

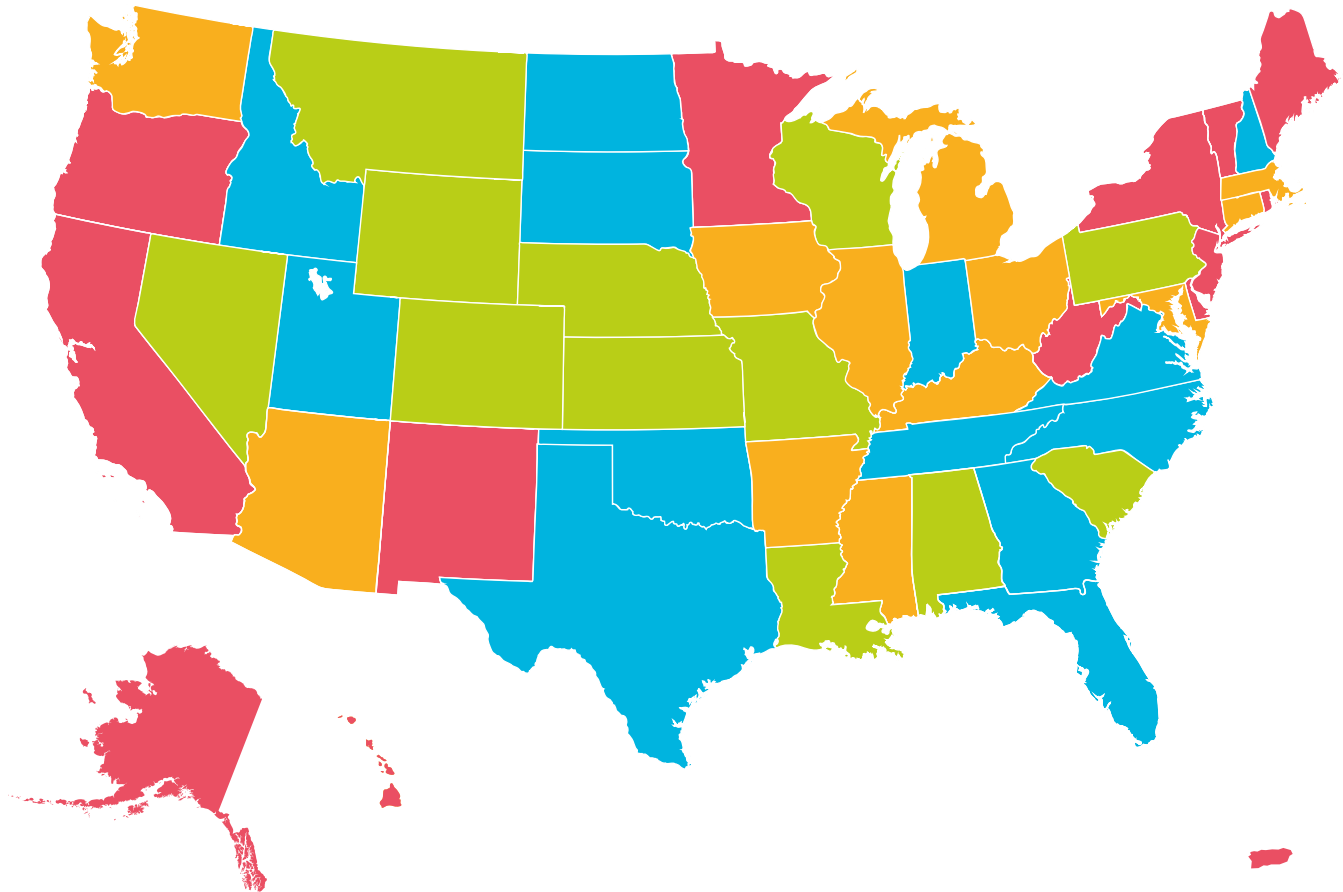
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ECONÓMICA



Economic Freedom of North America 2022



The map uses the subnational index.

