own books.

Rodríguez urged an immediate freeze on new bond-issuing corporations, a halt to projects that required additional borrowing, and a deep cut to already-approved capital programs until growth and debt indicators realigned. His memorandum became the unambiguous early-warning bell that set the Tobin process in motion.

The Tobin Report: Structure & Core Prescriptions

1. Revenue Policy – Replace excise-tax dependence with a balanced income and consumption tax mix; reduce exemptions; improve compliance.

2. Expenditure Control & Capital Budgeting – Introduce five-year rolling expenditure plans; prioritize investments with measurable economic returns; restrict subsidies to public corporations.

3. Debt Management – Consolidate public-corporation borrowing within the general budget; maintain total public debt below 20 % of GNP; limit the frequency and size of bond issues.

4. Economic Diversification – Encourage local entrepreneurship and service industries; reduce dependence on Section 936 manufacturing incentives; invest in education and workforce training.

These prescriptions married hard numerical thresholds to institution-building, a hallmark of Tobin's economic craftsmanship. They **gave Puerto Rico both a roadmap and measurable guardrails—if policymakers chose to follow them.**

Data Baseline in 1975–76 & Market Mechanics

The period data reveal why Tobin's caution was urgent:

- Public debt growth—**233% over five years versus 47% GNP growth**—signaled unsustainable leverage.
- Puerto Rico's municipal bond market share soared to **2.34 %**, far out of proportion to its U.S. economic weight.
- Issuance concessions widened, and major underwriters exited, showing clear market fatigue.

These indicators underscored the need for transparency, pacing of issuance, and fiscal discipline.

Fifty Years in Review—How Puerto Rico Fared vs. Tobin's Blueprint

Late 1970s–1980s

Growth flourished under Section 936, but debt issuance remained heavy and fiscal reform slow. Early prosperity masked mounting structural strain.

1996-2005

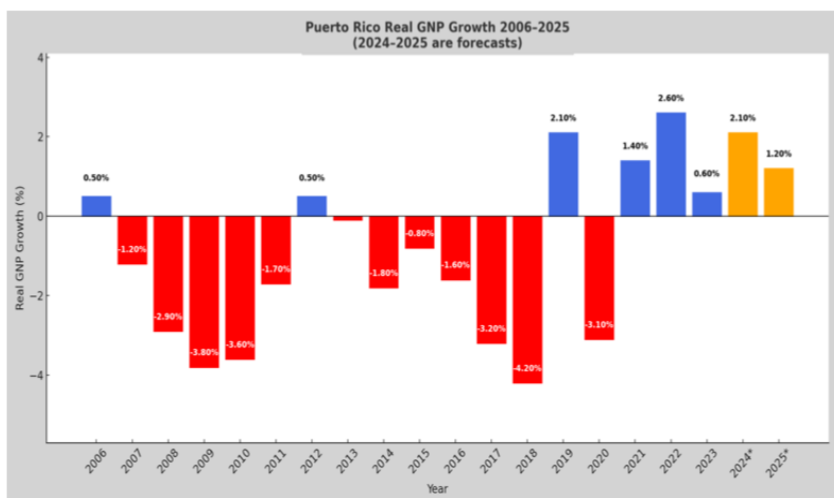
The repeal of Section 936 in 1996 validated Tobin's warning about dependence on federal incentives. Over the following decade, Puerto Rico lost more than **100,000 jobs**—especially in manufacturing, where nearly **40 %** of positions tied to 936 incentives disappeared.

2006–2016

Economic stagnation deepened. Only in 2006 did Puerto Rico introduce the Sales & Use Tax (IVU), a first substantial nod to Tobin's tax-base advice. By then Puerto Rico had entered in a 13 year recession, that subsised in 2019. Global recession and chronic deficits pushed debt near **100 % of GNP**. Ratings collapsed and borrowing costs soared.

Puerto Rico GNP Growth

2006-2025



2016–2022

PROMESA and the Fiscal Oversight and Management Board imposed multi-year fiscal plans. Hurricanes Irma and María, earthquakes, and a pandemic battered the economy but also attracted significant federal recovery funds.

