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Commentary: Puerto Rico's Billionaires Strategy

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Recently relocated millionaires are a happy lot in Puerto Rico. Their lifestyle was a selling point in an April investors' summit dedicated to luring financial sector firms and wealthy individuals to the island in exchange for exemption from United States taxes and a light local touch.

It's not hard to empathize with their optimism. If Puerto Ricans faced a 4% top marginal tax rate, they would surely be quite happy. They would feel optimistic if they could afford to send their children to one of a handful of excellent preparatory schools that are testament to what financial resources, parental involvement, clear goals and accountability can achieve.

They would be on their way to becoming billionaires or at least millionaires if they could buy assets at a fraction of the cost taxpayers paid to remodel them. They would be over the moon if invited to a private function by one of the world's great opera singers.

But life at the bottom 99.9% is another story. A middle class self-employed Puerto Rican faces a top tax rate of 48% when both local and Social Security taxes are taken into account. Corporations face even higher taxes, with Walmart declaring an average tax rate of over 70% and other businesses paying even more.

The average Puerto Rican household would need to devote half of gross income to send a single child to a top preparatory school. It would most certainly not be able to walk a child to school through the streets of El Condado, as suggested in a testimonial during the investors summit.

Rather, parents would have to wake up at five or six in the morning in order to beat gridlock traffic and get the student to a mediocre school in time for homeroom.

Local business owners would get few tax breaks and survive in spite of a government that provides few services but demands much in return.

Like it or not, getting wealthy individuals to move to the island in order to avoid U.S. taxes appears now to be a cornerstone of Puerto Rico's growth drive and is characteristic of the country's eternal search for a quick and painless way to grow. Contrary to most other initiatives — many gathered through an Internet suggestion box — this one is in fact based on sound economics.

Although it does nothing to abate the outflow of talented Puerto Ricans, it builds productive capacity by attracting in-migration of stateside residents. Even better, the strategy does not cost the commonwealth one single penny since it is entirely financed by the U.S. Treasury through foregone taxes.

It is then similar in effect to a law enacted in 2011 charging a tax that manufacturing sector firms can deduct from their U.S. liabilities. Puerto Rican officials have become quite adept at diverting income from the U.S. Treasury to the Puerto Rican Treasury.

Even more interesting is the strategy's distributive dimension. Every time a billionaire moves to Puerto Rico, inequality in the U.S. goes down while the opposite happens in the commonwealth, with consequences that are still far from well understood.

In a democracy each man and woman may be entitled to a single voice and vote, but some voices are louder than others. Some pointed out in the recent investors' summit that statistics do not reflect their view of the performance of the island's economy. Furthermore, they have suggested that indexes be changed to reflect such views.

Yet, official statistics paint a consistently bleak picture of the Puerto Rican economy. Yes, unemployment has fallen for three consecutive months, but so has employment. According to the same household survey, it is down 20% from a peak in 2006 and has declined every month without exception since mid-2012.

Sales tax collections are often offered as signs of economic recovery, but they are rarely corrected for inflation and do not account for expansions of their tax base. Likewise, overall tax-intake announcements do not come with warnings of one-time tax events and sharp hikes in corporate rates that are not sustainable over the long or medium term.

Most striking is the statistic that concerns the number of Puerto Ricans who have voted with their feet and chosen to move to the U.S. mainland in search of a better life. Just in the past three years, the equivalent of 4% of the population has opted for that way out. Middle class Puerto Ricans go north while U.S. millionaires and billionaires take their jets south.

The United States government does a disservice to the Puerto Rican people when it turns a blind eye to the back-door bailout it provides through the billionaire and manufacturing tax loopholes — the latter already accounting for over 20% of public revenues. It allows the commonwealth to avoid the politically costly reforms it must undertake if the island is to survive as a viable economic entity.

Both the tax code and the welfare state must be reformed to reward work and investment. Public schools need to provide education and not just jobs for potential voters. Utilities and other monopolies must be broken down or effectively regulated. This is what the island needs.

Unnecessary are cheerleaders or an Uncle Sam with deep pockets but a short attention span. If the U.S. government really wants to give us a hand, please do continue with the bailout, but demand reforms in return. Life in Puerto Rico is sweet at the top, now let's work on the other 99.9%.

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