

# ECONOMY

History repeats itself  
for the economy as well

THINK STRATEGICALLY:

## Same as it Ever was After 45 Years

Oil Crisis Brings Drastic Change in Fortune;  
Gov't Could Not Rely on Bond Issues to  
Finance Economic Development

BY FRANCISCO RODRÍGUEZ-CASTRO | frc@birlingcapital.com



### The 25 years of Operation Bootstrap ends

As we mark the 45th anniversary of Caribbean Business being founded as a weekly newspaper, we have dusted off some headlines from 1974 and, to our surprise, they fit right in with what is now happening. Let's examine the facts during that time. In 1974, Puerto Rico was marred in a period of economic contraction, record unemployment and uncertainty, and the island's prospects seemed bleak—all sound familiar today.

Then-Gov. Rafael Hernández Colón stated, "What has happened is that the vulnerability of our system has been exposed." The Puerto Rico economy had gone from being the poorhouse of the Caribbean to a success story. In the 1950s, the facts show Puerto Rico's gross domestic product was \$755 million and, by 1974, had grown to \$6.817 billion:

- With a growth rate that had been hovering at 6 percent per year, that went spiraling down to a contraction of minus-3.5 percent.

- Tourism, manufacturing and construction, all influential sectors of the

new economic boom in Puerto Rico, were all in trouble.

- Several hotels were on the verge of closing, and the occupancy rate went down to 45 percent.

- Construction permits had gone down 29 percent, and total employment in industry had plummeted by 23 percent.

- The initial result of this crisis was that north of 71 percent of all Puerto Ricans became dependent on U.S. federal food stamps.

- The unemployment rates in the towns of Jayuya, Adjuntas and Utuado were said to hit more than 80 percent.

What was behind such a drastic change in fortune for Puerto Rico was the impact of the oil crisis, which began in 1973. Puerto Rico had a well-developed oil industry with companies such as the Commonwealth Oil Refining Co. (Corco), PPG, Air Industries, Union Carbide and many others that had set up shop to process petroleum products on the island. By then, however, it was clear the petrochemicals industry would not produce the expected bonanza. Puerto Rico lost nearly \$500 million in its economy when oil prices

went skyrocketing.

In the process, a petrochemical plant built for \$1.6 billion between 1966 and 1972 was seen as the island's future economic model and became part of the many initiatives that crashed and burn. Since Puerto Rico did not have oil reserves, the prospects of revamping that industry were quickly abandoned. We can still see the ruins of that industry as we pass Guayanilla on PR-2.

In 1974, Fomento's efforts were to attract industries requiring increased technology, which was reflected with some success in attracting pharmaceutical and electronic companies to Puerto Rico. Teodoro Moscoso, Fomento

apparent back then that energy would be a strategic concern.

In 1974, there was an impact in the fiscal area because the government could no longer rely on bond issues for financing economic development. Alfredo Salazar, then-executive vice president of the Government Development Bank, said "Puerto Rico had been told it was "coming to the bond market with too much and too frequently." In addition, Guillermo Rodríguez Benítez, then-president of the Government Development Bank, had stated Puerto Rico's public debt had risen 233 percent and, compared to the gross national product (GNP), had risen 45 percent. When Rafael Hernández Colón became governor, Puerto Rico did not have access to the bond market.

The opinion of the rating agencies in 1974 was that a "rating of A1 on Commonwealth [general obligation] GO debt relies heavily on constitutional provisions, [which] makes debt service the first charge on available revenues. The debt burden is cumbersome, and borrowing has been frequent, raising concern, but the Commonwealth economy is still in the developmental stage. Incurrence, over the past two years, of deficits exceeding \$200 million has added to the debt and necessitated certain policy changes. Commonwealth has acted to alleviate financial distress by increasing taxes [and] cutting appropriations, and is preparing action to control future bond issuance. The A1 rating is being retained in recognition of the positive direction in which Commonwealth is attempting to move, but the success of planned actions remains to be demonstrated."

As we know, Puerto Rico was able to hunker down and the storm passed, and our economy became stronger than ever with the implementation of strict controls and the approval of Section 936.

Fast forward to 2018, our GDP has increased 898.10 percent in the past 45 years, from \$6.8 billion to \$68.0 billion. Sectors that were impacted, such as manufacturing, went from \$2.2 billion to \$47.8 billion in 2018. Puerto Rico's economic growth in the past 45 years shows Agriculture increasing 177.05 percent; Manufacturing 2073.52

Market Close Comparison	5/9/1974	5/9/2019	Change
Dow Jones Industrial Average	4,162.40	25,828.36	520.52%
Standard & Poor's 500	446.17	2,870.72	543.41%
Nasdaq	419.45	7,910.59	1785.94%
U.S. Treasury 10-Year Note	7.41%	2.45%	-66.94%

percent; Construction 70.84 percent; Transportation 58.74 percent; Retail 535.12 percent; Finance and Insurance 395.20 percent; and Services 1,430.15 percent. Although these growth numbers might lead you to believe Puerto Rico's economy is in a stable position, the fact is that it has a long road ahead to recover to its former glory. Keep in mind that average annual growth in real GNP since 1975 has been barely above 2.0 percent, hardly something to "write home about."