 MOST FREE

 2ND QUARTILE

 3RD QUARTILE

 LEAST FREE

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Executive Summary

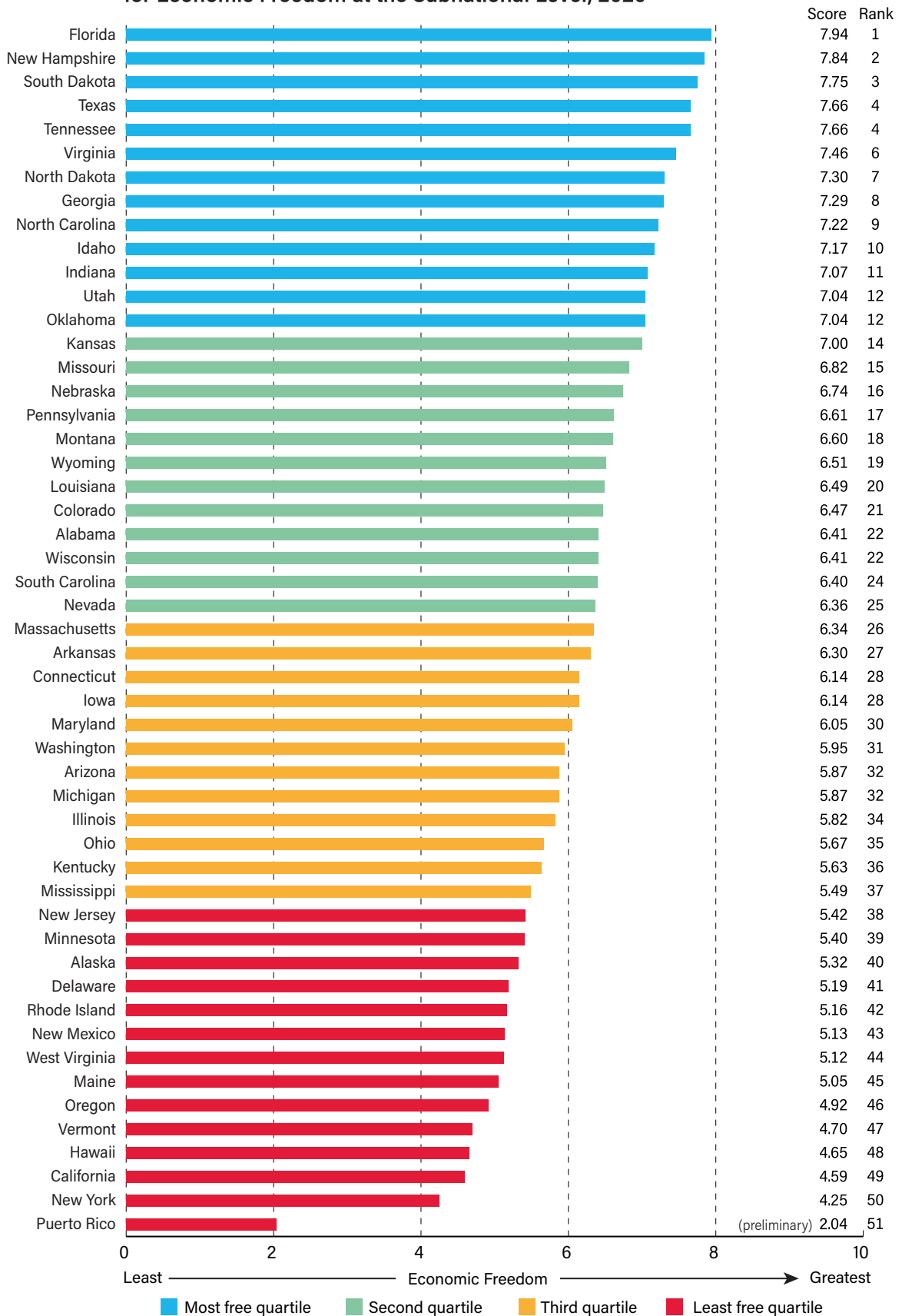
Economic Freedom of North America 2022 is the eighteenth edition of the Fraser Institute's annual report. This year it measures the extent to which—in 2020, the year with the most recent available comprehensive data—the policies of individual provinces and states were supportive of economic freedom, the ability of individuals to act in the economic sphere free of undue restrictions. The report includes two indices: one that examines provincial/state and municipal/local governments only and another that includes federal governments as well. The former, our subnational index, is for comparison of individual jurisdictions within the same country. The latter, our all-government index, is for comparison of jurisdictions in different countries.

