

# THE FIRST PRIVATIZATION POLICY IN A DEMOCRACY: SELLING STATE-OWNED ENTERPRISES IN 1948-1950 PUERTO RICO.

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**Abstract:** : In the 1940s, when the Governor of Puerto Rico was appointed by the US President and the Puerto Rican government was answerable only to the US Federal government, a large state-owned enterprise (SOE) sector was established on the island. Public services such as water, transportation and energy were nationalized, and several new manufacturing SOEs were created to produce cement, glass, shoes, paper and chalkboard, and clay products. These enterprises were created and managed by government-owned corporations. Later on, between 1948 and 1950, under the island's first elected Governor, the government sold these SOEs to private groups. This paper documents both the creation and the privatization of the SOE sector in Puerto Rico, and analyzes the role played by ideology, political interests, and economic concerns in the decision to privatize them. Whereas ideological factors might have played a significant role in the building of the SOE sector, we find that privatization was driven basically by economic factors, such as the superior efficiency of private firms in the sectors where the SOEs operated, and by the desire to attract private industrial investment to the Puerto Rican economy.

**Keywords:** Public enterprise, Privatization, Industrial policy, Puerto Rico.

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## **THE FIRST PRIVATIZATION POLICY IN A DEMOCRACY: SELLING STATE-OWNED ENTERPRISES IN 1948-1950 PUERTO RICO.**

Privatization is a policy that has been implemented all over the world in recent decades.<sup>1</sup> In regions such as Europe and Latin America privatization has been characterized primarily by the sale to the private sector of government-owned firms and assets.<sup>2</sup> In other regions where public ownership of firms was not as common, such as North America, privatization has mainly taken the form of contracting out services previously delivered by the government to the private sector.<sup>3</sup> Most Economics and Public Policy scholars consider the privatizations in Chile (1970s-early 1980s) and the United Kingdom (1980s-early 1990s) as the first privatization policies in modern history.<sup>4</sup> Others argue that the first privatization operation was the denationalization of steel in the UK in 1953,<sup>5</sup> and a few scholars identify the partial sales of state-owned enterprises in Germany under Adenauer's government (late 1950s-early 1960s) as the first large-scale privatization program.<sup>6</sup> However, recently published works document and analyze a large-scale privatization policy in 1930s Germany, under Hitler's government.<sup>7</sup> Indeed, between 1934 and 1937, the Nazi regime privatized almost all the firms that had been taken over by the Weimar government in the early 1930s during the Great Depression.

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<sup>1</sup> Roland, "Private and public ownership", p. 9.

<sup>2</sup> Bortolotti and Milella, "Privatization in Western Europe", p. 33; Estache and Trujillo, "Privatization in Latin America", p. 136; Hanousek, Kočenda and Svejnar, "Privatization in Central and Eastern Europe", p. 85; Kay and Thompson, "Privatisation", p. 18; Vickers and Yarrow, *Privatization*, p.7.

<sup>3</sup> Donahue, *The privatization decision*, p. 3; Sappington and Stiglitz, 'Privatization', p. 567; Savas, *Privatization*, p. 3. Public services have been contracted out to the private sector in many developed countries.

<sup>4</sup> Bortolotti and Milella, "Privatization in Western Europe", p. 32; Estache and Trujillo, "Privatization in Latin America", p. 136; Yergin and Stanislaw, *Commanding heights*, p. 115.

<sup>5</sup> Burk, *First privatization*; Megginson and Netter, "History and methods", p. 31.

<sup>6</sup> Megginson, *Financial economics*, p. 15; Schipke, *Why Do Governments Divest?*, p. 50.

<sup>7</sup> Bel, "The coining of 'privatization'", and "Against the mainstream".

Contemporary economic analyses of privatization have so far failed to take into account an important, early case of large-scale privatization: the one carried out by the first democratically elected Governor of Puerto Rico in the late 1940s, which appears to have been the first large-scale privatization policy implemented in a democratic regime.<sup>8</sup> A number of studies in the 1950s<sup>9</sup> and 1960s<sup>10</sup> analyzed industrial and administrative policy in Puerto Rico, and noticed the sale of the state-owned enterprises by Luis Muñoz Marín's government between 1948 and 1950 but, perhaps unexpectedly, the modern literature on privatization totally ignores this early privatization experience. Even more surprisingly, the recent literature on the twentieth-century Puerto Rican economy and the history of the island's industrial policy either has nothing to say on the subject or mentions it only in passing.<sup>11</sup>

Within two years of the first democratic gubernatorial election in Puerto Rico in 1948, the government of the *Partido Popular Democrático* (the Democratic Popular Party) had privatized all manufacturing state-owned firms. These firms belonged to a wide range of sectors: cement, glass, shoes, paper and chalkboard, and clay products. The enterprises which were transferred to the private sector had been created during the 1940s in an attempt to promote industrialization and had been managed by the island's government, still under the tenure of Governors

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<sup>8</sup> I am aware of one previous privatization operation (with transfer of full control to the private sector) implemented by a democratic government: In 1928 the Australian government sold a fleet of cargo ships that had been purchased during World War I to a private company (Neville, *Denationalisation*, pp. 18-19). This operation, which was in fact a reprivatization, was a single measure and it was not implemented within the framework of a wide privatization policy.

<sup>9</sup> Baer, "Puerto Rico", p. 649; Chase, *Operation Bootstrap*, p. 22; Lewis, "Puerto Rico", p. 625; Ojuda, *The industrial development program*, pp. 139-141; Ross, "Gordon Lewis", pp. 88-90.