2022–2025

Puerto Rico completed a landmark central-government debt restructuring and posted primary surpluses. Tourism revived and federal capital inflows stabilized public finances, though energy system reform and demographic decline remain challenges.

Puerto Rico 1975 vs. 2025—Key Indicators

Fifty years separate the two very different Puerto Rico economies.

The following data show how the island's population, labor market, and growth dynamics have evolved since the Tobin Report was published.

While the population grew only modestly, the economy experienced dramatic structural change—marked by lower unemployment, a larger labor force, and a sharp swing from negative to positive long-term real GDP growth.

Puerto Rico 1975 vs. 2025—Key Indicators

Indicator	1975	2025	Change
Population	2.994 million	3.111 million	3.90%
Unemployment Rate	17.10%	5.60%	-67.25%
Labor-Force Participation Rate	55%	45.10%	-18%
Labor Force (people)	884,000	1.171 million	32.46%
Real GDP Growth Trend	-0.70%	1.20%	271.43%

Key Observations

- **Population growth slowed to a crawl**—just 3.9 % over five decades—underscoring the demographic headwinds created by low birth rates and outward migration.
- **Unemployment dropped sharply**—from a crisis-level 17% to 5.6%—reflecting both structural shifts in the economy and a smaller labor force base.
- **Labor-force participation fell** by 18 %, revealing deeper social and demographic pressures despite a larger absolute labor force.
- **Labor force size grew** by over 32 %, evidence of higher female participation in earlier decades and changing age composition, before the more recent declines.
- **Real GDP growth trend reversed dramatically**, from slightly negative in 1975 to a positive 2.1% in 2025—a 400% swing—showing that, despite slow population growth, the economy has expanded in real terms.

Lessons Learned

The half-century since the Tobin Report offers more than a list of dos and don'ts—it tells a cautionary story about timing, institutions, and the deep mechanics of public finance.

The first and clearest lesson is that **early indicators must be heeded**. Guillermo Rodríguez's 1975 memorandum—warning of unsustainable debt growth, market fatigue, and the need to slow issuance—was not a footnote; it was a flashing red light. Yet the signal was ignored, and the cost of delay multiplied over decades. Puerto Rico ultimately implemented many of Tobin's prescriptions, but only after a full-blown fiscal crisis forced the issue.

Second, **debt is far more than a single balance-sheet number**. It is a living relationship with capital markets. The speed and pattern of bond issuance, the hidden liabilities of public corporations, and the clarity of financial reporting are as consequential as the headline total. Puerto Rico's experience shows that when cadence and transparency fail, investors demand a premium long before the ratios look alarming on paper.

Third, **a resilient tax base is the true engine of growth**. Tobin urged broadening the base and improving compliance to stabilize revenues through economic cycles. Later adoption of a sales and use tax (IVU) helped. Still, the island's heavy reliance on consumption taxes, combined with enforcement gaps, left the fiscal structure exposed to recessions and demographic decline.

Fourth, **growth and fiscal policy must reinforce each other**. Infrastructure investment, reliable energy, and development of human capital are not optional—they are the foundations on which a robust tax base and sustainable debt capacity rest. Where these investments lag, as they did for long stretches, the economy's potential growth rate falls and fiscal stress returns.

Finally, **institutional capacity itself is a competitive asset**. The reforms introduced under PROMESA—multi-year fiscal plans, independent oversight, and transparent reporting—illustrate how credible rules can lower risk premiums and create fiscal space. Institutional trust, once restored, can translate directly into cheaper credit and a stronger investment climate.

Together, these lessons form a single argument: **sound institutions and early action are the best economic development policy**. Puerto Rico's history confirms that fiscal discipline, like compound interest, rewards those who start early and punishes those who wait.

The Path Forward (2025-2030)

Puerto Rico's next chapter will be written by the choices it makes in the immediate future. The reforms of the last decade—debt restructuring, fiscal controls, and greater transparency—have stabilized the island's finances, but sustaining and deepening those gains will require a coordinated strategy across critical fronts.