For the subnational index, *Economic Freedom of North America* employs 10 variables for the 92 provincial/state governments in Canada, the United States, and Mexico in three areas: 1. Government Spending; 2. Taxes; and 3. Regulation. There is a separate subnational index calculated separately for each country. In the United States, the most economically free state was Florida at 7.94, followed by New Hampshire at 7.84, South Dakota at 7.75, and Texas and Tennessee at 7.66. The least-free state was New York at 4.25, following California at 4.59, Hawaii at 4.65, Vermont at 4.70, and Oregon at 4.92. For the first time, we have made a preliminary attempt to include the US territory of Puerto Rico in the US subnational index. It came in with a score of 2.04. The next lowest score was more than twice as high.

Economic freedom at the subnational level has generally been found to be positively associated with a variety of measures of the per-capita size of the economy and the growth of the economy as well as various measures of entrepreneurial activity. There are now more than 340 articles by independent researchers examining subnational economic freedom using the data from *Economic Freedom of North America*. Appendix C lists some of the most recent ones. Much of that literature discusses economic growth or entrepreneurship but the list also includes studies of a variety of topics such as income inequality, eminent domain, and labor markets. The vast majority of the results correlate higher levels of economic freedom with positive outcomes, such as economic growth, lower unemployment, reduced poverty, and so on.

Note. This document is a compendium of *Economic Freedom of North America 2022* focused on Puerto Rico. The full report and the full dataset, including all of the data published in this report as well as data omitted due to limited space, can be downloaded for free at <<https://www.fraserinstitute.org/studies/economic-freedom-of-north-america-2022>>.

Figure 1.2b: Summary of the Ratings of US States and Puerto Rico for Economic Freedom at the Subnational Level, 2020



Chapter 3

A First Look at Economic Freedom in Puerto Rico

Ángel Carrión-Tavárez

Ideas about economic freedom have existed in Puerto Rico for centuries. They appear in numerous primary sources such as the *Revista de Agricultura, Industria y Comercio* [Journal of Agriculture, Industry and Commerce], published in the late 19th century, and the *Memorial de la Cámara de Comercio de Ponce* [Brief of the Ponce Chamber of Commerce], from the early 20th century.¹ An understanding of the principles of economic freedom, however, and the situation of economic freedom on the Island are under-explored areas of research.

This chapter provides some brief historiographical notes as a backdrop to the status of economic freedom in Puerto Rico at the present time. It also offers information on the process of incorporating the Island into the *Economic Freedom of North America 2022*—including a description of the data and the results obtained. Finally, we explain the limitations of the work carried out and advance possible courses of action and methods to overcome them and increase the accuracy of Puerto Rico’s scores and ranks in the future.

Historiographical notes on Puerto Rico as a territory of the United States

After 390 years of Spanish colonialism and on the threshold of the 20th century, Puerto Rico was ceded by Spain to the United States, as a result of the Spanish-American War and the Treaty of Paris of 1898.² Since then, the Island has been a posses-

1. In the *Revista*, for example, there is praise for the “inhibition of the government of everything that is not of the particular domain, offering the guarantees for business to take place and avoiding unnecessary interventions” (Álvarez Curbelo, 2001: 207–208). The *Memorial*, for its part, states that “as a general principle, therefore, we are openly opposed to government intervention in matters of public enterprises, such as the docks. In these, even less, we believe in government effectiveness or action, and we see it rather as a delay in the face of the increasingly pressing needs of business life” (Armstrong, 1906: Día 6).
2. The text of this *Treaty of Peace between the United States and Spain* is available at <https://avalon.law.yale.edu/19th_century/sp1898.asp> (Avalon Project, 2008).

sion of the United States and its economic circumstances and those of its inhabitants depend, to a large extent, on the decisions of the United States Congress in which Puerto Rico does not have full representation. The Island's situation at present is partially the result of these historical facts and their consequences.