<sup>10</sup> Goodsell, *Administration of a revolution*, p. 179; Ross, *The Long Uphill Path*, pp. 108-117.

<sup>11</sup> Curet, *Puerto Rico*; Curet Cuevas, *Economía política*; De Jesús Toro, *Historia económica*; Irizarry Mora, *Economía de Puerto Rico*. One relative exception is Dietz's *Economic History*, published in 1986. This book briefly describes (pp. 215-216) the basic characteristics of the sale of state-owned firms. To do so, Dietz follows (and credits) the earlier account by Ross, *The Long Uphill Path*, but does not add any original research or further analysis.

appointed by the President of the United States. The decision to establish a state-owned manufacturing sector was taken within the pre-War and wartime context, when the growing tension and subsequent hostilities profoundly affected maritime transportation and commerce in the Caribbean, particularly between 1942 and 1944.

In 1939, *Cementos de Puerto Rico* (the Puerto Rico Cement Company) had begun operations and had become the island's largest industrial factory at that time. Built by the Puerto Rico Reconstruction Administration, this plant was transferred to the Island Government on May 11, 1942.<sup>12</sup> From 1942 onwards, five more manufacturing corporations were created. Four of them built factories and began commercial operations between 1945 and 1947: the Puerto Rico Glass Corporation, the Puerto Rico Pulp and Paper Corporation, the Puerto Rico Clay Products Corporation, and the Puerto Rico Shoe and Leather Corporation.<sup>13</sup> All these firms, including the cement plant, were later privatized, between 1948 and 1950.

The nationalization of existing public services companies (such as water, transportation and energy) and the creation of state-owned enterprise sectors was an important policy decision in Puerto Rico in the early 1940s. Nationalization and the expansion of the SOE sector were common in other countries in Latin America during the decade, but Puerto Rico was alone in reversing the trend and developing a policy of privatization of the state-owned manufacturing firms in the late 1940s; in fact, in the post-War period no other country in the world engaged in such a policy until 1959,<sup>14</sup> when Adenauer's Germany embarked on a privatization program which would last six years (although on a smaller scale than that applied in Puerto Rico, since

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<sup>12</sup> PRDC, *Annual Report 1944*, p. 27.

<sup>13</sup> In the case of the sixth subsidiary, Telares de Puerto Rico, inc., operations never actually started (PRIDCO, *Annual Report....1951*, p. 27)

<sup>14</sup> As mentioned above, Churchill's government reprivatized the steel in the United Kingdom in 1953, but this was a single operation intended to reverse the nationalization implemented by the Labour government in the late 1940s. No large-scale privatization policy was implemented besides the reprivatization of steel.

only three firms were partially privatized).<sup>15</sup> Therefore, a central question remains to be answered: Why did the Puerto Rico government depart from the mainstream policies regarding State ownership in the post-World War II era, and why did the government transfer state-owned manufacturing firms to the private sector?

Answering these questions requires an analysis of the objectives of the country's privatization scheme. Some of the contemporary analyses written in the 1960s are valuable,<sup>16</sup> but the authors of these studies lacked the theories, concepts, and tools supplied by recent literature. Theoretical developments have provided valuable hypotheses on the motivations of politicians choosing between public ownership and privatization<sup>17</sup> and have identified different objectives linked to privatization policies:<sup>18</sup> On the one hand, both the theoretical and the empirical literature have provided interesting results regarding the use of privatization to obtain political support,<sup>19</sup> and on the other international evidence shows as well that financial motivations have been a key factor in recent privatizations.<sup>20</sup>

This paper intends to fill a gap in the current economic literature by tracing the course of privatization in 1948-1950 Puerto Rico through a study of Muñoz Marín's personal archive (only

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<sup>15</sup> These firms were Preussag 1959, Volkswagen in 1961 and VEBA in 1965 (Schipke, *Why Do Governments Divest?*, p. 50).

<sup>16</sup> Particularly Ross, *The Long Uphill Path*, pp. 108-117, written in 1960 and first published in 1966, which is the only thorough description of the sale of the state-owned enterprises in Puerto Rico.

<sup>17</sup> Bel and Calzada, "Privatization"; Boycko, Shleifer, and Vishny, "A theory of privatization"; Shleifer and Vishny, "Politicians and firms".

<sup>18</sup> Vickers and Yarrow, *Privatization*; Vickers and Yarrow, "Economic perspectives".

<sup>19</sup> Bel and Fageda, "Factors explaining"; Biais and Perotti, "Machiavellian privatization"; Bortolotti, Fantini, and Siniscalco, "Privatisation around the World"; Perotti, "Credible privatization".

<sup>20</sup> Bortolotti and Milella, "Privatization in Western Europe"; Yarrow, "A Theory of Privatization".

accessible after the Fundación Luis Muñoz Marín was created in 1980),<sup>21</sup> and documentation of the Puerto Rico Industrial Development Company, which only became available after they were donated to the Fundación Luis Muñoz Marín in December 2008. The analysis of privatization in Puerto Rico suggests that the objectives pursued by the island government were mostly related to economic concerns. One key factor was the much higher level of efficiency achieved in comparable private firms on the island, and another was the desire to enhance Puerto Rico's ability to attract private capital (particularly from continental US) to invest in industries. In contrast, fiscal objectives do not seem to have been an important issue in the decision to privatize; nor did strong ideological or political motivations play a significant role.