### Week in markets— 1974 vs. 2019: Never bet against the market

These past 45 years were very productive for the stock markets. The Dow Jones Industrial Average closed the first 45 years with a rise of 21,665.96 to close at 25,828.36, or a 520.5 percent increase. The S&P 500 closed at 2,870.72, with a gain of 2,424.72, or a 543.4 percent increase on May 9, 1974. The Nasdaq closed at 7,910.59, an increase of 7,491.14, or 1,785.94 percent. Meanwhile, the U.S. Treasury's 10-year note fell to 2.53 percent, from 7.41 percent on May 9, 1974, or a return of minus-65.86 percent. Investors that remained in the market since 1974 made an enormous amount of wealth, let's hope the next 45 years turns out to be as profitable, even with the U.S.-China trade war and Uber crashing post-IPO. The future looks quite good.

### Final word: CB 45 years as a voice for business

Caribbean Business marks its 45th anniversary this week with an extraordinary edition examining the paper's history and what the paper has stood for. Though initially conceived as solely a business newspaper, CB has become an integral part not only of the business community but also of the fabric of Puerto Rico. Caribbean Business coverage of the news is shaped by a belief that to understand and explain business trends, it is necessary to look at the people. The people who take risks every day, the dreamers, the entrepreneurs, the change agents, the ones who defy the odds and then merge these stories at the intersection of Corporate Responsibility, Integrity and Honesty while exposing us to matters that may seem remote from "business," but are very much influenced by them, even indirectly.

*Francisco Rodríguez-Castro, president & CEO of Birling Capital, has more than 25 years of experience working with government, and multinational and public companies.*



## Same as it ever was After 45 Years

May 16, 2019

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### Puerto Rico 45 Years Ago: The 25 years of Operation Bootstrap End

As we mark the 45th anniversary of Caribbean Business being founded as a weekly newspaper, we have dusted off some headlines from 1974, and to our surprise, they fit right in with what is now happening. Let's examine the facts, during that time in 1974 Puerto Rico was marred in a period con economic contraction, record unemployment, uncertainty, and the prospects of the Island seemed bleak, sounds familiar. Then Governor Rafael Hernandez-Colon stated, "What has happened is that the vulnerability of our system has been exposed." The Puerto Rico economy had gone from being the poor house of the Caribbean to a success story, in the 1950's Puerto Rico Gross Domestic Product was \$755 million, and by 1974 \$6,817 Billion, these are the facts:

- With a growth rate that had been hovering at 6% per year, went spiraling down to a contraction of (3.5%).
- Tourism, manufacturing, and construction influential stalwarts of the new economic boom in Puerto Rico were all in trouble.
- Several hotels were on the verge of closing, and the occupancy rate went down to 45%.
- Construction permits had gone down 29%, and total employment in the industry had plummeted by 23%.
- The initial result of this crisis was that north of 71% of all Puerto Ricans became dependent on Federal Food Stamps.
- The towns of Jayuya, Adjuntas, and Utuado the unemployment rate was said to hit more than 80%.

What was behind such a drastic change in fortune for Puerto Rico was the impact of the Oil Crisis, that began in 1973, Puerto Rico had a well-developed oil industry with companies such as CORCO, PPG, Air Industries, Union Carbide, and many others had set up shop to process petroleum products in Puerto Rico. Although by then it was clear that the petrochemicals industry would not produce the expected bonanza, Puerto Rico lost close to \$500 million of its economy when oil prices went spiraling up. In the process, a petrochemical plant built at the cost then of \$1.6 Billion that was built between 1966 to 1972 and was seen then as the

future economic model of the Island became part of the many initiatives that crashed and burn and, since Puerto Rico did not have then like now any oil reserves, the prospects of revamping that industry was quickly abandoned. We can still see the ruins of that industry as we pass Guayanilla in state road #2. In 1974, Fomento's efforts were to attract industries requiring increased technology was reflected some success in attracting pharmaceutical and electronic companies. Teodoro Moscoso Fomento's administrator would have been proud to know that we are still living off his success with the pharmaceutical industry. In 1974 Governor Hernandez Colon was responsible for the establishment of the Tobin Committee, the equivalent of today's FOMB, except that it was not imposed by the federal government. Its recommendations were very similar to the FOMB's and were implemented in 1975 and 1976, possibly causing the loss of the election by the Governor. Then-Secretary of the Treasury Salvador Casellas and others from Puerto Rico's financial sector came up with the Section 936 concept, and the Section became law in 1976. An interesting historical footnote is that Governor Hernández Colón created an energy policy committee in 1973 because it was apparent back then that energy would be a strategic concern.