Since the beginning of the 20th century, the economic and political relationship between Puerto Rico and the United States has been defined by a series of actions, decisions, initiatives, and organic charters. The first of the latter was the *Organic Act of 1900* (1900)—known as the *Foraker Act*. After approximately 20 months of military rule, the *Foraker Act* established a civilian government on the Island. Executive power was exercised by a governor and his cabinet appointed by the president of the United States.

This Act provided for the election of a non-voting resident commissioner of Puerto Rico to Congress, a figure who currently remains the only representative of the Island in the federal legislative branch. It also named the inhabitants of the Island citizens of Puerto Rico; substituted the provincial currency for the dollar; regulated Puerto Rico's commercial relations with the United States; made the laws of the United States applicable to Puerto Rico, except for internal revenue laws; and established a federal district court on the Island.

From 1901 to 1905, a series of decisions by the Supreme Court of the United States³ began to define Puerto Rico's legal status as an unincorporated territory under the plenary powers of Congress.⁴ In *Downes v. Bidwell* (1901) the Court established that Puerto Rico belongs to, but is not a part of, the United States. On March 2, 1917, Congress approved a new organic charter, known as the *Jones Shafroth Act* (1917) for Puerto Rico and the adjacent islands owned by the United States. This Act provided a Bill of Rights and conferred United States citizenship on the citizens of Puerto Rico. Congress granted Puerto Rico the right to draft its own constitution—subject to that of the United States—through the *Puerto Rico Federal Relations Act of 1950* (1950). This law did not alter the sovereign powers acquired by the United States over Puerto Rico under the Treaty of Paris of 1898, nor did it change the economic and political relations between the two. A constituent assembly on the Island drafted the Constitution of the *Estado Libre Asociado* [Associated Free State] of Puerto Rico,⁵ which was approved by the people on March 3, 1952.

The *Estado Libre Asociado* is a problematic name because Puerto Rico is neither a federal nor national “state”, since it is an unincorporated territory of the United States; it is not “free”, as it lacks the sovereignty to act according to its interests; and it is not “associated” because, not being free, it does not have the power to as-

3. These decisions of the Supreme Court of the United States are known as the Insular Cases. Torruella (2013) offers a perspective on these decisions and their scope.
4. Later, in cases such as *Califano v. Torres* (1978), *Harris v. Rosario* (1980), and *Puerto Rico v. Sánchez, Valle* (2016), the Supreme Court of the United States also reaffirmed the plenary powers of Congress over Puerto Rico, in accordance with the territorial clause of the Constitution of the United States; and confirmed that the entry into force of the Constitution of the *Estado Libre Asociado de Puerto Rico* did not alter the economic and political relationship.
5. The *Estado Libre Asociado de Puerto Rico* is called the Commonwealth of Puerto Rico in English; however, the accurate translation is Associated Free State of Puerto Rico, as indicated.

sociate with any nation-state. It is, therefore, a euphemism that disguises the reality that the Island continued to be a colony, with a delegated government subordinated to the plenary powers of Congress.

As a matter of fact, Congress exercised its faculties over Puerto Rico by introducing amendments to the constitution approved by the vote of the people, in various sections;⁶ one of these amendments was to Article VII, to ensure that no future amendment to the Island's constitution could alter the fundamental structures that defined the relationship between Puerto Rico and the United States. The amended constitution was approved by Congress, through *Public Law 447* (1952) signed by President Harry S. Truman on July 3, 1952.

Puerto Rico in Economic Freedom of North America 2022

There are significant variations among the US states⁷ in *Economic Freedom of North America* but the difference between them and the Island was unknown. The incorporation of Puerto Rico, as a territory of the United States, into the report was a pending matter. This depended on the determination and possibility of collecting the necessary data, and on the willingness of the coauthors of the report to include the Island. Both things happened in the course of the last year and, thus, the 2022 edition features Puerto Rico, for the first time.