The rest of the paper is organized as follows. First, I sketch the background to the study with a brief description of pre-World War II Puerto Rico and document the building of the Puerto Rico SOE sector. Next, I examine the privatization process and its results. After this, I analyze the objectives of privatization policy in Puerto Rico. Finally, the main conclusions are drawn.

### **PUERTO RICO IN THE INTER-WAR ERA**

During practically all the first half of the twentieth century, the President of the US appointed the Governor of Puerto Rico and the leading figures of the island's government. After 1917, the island's voters democratically elected the Puerto Rico Legislature (Senate plus Lower House). The President of the Senate was the main local policymaker, and enjoyed substantial power, although the US Congress retained the last word regarding the legislation passed in the Puerto Rico Legislature. The island's Governor was answerable only to the US President, but needed to negotiate with the Puerto Rico Legislature in order to pass legislation and to appropriate budget funds for implementing the government programs. Although civil law in Puerto Rico retained

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<sup>21</sup> Within Muñoz Marín's personal archive held by the Fundación Luis Muñoz Marín, the following sources have been particularly useful: Section IV, Series 2 [(a) personal correspondence; (b) Data and statistics]; Section V, series 16 (Statistics and Economic reports].

features inherited from the legal tradition of the Spanish colonial period, the legislation regulating the economy was basically the same as in the US.<sup>22</sup>

Within the policies implemented under Roosevelt's New Deal, in August 1933 the Puerto Rican Emergency Relief Administration (PRERA) was set up to provide economic assistance to alleviate the desperate state of the Puerto Rican economy, and to spend its funds on direct relief or work relief. PRERA was soon followed by the Puerto Rico Reconstruction Administration (PRRA), created to implement the proposals in the report produced by the Puerto Rico Policy Commission in 1934, known as the Chardón Plan.<sup>23</sup>

Among the many activities undertaken by the PRRA, one was of special relevance to our study: the construction of a cement plant, the Puerto Rico Cement Company. Ernest Gruening, Director of Territories in the Federal Government and Administrator of the PRRA, had pushed strongly for the project of building a cement factory on the island since the mid-1930s.<sup>24</sup> At that time, cement production in the US was falling behind demand, because of the implementation of several Federal programs, and particularly the Federal Housing Authority. Because of this, cement prices in Puerto Rico were growing rapidly.<sup>25</sup> As the island's government lacked the

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<sup>22</sup> Several specific differences existed, nonetheless. For instance, the federal regulation on minimum wage was not binding in Puerto Rico after 1940, because of the disastrous consequences caused by the initial application to the island of the earliest Federal minimum wage law, the Fair Labor Standards Act, approved in 1938 (Ross, *The Long Uphill Path*, pp. 42-43). Also, the island taxpayers were exempt from paying Federal Income Tax. Correspondingly, Puerto Rico did not automatically benefit from the Federal Programs of public expenditure.

<sup>23</sup> After the name of Carlos Chardón, Chancellor of the University of Puerto Rico. Ross, *The Long Uphill Path*, pp. 28-39, provides details on PRERA and its inheritor agency, the PPRA.

<sup>24</sup> Mathews, *Puerto Rican Politics*, p. 242.

<sup>25</sup> In the island the price of cement increased by 67% through the 1930's, from US\$1.75 per barrel (average price between 1930 and 1935) to US\$2.92 in 1939 (Baralt, *La vida*, pp. 123-124). Regarding the decision to build a cement plan in Puerto Rico, Rodríguez Beruff (*Strategy*, p. 366), emphasizes as well the importance of the preparations for war and the strategic character of Puerto Rico, which led to the building of large military facilities in the island.

funds to build the cement plant, the PRRA undertook the enterprise with federal funds.<sup>26</sup> The Puerto Rico Cement began commercial operations in January 1939, and became the first non-agricultural heavy industry in Puerto Rico.

### **THE BUILDING OF THE STATE-OWNED ENTERPRISE SECTOR**

A crucial change came with the appointment of Rexford G. Tugwell as Governor of Puerto Rico in September 1941. A former professor at Columbia University, Tugwell had served as Undersecretary in the Department of Agriculture in Roosevelt's first New Deal Government. At that time, he had visited Puerto Rico, and on his return he prepared a report for President Roosevelt, in April 1934. Among other proposals, the report included two of special interest here: (1) The possibility of socializing the sugar industry in Puerto Rico, and running it by means of a government corporation; and (2) the establishment of light domestic industries: bottles, cement, rayon, cellulose products, sugar refining, rum, and furniture.<sup>27</sup> Indeed, Tugwell's view of the transformation of Puerto Rico was that industrialization would not occur unless the government took the initiative. This continued to be his approach when he became Governor at the end of the summer 1941; throughout his tenure, he made concerted efforts to promote a policy of government-induced industrialization.<sup>28</sup> Indeed, Tugwell made his intentions very clear in his earliest speeches to the Puerto Rico Legislature.<sup>29</sup>

On November 18, 1941, Tugwell appointed Teodoro Moscoso as coordinator of the island's affairs, and his only Spanish-speaking aide. Moscoso was to play a crucial role in the industrialization program soon to begin.<sup>30</sup> To improve Tugwell's relationship with the Puerto

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<sup>26</sup> Maldonado, *Teodoro Moscoso*, p. 27.

<sup>27</sup> Matthew, *Puerto Rican Politics*, p. 162.

<sup>28</sup> Tugwell, "What next for Puerto Rico", p. 147.

<sup>29</sup> Tugwell, *Message to the Fifteenth Legislature*, p. 58.

