

Puerto Rico's governance problem

During the last few years economists and non-governmental institutions have studied the link between governance and economic performance. According to the World Bank, governance consists of the traditions and institutions by which authority in a country is exercised. This includes "the process by which governments are selected, monitored and replaced; the capacity of the government to effectively formulate and implement sound policies; and the respect of citizens and the state for the institutions that govern economic and social interactions among them."

In this column we will analyze the second element of the World Bank's definition, namely the capacity of Puerto Rico's government to effectively formulate and implement sound policies. It is obvious, even to a casual observer, that our government's capacity to formulate and implement sound policies has been severely weakened during the past two or three decades. Enacting even the most basic of laws, or implementing simple common sense policies is bound to become a bitter, drawn-out affair.

These difficulties can be partly explained by what social scientists call "rent-seeking" behavior. "Rent-seeking" is defined as the pursuit of uncompensated value from other economic agents; in contrast with profit-seeking, where economic agents seek to create value through mutually beneficial economic activity. Lobbying for the imposition of a tariff or for obtaining a special economic privilege from government are classic cases of rent-seeking behavior. In Puerto Rico we can observe rent-seeking behavior at two levels. First, special interest groups of all kinds organize to nibble away at the welfare state. Second, the Puerto Rican government itself could be said to engage in rent-seeking vis-à-vis the federal government. Let's take a look at each of these phenomena.

For centuries, different social groups have organized to obtain favors from the ruling class and, until fairly recently, obtaining special privileges from government was the only way to get ahead in many societies. Adam Smith strongly criticized this practice in his seminal work "The Nature and Causes of



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the Wealth of Nations" (1776) when he argued against the then prevailing mercantilist economic system in general and the practice of granting government-sanctioned monopolies to favored subjects in particular. Some economic historians go so far as to claim that Smith's criticism of the British economic system laid the groundwork for the Industrial Revolution, as economic agents ceased to dedicate resources to curry favor with the Crown and instead invested them in productive endeavors.

It is difficult to overstate the damaging effects of rent-seeking behavior on economic development. For example, up to 1750 there was no appreciable difference in the living standards of Eastern and Western societies. In fact, Jesuit missionaries returning from China thought it had a higher level of civilization than Europe prior to the late 18th century. China, however, was organized as a classic rent-seeking society, where everything depended on the whims of the emperor and where currying favor with the ruling class was essential for getting ahead. So while Western Europe was moving away from this type of society and turning to one where getting ahead depended on production, not rent-seeking, in China, equally talented people were instead engaged in seeking special privileges.

Puerto Rico in 2010 has become the quintessential rent-seeking society. Economic activity is dominated by the government and, as in 18th century China, different social groups have organized to obtain special privileges from the government and to redistribute economic benefits to their respective groups. Indeed, the labyrinthine structure of our government, with its manifold executive departments and its lack of accountability, oversight and transparency, comes fairly close to the old court of the Chinese

emperors.

It should not be surprising that this environment has proven to be a greenhouse for competing rent-seeking groups. Among these groups we find a whole host of "private sector" suppliers of goods and services that compete to obtain special favors from the government. Their methods are subtle, usually involving a quiet lunch with a legislator at a fancy San Juan restaurant, a discreet telephone call to a well-placed aide at La Fortaleza or a generous campaign contribution, and perhaps because of this subtlety, they are all the more effective. It could be argued that the principal objective of politics in Puerto Rico is to be elected so as to be able to transfer public wealth to family and friends, through contracts and government jobs.

In addition, Puerto Rico's central government behaves as one giant rent-seeking special interest group with respect to the federal government. The imperative seems to be to obtain federal funds at all costs, regardless of the real administrative needs of the agency. The result is that many agencies in Puerto Rico are run mainly to comply with federal requirements and regulations to keep the money flowing, instead of being run to address the real needs of the public.

The costs associated with rent-seeking behavior in Puerto Rico are enormous. Untold millions are wasted on efforts to obtain special privileges from government. Many "businessmen" spend more time lobbying government for special treatment than running their companies; just like many government agency heads spend more time seeking money from the federal government than running their agencies and serving the public. Both kinds of behavior are the product of centuries of colonialism, but if we want our government to effectively formulate and implement sound policies, we have to dismantle the existing Byzantine system of special privileges, reward investment in productive activities, and wean agency heads away from their addiction to federal funds.

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