The *Economic Freedom of North America* contains subnational (state and local) level variables on government spending, taxes, and labor market regulation. Data on the rule of law, sound money, freedom to trade, and most regulatory areas are either not available or not relevant to subnational jurisdictions. The report assumes that these are roughly equivalent within nations and subnational scores, and ranks are solely based on the variables for spending, taxes, and labour market regulation; however, they are clearly not equivalent across nations, so the all-government index adds variables from *Economic Freedom of the World*, giving each province or state the score in their nation's world data for these areas. For example, all Canadian provinces receive the Canadian national score on the index published in *Economic Freedom of the World*, again on the assumption of equivalence across Canada. Since this similarity between Puerto Rico and the 50 US states could not be assumed, we could not include it on the all-government index.

Incorporating Puerto Rico into *Economic Freedom of North America 2022* was important in order to have a benchmark to assess the situation of economic freedom on the Island. From the outset, the initiative faced two limitations that posed a challenge of measurement: first, a lack of data since *Economic Freedom of the World* does not include Puerto Rico; and second, the Island's weakness compared to the United States' averages in core areas such as rule of law and regulation. This laid out

6. Congress has continued to exercise its authority over Puerto Rico, such as when it decided not to return to the *Departamento de Hacienda* [Puerto Rico Treasury] the surplus taxes on rum produced on the Island, in 1984, in contravention of Section 9 of the *Federal Relations Act* of 1950.
7. That is, the 50 federated states of the United States.

the problem of whether or not to give Puerto Rico the international scores of the United States.

The question did not have a clear and simple solution since the limitations mentioned affect both the all-government index and subnational index. As noted, the all-government index gives the 50 US states the score of the United States as a country in the *Economic Freedom of the World* index and the subnational index assumes equality among the states—that the 50 US states have relatively similar scores for the areas covered only in the world report;⁸ the available data suggest this is not true for Puerto Rico (F. McMahon, personal communication, December 14, 2021). As a result, with the data currently available, we are only able to include Puerto Rico in the subnational index.

Bearing this in mind, the decision was made to collect comparable data from Puerto Rico for the 10 subnational variables, for the five most recent years of the index (2016–2020). This was a starting point to get a general idea of how Puerto Rico compared to the 50 US states. Although it would not be a perfect exercise, regardless of how the score would be adjusted, the data of these 10 variables were necessary as a first step; furthermore, after seeing how Puerto Rico fit in the subnational index, we would be able to determine the next step (D. Stansel and F. McMahon, personal communications, December 17, 2021).

Data

Puerto Rico is not efficient in producing and disseminating statistics; and requesting data from relevant agencies and institutions can be a complex and time-consuming process; for this reason, the available published economic and fiscal data were used. Data collection was based on the definitions and descriptions of the areas and components, as well as the methodological notes for each component for Canada, Mexico, and the United States included in the *Economic Freedom of North America 2020 and 2021*.⁹

Data for “Personal Income” and the components “General Consumption Expenditures by Government” (1A), “Transfers and Subsidies” (1B), “Insurance and Retirement Payments” (1C), and “Government Employment” (3Aii) were obtained from the Economic and Social Planning Area of the Planning Board (similar to the US Bureau of Economic Analysis). The data source for the “Income and Payroll Tax Revenue” (2A), “Top Marginal Income Tax Rate” (2B), and “Sales Taxes” (2D) components was the *Departamento de Hacienda* (similar to the US Treasury).¹⁰

8. McMahon also pointed out that, while most of the missing data are in the federal policy area, state or territorial governments also play a role in trade, rule of law, and regulation that can be just as important, if not more. Similarly, national scores for Canada and Mexico are assumed to apply across subnational jurisdictions in these nations.
9. The data of some variables were acquired directly from the sources used while others required elaboration based on the information in this annual report.
10. The Economic and Social Planning Area of the Planning Board and the *Departamento de Hacienda* are the main sources of economic information in Puerto Rico.

Other sources used were the US Census Bureau, for “Population”; the *Centro de Recaudación de Ingresos Municipales*, for the “Property Tax and Other Taxes” (2C) component; *LexJuris de Puerto Rico*, for the “Full-time Minimum Wage Income” (3Ai) component; and the Department of Labor and Human Resources (similar to the US Department of Labor), for “Employment” and the “Union Density” component (3Aiii); incidentally, data on 3Aiii were collected and published sporadically until 2015; since then, no institutional data have been published in Puerto Rico.