<sup>30</sup> Maldonado, *Teodoro Moscoso*, provides a detailed and excellent account of Moscoso's key role in the Puerto Rico public policy in that period.



Rico Legislature, he forged an alliance with Luis Muñoz Marín,<sup>31</sup> who had obtained the powerful position of President of the Senate (the highest post that a Puerto Rican politician could hold) after the November 1940 election. In the 1940 electoral campaign Muñoz Marín's Partido Popular Democrático (PPD) had pledged to place primary emphasis on the issues related to economic reform, instead of the traditional discussion of the island's political status. A majority in the Legislature was in favor of economic reform,<sup>32</sup> and Tugwell was able to pass the legislation required to create the legal framework for the government-induced industrialization policy. The key step was the approval by Act No. 188 (May 11, 1942) of the Law of the Development Company. According to Tugwell: "Intentions with the law for the Development Company were clearer at outset.... wide authorization to go into business was provided."<sup>33</sup>

The Puerto Rico Development Company (PRDC henceforth; in 1946 it was renamed the Puerto Rico Industrial Development Company, PRIDCO thereafter) was organized following the lines of the Chilean Development Company, which had been created several years before.<sup>34</sup> Moscoso was appointed general manager of the PRDC on September 30, 1942, and the company began operating in October. Its first and main factory was the cement plant, with assets of around US\$2,000,000.<sup>35</sup> The common stock participation of the island's government in this

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<sup>31</sup> Carr, *Puerto Rico*, pp. 65-66; Goldsmith, Clavel and Roth, "A bibliography", 144; Maldonado, "Tugwell", p. 3.

<sup>32</sup> However, the margin of the PPD's victory in 1940 was extremely narrow. The PPD obtained a majority of one vote in the Senate. In the lower house, the PPD and the Coalition between the Republican Party (pro-statehood) and the Socialist Party obtained 16 seats each. A third party, Unification (Liberal), gained three. Data on Senatorial and Representative Districts for 1940 (as well as for 1944 and 1948, below) have been obtained from the Biblioteca Virtual de Puerto Rico ([http://eleccionespuertorico.org/mapas/index\\_es.html](http://eleccionespuertorico.org/mapas/index_es.html), accessed on June 2, 2009).

<sup>33</sup> Tugwell, *The stricken land*, p. 263.

<sup>34</sup> Moscoso, "Industrial development", p. 60.

<sup>35</sup> PRDC, *Annual Report 1944*, p. 30.

venture was transferred to PRDC in late 1943,<sup>36</sup> and thereafter the federal participation was paid in full out of the profits.<sup>37</sup>

Besides PRDC, two other key agencies for the development program were created in 1942: the Puerto Rico Planning Board, and the Government Development Bank. Other sector-related agencies were created between 1941 and 1945:<sup>38</sup> The Water Resources Authority,<sup>39</sup> the Transportation Authority, the Communications Authority, the Insular Sewerage Service, and the Puerto Rico Aqueduct Service.<sup>40</sup> Thus, the institutional framework needed to develop the policy of government-induced industrialization had been put in place.

It should be stressed that all public enterprises established by the Tugwell administration were organized as independent public corporations; they were legally incorporated, intended to be financially self-sufficient, and were administratively outside the regular departments and agencies of the bureaucracy.<sup>41</sup> In line with this modern approach to public management of commercial firms, Moscoso – the general manager of the PRDC – worked hard to make the PRDC’s operations profitable, and soon demanded that services that were provided free should be separated from the company’s general services.<sup>42</sup>

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<sup>36</sup> Descartes, *Financing Economic Development*, p. 4.

<sup>37</sup> Moscoso, “Industrial development”, p. 60.

<sup>38</sup> Baer, “Puerto Rico”, p. 647.

<sup>39</sup> This agency, which produced electric power, was created before Tugwell was appointed Governor (Dietz, *Economic History*, p. 187).

<sup>40</sup> These last two concerns merged in 1945 forming the Aqueduct and Sewer Authority (Goodsell, *Administration of a revolution*, p. 189).

<sup>41</sup> Goodsell, *Administration of a revolution*, p. 183.

<sup>42</sup> Moscoso, *Letter to Rexford Tugwell*, June 30, 1945. Muñoz Marín soon endorsed Moscoso’s view. In a speech broadcast on August 20, 1945 (“Sobre las empresas públicas y el desarrollo de las estructuras económicas del gobierno de Puerto Rico”), he stated that activities employing workers must be split in two parts: (1) private and government owned firms (being the functioning and financing of these last ones similar to that of the private firms); and (2) the properly governmental services, paid for with fiscal revenues (Muñoz Marín, *Palabras*, p. 87).

In the following years, the newly created agencies took over several privately owned utilities. In January 1944 the Puerto Rico Water Resource Authority took over the Puerto Rico Railway Light and Power Company and the Mayagüez Light Power and Ice Company, bringing all electric power utilities in Puerto Rico under its control.<sup>43</sup> Later the Transportation Authority took over the urban transport system in San Juan, as the private system was collapsing and no private group was in a position to revive it.<sup>44</sup> Even though it took longer to implement, this policy can be seen as similar to the ones applied in many US states and municipalities in the late nineteenth and early twentieth centuries, a period characterized by a progressively greater involvement of governments in the delivery of local services.<sup>45</sup> Indeed, in that period there was a noticeable trend toward increased public ownership of local energy suppliers,<sup>46</sup> municipal water networks,<sup>47</sup> and solid waste collection suppliers.<sup>48</sup>

What was really exceptional in the Puerto Rico economic policy in the 1940s was the fact that the PRDC created new manufacturing plants, which were built and run by government corporations. Soon after the PRDC began operating, the decision was taken to build a glass container factory, and the Puerto Rico Glass Corporation (PR Glass, henceforth) was incorporated on February 24, 1943.<sup>49</sup> The construction of the glass factory began in May 1943, and the forecast cost was US\$2,000,000.<sup>50</sup> After a total investment of US\$3,026,000, much higher

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<sup>43</sup> Lugo-Silva, *The Tugwell Administration*, pp. 83-84; Richardson, *Puerto Rican*, p. 113.