Puerto Rico's economic challenges have been a topic of discussion for decades. While political leaders focused on headline-grabbing ribbon cuttings, new public-works projects, and short-term vote-generating programs such as the government health plan, fundamental weaknesses deepened: chronic budget deficits, pension underfunding, and a reflex to raise taxes instead of controlling spending. The result is a government sector that now equals **20.5 % of Puerto Rico's GDP**, well above the state and local government spending of 13–14% of GDP, using figures of the second quarter of 2025.

This heavier footprint reflects Puerto Rico's unique political and economic status, but it also shows how deeply political decisions—not market discipline—shape local economic life.

From Fiscal Storm to Bankruptcy

The island's 2016 bankruptcy was not a single downturn but the culmination of **decades of structural imbalance and politically driven choices**. Public debt ballooned past **$72 billion**, while pensions were left unreformed and budgets were rarely balanced. When the collapse came, **over $37 billion in bondholders' savings evaporated, affecting most residents**. Retirements were delayed, middle-class families were thrust into poverty, and confidence in government all but disappeared.

Even after court-supervised restructuring slashed central-government bonded debt to roughly **$34 billion**, the damage lingers. PREPA's unresolved case, unfunded pensions, and weak long-term planning remain a drag on growth.

Six Interlocking Structural Challenges

Birling Capital sees **six forces still constraining Puerto Rico's growth**:

- **Lack of Economic Freedom – Ranked 51st (last)** by the Fraser Institute with a score **of 2.6.** Notably, the **Puerto Rico Institute of Economic Freedom** is actively proposing legislation to enhance our economic freedom, with **three landmark pieces of legislation enacted.**
- **Debt Overhang** – Even after restructuring, high leverage limits investment in infrastructure, education, and innovation.
- **Population Decline** – Out-migration erodes the tax base and consumer demand.
- **Natural Disasters** – Hurricanes such as María (2017) and recurrent earthquakes damage infrastructure and drain fiscal resources.
- **Economic Concentration** – Heavy reliance on manufacturing and tourism makes the economy vulnerable to sector shocks.
- **Political Status & Federal Funding Gaps** – As a U.S. territory, Puerto Rico receives only **$4,000 per capita in healthcare vs. $13,000 for states**, a roughly **$29 billion annual shortfall**, and lacks full authority over economic policy.

Debt restructuring, infrastructure upgrades, and industry diversification are underway, **but the reforms remain incomplete**.

The Final Word: An Inflection Point—Converting Half a Century of Warnings into Lasting Prosperity
Fifty years ago, **James Tobin and Guillermo Rodríguez** sounded alarm bells and mapped both the risks and opportunities ahead. Puerto Rico now stands at a **strategic inflection point**. Puerto Rico should lock in the reforms of the last decade and pair them with sustained investment in infrastructure, skills, and energy. In that case, it can emerge as a stable, competitive economy in the Caribbean and U.S. sphere. If reforms falter, demographic and debt pressures could swiftly erode recent gains.

This reflection will also find expression in a **milestone gathering**. On **Friday, October 10, 2025**, the **Center for a New Economy and Yale's Tobin Center for Economic Policy will convene a conference in New Haven to mark the report's 50th anniversary**, underscoring that sound finance and strategic foresight are not merely technical aims but essential ingredients of long-term prosperity.

As **Governor Rafael Hernández-Colón** cautioned during a 2014 speech at the Puerto Rico Financial Analyst Association, known as "APAF, ***"The only durable foundation for prosperity", said Tobin, is to develop and maintain on the island economic activities competitive in the U.S. markets, in world markets, and in local markets. To achieve this, we have to endure several years of fiscal, financial, and economic austerity—limiting government consumption and salary increases for public employees, increasing tax revenues, generating surpluses in public corporations, and properly marketing our bonds—to establish the foundations for renewed economic growth".***

The analysis of the Tobin Report and the historical dialogue surrounding it confirm the clarity of that warning. Over the ensuing decades, Puerto Rico largely moved in the opposite direction—expanding government payrolls, deferring hard tax reforms, running chronic deficits, and allowing public corporations to accumulate losses. Instead of sustained austerity and competitiveness, policy choices often favored short-term stimulus and political patronage. The result was an economy increasingly dependent on external transfers and debt financing, culminating in the fiscal and demographic crises the Tobin Report sought to avert.

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