The creation of the dataset did not face different or greater challenges than those of a quantitative data-collection research project. A minor issue encountered was that some of the documents used as sources were in Spanish; in those cases, additional documents in English were identified, which helped the co-authors to contextualize and understand the component information provided.

The dataset included a Comments section with the following information about Puerto Rico and the data.

- The Government of Puerto Rico is considered a state government subject to the jurisdiction of the United States; it has fiscal autonomy to impose taxes, manage its budget, and issue debt; and receives funds from the federal government.
- In Puerto Rico, economic and fiscal data are presented mostly in fiscal years (July 1 to June 30).
- The variations in the economic and fiscal data from 2016 to 2020 represent the net effect of a set of economic events.
- In 2016, the Government of Puerto Rico declared itself unable to pay its debt. As a result, the US Congress enacted the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA),¹¹ which established a fiscal oversight board¹² to manage the Puerto Rico government’s fiscal crisis, while the latter restructures its debt.
- Under PROMESA, the Government of Puerto Rico filed for bankruptcy in 2017 and did not have to pay debt-servicing costs from 2017 to 2020 as it was in bankruptcy proceedings.
- In September 2017, the Island was struck by two hurricanes—Irma and María—that caused catastrophic damages.¹³ This interrupted production and billions of dollars were received from the federal government to mitigate damages and rebuild infrastructure.
- A series of earthquakes affected Puerto Rico in January 2020.
- Since March 2020, the Island has been affected by the COVID-19 pandemic.

11. The acronym PROMESA means promise in Spanish.

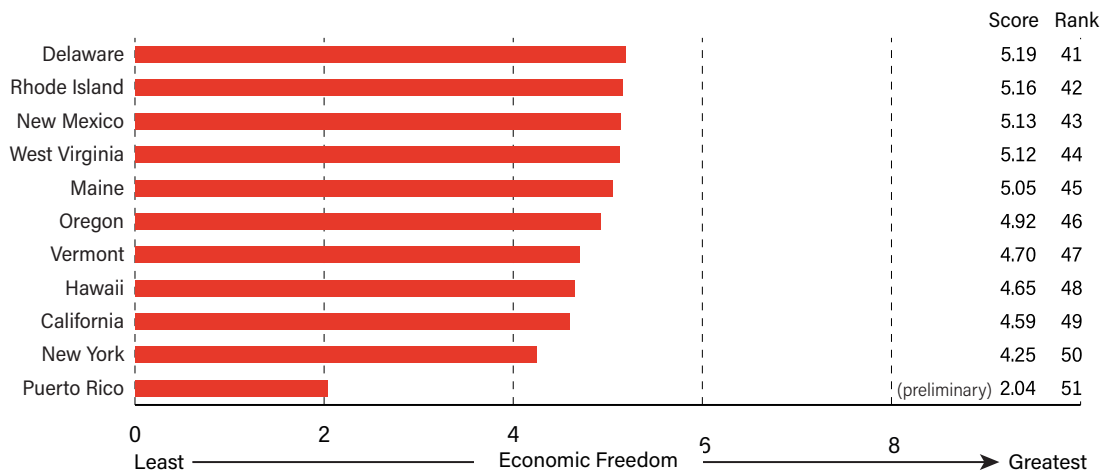
12. For Bevir (2010), the rule of law is usually defined in opposition to the arbitrariness typical of various forms of despotism, absolutism, authoritarianism, and totalitarianism, which are widely thought to be evils that the rule of law is supposed to curb. According to Bevir, these include even highly institutionalized forms of rule were atop the apex of a power structure sits some sovereign entity such as a *junta*. It is interesting, therefore, that this body is commonly called the “*Junta de Control Fiscal*” [Fiscal Control Junta] or simply the “*Junta*” by the people in general on the Island.

13. Puerto Rico experienced a historic migration loss a year after these hurricanes. About 133,500 people moved from the territory to the US states in 2018—up 36.9% from 97,500 movers the year before. The US states that received the largest number of Puerto Ricans were Florida, Pennsylvania, Massachusetts, New York, and Texas (Glassman, 2019).