<sup>44</sup> Tugwell, *Message to the Sixteenth Legislature*, p. 44.

<sup>45</sup> Gómez-Ibáñez, *Regulating infrastructure*.

<sup>46</sup> Troesken and Geddes, "Municipalizing American waterworks", p. 376.

<sup>47</sup> Gómez-Ibáñez, *Regulating infrastructure*, p. 160.

<sup>48</sup> Melosi, *Garbage in the cities*, p. 154.

<sup>49</sup> PRDC, *Annual Report 1944*, p. 13.

<sup>50</sup> PR Government, *Forty-Third Annual Report*, p. 47.

than expected, glass production began in January 1945, but production was stopped due a strike which began in February and lasted until June 25, 1945.<sup>51</sup>

The Puerto Rico Pulp and Paper Corporation (PR Pulp and Paper, henceforth) was organized on April 23, 1944.<sup>52</sup> In the same month a contract was awarded for the building of a paper mill, with a budget of US\$1,200,000.<sup>53</sup> Construction began in May 1944 and the production of paperboard began on May 6, 1946,<sup>54</sup> after US\$1,504,436 had been invested.<sup>55</sup>

The Puerto Rico Clay Products Corporation (PR Clay Products, henceforth) was created on November 6 1944;<sup>56</sup> the preliminary work for building the clay products factory was completed by June 1945, and the funds available for use by this company amounted to U\$247,504.75.<sup>57</sup> The first kiln was completed in May 1947 and production of brick and hollow tile began in August 1947. In this case, again, the cost was much higher than expected: total investment by June 30, 1947 was US\$1,140,595.<sup>58</sup>

The fifth subsidiary to be incorporated was the Puerto Rico Shoe and Leather Corporation (PR Shoe and Leather, henceforth), in January 1946. The plant opened (although construction was still incomplete) on July 1, 1946, and commercial operations began in February 1947.<sup>59</sup> Total investment amounted to US\$319,247.<sup>60</sup>

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<sup>51</sup> PR Government, *Forty-Fifth Annual Report*, p. 30.

<sup>52</sup> PRDC, *Annual Report 1944*, p. 13.

<sup>53</sup> PR Government, *Forty-Fourth Annual Report*, p. 31.

<sup>54</sup> PR Government, *Forty-Sixth Annual Report*, p. 39.

<sup>55</sup> PRIDCO, *Annual Report 1947*, p. 27.

<sup>56</sup> PRDC, *Annual Report 1944*, p. 13.

<sup>57</sup> PR Government, *Forty-Fifth Annual Report*, p. 31.

<sup>58</sup> PRIDCO, *Annual Report 1947*, p. 31.

<sup>59</sup> PRIDCO, *Annual Report 1947*, p. 16.

<sup>60</sup> PRIDCO, *Annual Report 1947*, p. 30.

Interestingly, the *Forty-Sixth Annual Report of the Governor of Puerto Rico*, the last one delivered under Tugwell's governorship, included Telares de Puerto Rico, inc. (PR Telares, henceforth) among the subsidiary manufacturing corporations that had been created (this one being the sixth), and announced that work at PR Telares was scheduled to start before the end of 1946.<sup>61</sup> Indeed, plans were completed for a modern textile factory to produce for the local market.<sup>62</sup> But the plant was never built to be managed by PR Telares,<sup>63</sup> and this subsidiary was dissolved on June 30, 1951.<sup>64</sup>

Table 1 provides details of PRIDCO's six subsidiary corporations. Total direct investment of PRIDCO in the subsidiary plants until June 30, 1949 was US\$11.1 million,<sup>65</sup> a large financial commitment. However, PRIDCO plants were capital intensive and they employed relatively few workers: in June 1948, when all plants were in operation, the total work force was 992 employees.<sup>66</sup> In fact, the creation of the manufacturing state-owned sector in Puerto Rico seems to have had a minimal effect on industrial employment – far below what an effective industrialization policy for the island might have been expected to achieve.

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<sup>61</sup> PR Government, *Forty-Sixth Annual Report*, p. 38.

<sup>62</sup> Moscoso, "Industrial development", p. 61.

<sup>63</sup> The plant was only constructed when arrangements had been made for it to operate under a lease contract by a US textile firm (Ross, *The Long Uphill Path*, p. 74).

<sup>64</sup> The total deficit accumulated until PR Telares was liquidated was US\$86,000 (PRIDCO, *Annual Report 1951*, p. 27).

<sup>65</sup> Descartes, *Financing Economic Development*, p. 31.

<sup>66</sup> Moscoso, *Letter to Luis Muñoz Marín*, June 24, 1948.

Table 1. PRIDCO manufacturing corporations: organization, operations, initial investment, work force.