In 1974 there was an impact in the fiscal area as the government could no longer rely on bond issues as it had before 1974 for financing economic development. Alfredo Salazar, then executive vice president of the Government Development Bank, said "Puerto Rico had been told it was "coming to the bond market with too much and too frequently." Also, Guillermo Rodríguez Benitez, then President of the Government Development Bank had stated that the Puerto Rico public debt had risen 233% and when compared to the GNP it had risen 45%. When Rafael Hernández Colón became Governor **Puerto Rico did not have access to the bond market.**

The opinion of the rating agency in 1974 was and we quote "Rating of A1 on Commonwealth G.O. debt relies heavily on constitutional provision making debt service the first charge on available revenues. The debt burden is cumbersome, and borrowing has been frequent, raising concern., but the Commonwealth economy is still in the developmental stage. Incurrence over the past two years of deficits exceeding \$200 million has added to the debt and necessitated certain policy changes. Commonwealth has acted to alleviate financial distress by increasing taxes., cutting appropriations., and is preparing action to control future bond issuance. The A1 rating is being retained in recognition of positive direction in which Commonwealth is attempting to move, but the success of planned actions remains to be demonstrated".

As we know Puerto Rico was able to hunker down and the storm passed, and our economy became stronger than ever with the implementation of strict controls and the approval of section 936. Enough with the 1974 crisis, we have compared how Puerto Rico has fared since 1974 to 2018, and you note some dramatic changes to our economy.

For instance, our GDP has increased 898.10% in the past 45 years, from \$6.8 Billion to \$68.0 Billion. Sectors that were then impacted like manufacturing went from \$2.2 billion to \$47.8 Billion in 2018. Puerto Rico's economic growth in the last 45 years shows Agriculture



increasing 177.05%, Manufacturing 2073.52%, Construction 70.84%, Transportation 58.74%, Retail 535.12%, Finance, and Insurance 395.20% and the Services sector 1,430.15%. Although these growth number might lead you to believe that Puerto Rico's economy is in a stable position, the fact is that our economy has a long road ahead to recover its former glory. Keep in mind that average annual growth in real GNP since 1975 has been barely above 2.0%, hardly something to "write home about".

<b>Puerto Rico Economy</b>	<b>1974</b>	<b>2018</b>	<b>Change</b>
<b>GNP</b>	\$ 6,817.80	\$ 68,048.70	898.10%
<b>Number of Persons per family</b>	4.5	2.8	-37.78%
<b>Total Employment</b>	744.0	971.0	30.51%
<b>Total Population</b>	2,881.0	3,260.0	13.16%
<b>Agriculture</b>	\$ 285.90	\$ 792.10	177.05%
<b>Manufacturing</b>	\$ 2,200.80	\$ 47,834.80	2073.52%
<b>Construction</b>	\$ 505.20	\$ 863.10	70.84%
<b>Transportation</b>	\$ 690.00	\$ 1,095.30	58.74%
<b>Retail</b>	\$ 1,261.20	\$ 8,010.10	535.12%
<b>Finance and Insurance</b>	\$ 913.30	\$ 4,522.70	395.20%
<b>Services</b>	\$ 734.10	\$ 11,232.80	1430.15%
<b>Total Government</b>	\$ 1,090.60	\$ 6,438.60	490.37%
<b>Central Government</b>	\$ 955.70	\$ 4,926.60	415.50%
<b>Municipalities</b>	\$ 134.80	\$ 1,512.00	1021.66%

### Week in markets: 1974 versus 2019, Never bet against the market

These past 45 years were very productive for the stock markets; The Dow Jones Industrial Average closed the first 45 years with a rise of 21,665.96 to close 25,828.36 or 520.5%. The S&P 500 closed at 2,870.72, with a gain of 2,424.72 or 543.4 percent, in May 9, of 1974, The Nasdaq closed at 7,910.59, an increase of 7,491.14, or 1,785.94 percent, Meanwhile, the U.S. Treasury's 10-year note fell to 2.53 percent from 7.41% in May 9, 1974, a return of minus-65.86 percent. Investors that remained in the market since 1974 made an enormous amount of wealth, let hope the next 45 years turn out to be as profitable, even with the U.S.-China Trade war on again and with Uber crashing post IPO. The future looks quite good.

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President & CEO

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