Results

As discussed above, Puerto Rico is only included in the subnational index for the United States. The standardized scores on each variable are determined in part by the minimum and maximum values in a fixed base year (2005).¹⁴ Since we do not have data for Puerto Rico for that year, including this data in the index does not affect the scores of the 50 US states. The preliminary results rank Puerto Rico at 51st overall in this year's index, with a score of 2.04, based on data for fiscal year 2020. For comparison, the next lowest are New York at 50th with 4.25 and California at 49th with 4.59 (figure 3.1). Florida was the highest with 7.94.

Figure 3.1: Summary of the Ratings of Puerto Rico and the Bottom 10 US States for Economic Freedom at the Subnational Level, 2020



Puerto Rico also ranks 51st in all three Areas of the index. As table 3.1 shows, the Island is 51st on four of the ten variables, tied for last on three others, and 36th, 46th, and 1st on the other three.¹⁵ Looking further back, Puerto Rico is 51st in all five years. The Island's overall score declined steadily from 1.98 in 2016 to 1.14 in 2019, though its score of 2.04 for 2020 represents a substantial increase from that of 2019. The Island was 51st on all three Area scores for all but the first year of our data (2016), when it was 50th in Area 1, followed by Alaska.

Given Puerto Rico almost certainly scores well behind the United States on rule of law and related variables that we do not include in the subnational index, the preliminary scores understate the gap between Puerto Rico and the other US

14. See Appendix A (pp. 69–74) for further explanation of the methodology.

15. Regarding the “Union Density” variable (3Aiii) our data for Puerto Rico are for year 2014 (published on April 17, 2015), since more recent data were unavailable.

states in economic freedom.¹⁶ The subnational indexes do not contain explicit data on the rule of law and other key measures, which are assumed to be roughly the same within each nation, though that assumption does not hold for Puerto Rico. For that reason, Puerto Rico is not included in the all-government index, which has national-level variables for Canada, Mexico, and the United States.

Table 3.1: Economic Freedom in Puerto Rico, 2020

Areas and components	Data	Score	Rank
Area 1: Government Spending		2.34	51
1A: Consumption spending, % of personal income	16.2%	7.03	36
1B: Transfers & subsidies, % of personal income	10.0%	0.00	50*
1C: Insurance & retirement payments, % of personal income	6.8%	0.00	49*
Area 2: Taxes		0.46	51
2A: Income & payroll tax revenue, % of personal income	9.4%	0.00	51
2B: Top income tax rate	31.4%	0.00	51
<i>Top income tax threshold</i>	\$61,500		
2C: Property tax & other tax revenue, % of personal income	5.1%	1.82	46
2D: Sales tax revenue, % of personal income	7.0%	0.00	50*
Area 3: Regulation		3.33	51
3Ai: Minimum wage income, % of per capita personal income	69.7%	0.00	51
3Aii: Government employees, % of total employees	18.2%	0.00	51
3Aiii: Union density, % of total employees	6.2%	10.00	1

Note: * tied for last; no US state had a lower score.

16. For example, consider the indirect measure of the rule of law and efficient regulation in the *Doing Business* index (World Bank, 2020), now canceled. In the last edition of this report in 2020, Puerto Rico ranked 65th while the United States was 6th and Canada 23rd; thus, the assumption made for the other states and provinces, that they have roughly comparable scores to their national average, does not hold for Puerto Rico. Puerto Rico might be roughly comparable to Mexico, 60th in the *Doing Business* index.

Going forward

In the process of incorporating the Island in the report this year, ideas to increase the accuracy and adjust Puerto Rico's presence in the report began to emerge. Among the possible courses of action are, in general: (a) expand data collection to complement the absence of information on Puerto Rico in world indexes and reports; and (b), as F. McMahon suggested (personal communication, December 14, 2021), construct a scalar for Puerto Rico from the international data that includes the Island. On this, McMahon specifically proposed the following:

- Calculate Puerto Rico's scores for Area 2: Legal System and Property Rights in *Economic Freedom of the World* and other scores related to the rule of law in Area 4: Freedom to Trade (for example, non-tariff trade barriers, which may be a screen for corruption) and Area 5: Regulation (for example, extra payments), if enough data are available.
- Develop a ratio between the available relevant US and Puerto Rican scores and apply this ratio to relevant variables; this has several difficulties and two approaches:
 - Develop an overall ratio to be applied to the overall score leaving the individual variables blank.
 - Apply the ratio directly to the variables with data (if enough exist) and the others could be left blank or an overall ratio could be applied to them;¹⁷ *ergo*, if the Puerto Rico score on the based variable is 2/3 of the United States score, then the relevant variables from *Economic Freedom of the World* would be multiplied by 2/3 to get an estimate for the federal government part of Puerto Rico's score for *Economic Freedom of North America*. (Personal communication, August 30, 2022).