Corporation	Date of organization	Beginning of commercial operations	Initial Investment (US\$)	Work force, as of June 1948
Puerto Rico Cement Corporation	February 1938 <sup>a</sup>	January 1939	1,500,000	156
Puerto Rico Glass Corporation	February 1943	January 1945	3,026,000	176
Puerto Rico Pulp and Paper Corporation	April 1944	May 1946	1,504,436	173
Puerto Rico Clay Products Corporation	November 1944	August 1947	1,140,595	205
Puerto Rico Shoe and Leather Corporation	January 1946	February 1947	319,247	282
Telares de Puerto Rico, inc.	Early 1946	Never	86,000 <sup>b</sup>	-

Notes: <sup>a</sup> The Cement plant was acquired by PRDC in 1943, with assets near to US\$2,000,000.

<sup>b</sup> The amount for Telares de Puerto Rico, inc. is the deficit accumulated by June 30, 1951.

Sources: Author, based on: (a) PRDC *Annual Report 1944*; (b) PRIDCO, *Annual Reports 1947, and 1951*; (c) PR Government, *Forty-Fifth, and Forty-Sixth*. Work force: Moscoso, *Letter to Luis Muñoz Marín*, June 24, 1948.

## PRIVATIZATION OF THE STATE-OWNED MANUFACTURING FIRMS

On February 12, 1946, Tugwell delivered his last Governor's Message to the Legislature. A large part of his speech was dedicated to the publicly owned firms and utilities. He claimed that one of the reasons for the success in the ownership and operation of public utilities was the fact that they had been organized as corporations that were legally independent from the government. This allowed them to operate as business organizations, without interference from bureaucratic procedures.<sup>67</sup> Tugwell concluded as follows: "It is with some emotion that I tell you at the opening of this regular session of my approaching departure....I have already noted some of the credits, the largest being the program for economic rehabilitation which has been begun. And next, perhaps, the public ownership and operation of public utilities".<sup>68</sup> The 46<sup>th</sup> Annual Report (1945-46) was the last one delivered by Tugwell, and soon Jesús T. Piñero, the first native Puerto Rican Governor, replaced him.

Piñero was the last Governor appointed by the US President. Interestingly, Muñoz Marín – then still President of the Senate – had been offered the governorship, but he preferred to wait until the first gubernatorial election, scheduled for November 1948. Following Muñoz Marín's suggestion, Piñero, a PPD member, was appointed to the office. In any case, thereafter Muñoz

<sup>67</sup> Tugwell, *Message to the Sixteenth Legislature*, p. 48.

<sup>68</sup> Tugwell, *Message to the Sixteenth Legislature*, p. 49.

Marín held total command of the executive power in Puerto Rico, adding this to the full control PPD had obtained over the Legislature. Whereas the PPD had won the 1940 election to the Legislature by a very narrow margin, the 1944 election had produced the largest victory in the history of Puerto Rico: the PPD took all seven Senatorial districts and 34 of the 35 Representative districts, thus gaining full control of the Legislature.

Together with these institutional changes, the economic environment had dramatically changed as well after the end of World War II. Maritime transportation and trade in the Caribbean Sea progressively returned to normal, thus increasing the competition facing the commercial products manufactured in the island. This change was of great importance, because most government-owned manufacturing firms had been designed to supply the local market;<sup>69</sup> by the time all five subsidiaries were finally in full commercial operation in 1947, the market conditions on the island had changed dramatically. Besides, technical and commercial problems had seriously affected the performance of some of the subsidiaries, especially the PR Pulp and Paper C., and the PR Shoe and Leather C.<sup>70</sup>

All these developments had a strong influence on the Puerto Rico government, which expressed its official views in the Annual Reports to the Legislature (see table 2). Tugwell's Reports (1941-1946) had continuously supported the increasing role of the government in manufacturing. Projects were expanding each year, and strong emphasis was put on the development of the factories, although the difficulties faced were also mentioned, related above all to labor conflicts and extra costs of investments.

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<sup>69</sup> Moscoso, "Industrial development", p. 61.

<sup>70</sup> Detailed accounts of the problems faced by these subsidiaries can be found in Moscoso, "Industrial Development", p. 61, and Ross, *The Long Uphill Path*, pp. 64-73.

Table 2. The state-owned enterprise sector in Puerto Rico Governors' Annual Reports -AR-.