Additional data could show if the situation of economic freedom in Puerto Rico is even more precarious than what is reflected in this year's report and, thus, if the Island received a higher score than it should (J. Torra, personal communication, August 29, 2022). If this were the case, Puerto Rico's score and rank in the future would show the true size of the gap between the Island and the US states. These and other possible courses of action will be analyzed and determined in due course for *Economic Freedom of North America 2023*.

Effects of the lack of economic freedom in Puerto Rico

As hundreds of independent research papers have found, economic freedom tends to be positively associated with a variety of positive economic outcomes, including the level and growth of income. The lack of economic freedom in Puerto Rico stands at the center of the main socioeconomic issues facing its residents. For the last 70 years, Puerto Rico has had poor economic growth relative to the United

17. In this case it would be reported that Puerto Rico's scores for rule of law are more a "guess-timate" than an estimate and the procedure used would be explained.

States; and the gap between the Island and the US states has become increasingly wider. The expectation of converging with the richest jurisdictions in the United States did not materialize; on the contrary, instead of a convergence there has been a divergence—a distancing of the economy of the Island from that of the US states.

Puerto Rico has not been able to close the gap even with the poorest US states. The US Census Bureau (2021) reports that 43.4% of the people in Puerto Rico live in poverty while the official United States poverty rate was 11.4% in 2020 (Shrider, Kollar, Chen, and Semega, 2021). Mississippi, the poorest state, has a poverty rate of 18.7%, less than half of Puerto Rico's (US Census Bureau, 2021). Puerto Rico's per-capita income of \$13,318 in 2020 is barely half of Mississippi's \$25,444 (US Census Bureau, 2021, 2021). Additionally, with a Gini Index of 0.5448, the Island's income inequality is higher than that of any state, and of the District of Columbia, which is second with 0.5212 (US Census Bureau, 2020).

Puerto Rico has had a considerably low labor-force participation rate for decades. From 1990 to 2021, it averaged 44.52%, reaching an all-time high of 49.80% in February 2007 and a record low of 38.50% in October 2017 (International Labour Organization, 2022a). In the States and the District of Columbia, the average was 65.3% from 1990 to 2020 (International Labour Organization, 2022). Unemployment on the Island has been historically higher than in United States as well, with an average unemployment rate of 14.4% from 1976 to 2020.

The situation of Puerto Rico can be seen in the outbound net migration that the Island experienced from 2011 through 2020; in these years, it is estimated that 550,421 individuals migrated to the US states (Universidad de Puerto Rico, 2021). This is a significant figure taking into account that the population of Puerto Rico in 2020 was 3,285,874 (US Census Bureau, 2020). For Duany (2022), Puerto Ricans will probably continue to emigrate in large numbers as a result of the persistent economic hardships and the wage gaps between the Island and the US states. This pattern is consistent with the findings of previous research that population in-migration is positively associated with economic freedom.

Conclusion

The incorporation of Puerto Rico in *Economic Freedom of North America 2022* is a first attempt at assessing economic freedom on the Island. It was to be expected that Puerto Rico would compare poorly with any US state. Notwithstanding, this year's results confirm that; and—what is more important from a research point of view—the questions raised and the dialogue initiated during this process suggest that the Island's situation could be worse than what the scores and ranks indicate this year.

The precise state of economic freedom in Puerto Rico will only be known through the collection of additional data on the rule of law and related areas on the Island. The work carried out this year represents, therefore, a beginning and leaves

a task pending for the next cycle. For now, it is important to disclose this year's results to raise awareness about the dire situation of the territory both in Puerto Rico and in the US states—where more Puerto Ricans currently reside than on the Island.

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