Report	Governor	SOEs in the Governor's Annual Report	Emphasis
43 <sup>rd</sup> AR 1943	Tugwell	PR Glass C. is an already undertaken project. Expected investment is US\$2,000,000. Other projects under consideration: (1) plant for the manufacture of wall board; (2) textile mill; (3) hosiery kitting mill; (4) paper mill; (5) yeast plants; (6) plant for the production of edible oils and fats and laundry soaps.	Ambitious projects for building publicly operated plants.
44 <sup>th</sup> AR 1944	Tugwell	Virtual completion of the glass container plant, with a total investment of US\$2,276,890. Creation of the PR Pulp and Paper C., and the beginning of construction of a paper mill in May 1944. Expected cost to be US\$1,200,000.	Building cost of the glass container plant 14% above expectations.
45 <sup>th</sup> AR 1945	Tugwell	Glass production began in January 1945; a strike in February stopped production for 86 days. Building of the paperboard mill was repeatedly held up by delays in delivery of construction material and machinery; total capital stock issued amounted to US\$1,325,000. The PR Clay Products C. was organized late in 1944; funds available for use by amount to US\$247,504.75. Plans under consideration by the Research and Development Department include plants for making wallboard, cotton cloth, food yeast, shoes, vegetable oils, and meat packing.	Paper mill costs more than 10% above expected. Problems in glass production and paper plant construction. Still, ambitious plans to be implemented.
46 <sup>th</sup> AR 1946	Tugwell	By the end of the fiscal year, PRIDCO had six subsidiary corporations: PR Glass C., PR Cement C., PR Pulp and Paper C., PT Clay Products C., PR Shoes and Lather C., and Telares de PR. Glass, Cement and Pulp and Paper were in operation, Clay, and Shoe and Leather were under construction; construction of Telares was expected to start by the end of 1946.	Three subsidiaries working, and two plants being built. Construction of Telares scheduled.
47 <sup>th</sup> AR 1947	Piñero	The PR Shoe and Leather C. went into operation, and the subsidiary to manufacture heavy clay products had successful test-runs. All of the foregoing contributes to the fulfillment of the basic program approved by the Insular Government when PRDC was founded in 1942. To achieve this end the company has developed basic industries such as cement, glass, clay products, paper and shoes. The Company has scheduled construction of a new textile mill in Ponce which will employ more than 500 persons, and has contracted for the building of a yeast pilot plant capable of producing 1,000 pounds of dry yeast daily.	Four subsidiaries working, and one plant to begin soon commercial operations. Basic PRDC program completed. Construction of Telares scheduled.
48 <sup>th</sup> AR 1948	Piñero	PRIDCO has laid special emphasis on two important aspects of the long range program: encouragement of private industrial enterprise and the development of tourism as a source of income to the island.	More emphasis on encouragement of private industrial enterprise
49 <sup>th</sup> AR 1949	Muñoz Marín	The PRIDC program began with the acquisition of a cement plant, and later the creation of four other industrial plants, three of which showed signs of becoming profitable ventures. PR Glass., PR Clay., PR Shoe and Leather, and PR Pulp and Paper all operated at a loss. The solution to the difficulties of this plant [Pulp and Paper] appeared either to be to adapt it to the manufacture of cardboard or to sell it to private interests who would make an integrated enterprise.	Privatization of PR Pulp and Paper C. envisaged as a likely solution for its difficulties.
50 <sup>th</sup> AR 1950	Muñoz Marín	During the year Joyce of Puerto Rico, a subsidiary of Joyce Inc. of California, leased the PRIDCO's shoe factory at Ponce. The PR Clay C. and the PR. Glass C. operated at a loss. Production by the Cement Corporation was interrupted by a 50-day strike which caused a sharp drop in earnings. The plant had a net profit of US\$758,000 compared with the last year's US\$1,271,000.	PR Shoe and Leather C. was privatized. Most plants operated at a loss, and PR Cement C. profits decreased .

Note: Fiscal years July 1 to June 30.

Source: Author, based on PR Government (43<sup>rd</sup>, p. 47; 44<sup>th</sup>, p. 31; 45<sup>th</sup>, pp. 30-31; 46<sup>th</sup>, pp. 38-39; 47<sup>th</sup>, pp. 93-97; 48<sup>th</sup>, p. 60; 49<sup>th</sup>, pp. 60-65; and 50<sup>th</sup>, pp. 88-90).



The 47<sup>th</sup> Report (1946-47), delivered by Piñero, differed little from Tugwell's last report. However, the following report (that of 1947-48) explicitly stated that PRIDCO had turned its attention to two important aspects of the long-range program: encouragement of private industrial enterprise, and the development of tourism as a source of income for the island. Publicly managed manufacturing firms received much less attention in the report, thus providing a clear signal that a reorientation of the development policy was underway.

Interestingly, the 49<sup>th</sup> Report (1948-1949), the first one delivered by Muñoz Marín, openly admitted that selling the PR Pulp and Paper C. to private interests could be a solution for its problems. In his second Governor's Report (50<sup>th</sup>, 1949-1950), Muñoz Marín emphasized that the PR Shoe and Leather C. had been privatized, that most PRIDCO plants were operating at a loss, and that profits were falling in the only profitable firm, the PR Cement C. By then, the question of privatization had irreversibly entered the fray.

Although contemporary studies claimed that 1948 was the year in which the decision to sell the subsidiaries was first made,<sup>71</sup> the possibility of privatization was already being discussed by PRIDCO in mid-1947. At a meeting of the PRIDCO Planning and Executive Committees held on May 30, 1947, Moscoso reported on negotiations held during a recent trip to the US regarding the transfer of the shoe factory to a private firm: "2. Shoe factory – It was reported that Mr. Weinbrot of the Mercury Footwear reiterated its willingness to consider renting the shoe factory of the Company. The President [Moscoso] stated that a letter to that effect should be obtained from Mr. Weinbrot but that it would be preferable to negotiate along these lines with either Penaljo or Joyce, two other reputable shoe manufacturers of apparently higher standards."<sup>72</sup> In fact, the shoe and leather factory was sold to Joyce of California in October

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<sup>71</sup> Ross, *The Long Uphill Path*, p. 111.

<sup>72</sup> PRIDCO, *Minutes of the meeting*. Muñoz Marín was well aware of this, since a copy of these Minutes was sent to him, as usual.

1949. However, more negotiations were needed before the privatization policy could finally proceed.

As early as May 1948,<sup>73</sup> PRIDCO received an offer to buy all its five operating subsidiaries, from a group headed by Royal Little, President of Textron. This proposal divided the subsidiaries into two groups – one formed by the cement plant, and the other formed by the remaining four. The proposal included: (1) payments in cash for prepaid items and inventories; (2) the payment of US\$3,000,000 in cash for the cement plant (or alternatively a lease for six years at a rental of US\$500,000 per year, and US\$100,000 per year thereafter for 93 years); and (3) the payment of the depreciated value of the four other plants over ten years with 3% interest payable quarterly.<sup>74</sup> This proposal would have resulted in a payment well below the net investment made by PRIDCO in the five subsidiaries, which had been set as the minimum sum to be met for the approval of any sale. Accordingly, the proposal was turned down.

Even though the Puerto Rico government would not make any official statement on its willingness to privatize PRIDCO subsidiaries before the gubernatorial election of November 1948, the question of privatization was debated publicly. In early July 1948, Luis Ferré, one of the leaders of the Statehood Party (and a member of the Ferré Group, a family industrial holding that would be crucial later in the sale of the subsidiaries) made a public statement asking that the firms be sold by an auction, in which Puerto Rican firms should participate.<sup>75</sup>

New proposals for the acquisition of the subsidiaries were soon forthcoming. Following a conversation held with Moscoso on February 1, 1949, David G. Baird (Vice-President of Marsh & McLennan Inc.) sent PRIDCO a formal bid to buy the cement, glass, paper, and clay product

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<sup>73</sup> That is, long before the proposal for the acquisition of the paperboard plant made by Karl F. Landegger by the end of 1949, which is considered by Ross (*The Long Uphill Path*, p. 115) as the first formal proposal to buy a PRIDCO subsidiary.

<sup>74</sup> PRIDCO, *Proposal for the sale of subsidiaries*. All the details of the proposal can be found in this PRIDCO Internal Memorandum.

<sup>75</sup> *El Mundo*, July 7, 1948, p. 1.

companies.<sup>76</sup> One week later, on February 7, 1949, Moscoso sent copies of Baird's letters to PRIDCO's Board of Directors, together with a Memorandum stating his opinion that "it is an operation to be studied in detail....I want to let you know in advance that our recommendation will probably be to ask for a higher amount regarding the 'going-concern value' of all plants. Perhaps one or two million dollars in addition to the million offered. Furthermore, the accumulated deficits must be absorbed by the company that buys the plants".<sup>77</sup>

No agreement was reached between PRIDCO and Baird, but the subsidiaries would soon be privatized. In October 1949, PRIDCO sold the PR Shoe and Leather C. to Joyce de Puerto Rico, Inc., a subsidiary of Joyce California. Joyce purchased the machinery for US\$35,000.<sup>78</sup> More importantly, at the end of 1949 the New York businessman Karl F. Landegger showed interest in acquiring the paper plant. Later, in July 1950, he submitted a formal bid for the acquisition of all four subsidiaries still under PRIDCO ownership (cement, glass, paper, clay products). The nominal price he offered was US\$10,000,000, to be paid in ten years. However, Landegger offered only US\$2,000,000 as down payment and an interest-free mortgage.<sup>79</sup> Although the total amount offered was close to the book value of the plants, the interest-free mortgage made the proposal far less attractive, and PRIDCO did not accept it.

The final step was in late September 1950, when the Puerto Rican Ferré Group unexpectedly<sup>80</sup> offered US\$10,500,000, to be paid as follows: a down payment of US\$2,000,000,

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<sup>76</sup> Details of this proposal can be found in Baird, *Letter to PRIDCO*.

<sup>77</sup> PRIDCO, *Memorandum from Teodoro Moscoso* (Author's translation).

<sup>78</sup> Joyce agreed to add at least US\$65,000 worth of additional machinery, and took over the factory building on a lease basis (PRIDCO, *Annual Report 1950*, p. 36). Full details of the operations can be found in PRIDCO, *Annual Report 1950*, p. 20.

<sup>79</sup> See further details of Landegger's proposal in Ross, *The Long Uphill Path*, 115.

<sup>80</sup> While PRIDCO was still considering the possibility of selling the firms to Landegger if he improved his offer, the Ferré Group asked Martín Muñoz to withhold any final decision until that holding could make an offer for PRIDCO subsidiaries; Muñoz complied with this request (Muñoz Marín, *Memorias*, p. 252).

3.5% preferred stock of another US\$2,000,000, and a 4% first mortgage of US\$6,500,000.<sup>81</sup> This proposal was the first to meet PRIDCO's demands in full, and an agreement was reached less than one week after intense negotiations between the technical teams of PRIDCO and the Ferré Group to work out the details.<sup>82</sup> On October 3, the official agreement to sell the cement, glass, paper and clay products companies to the Ferré Group was publicly announced.<sup>83</sup>

The total amount agreed for the sale, US\$10,500,000, slightly above the book value of PRIDCO's subsidiaries.<sup>84</sup> PRIDCO saw the operation as a "commercial deal which, from the point of view of valuations and economic consequences involved, may be classified among the most important ever made in the history of Puerto Rico."<sup>85</sup> The quantitative significance of the sale can hardly be underrated. Proceeds from privatization amounted to 9.3% of fiscal receipts for island's government purposes, and to 1.4% of Puerto Rico's total Gross Product in 1950.<sup>86</sup>

### **ANALYSIS OF THE OBJECTIVES OF PRIVATIZATION IN PUERTO RICO**

Contemporary authors paid little attention to the reasons why the Puerto Rico government privatized the manufacturing firms under its ownership. In 1954, a few years after privatization had been implemented, Ojuda emphasized the economic and technical difficulties faced by most subsidiaries in undertaking successful operations (such as the market dimension, and changes in

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<sup>81</sup> Taking everything into account, the Ferrés proposal amounted to US\$3,000,000 over the bid offered by Landegger (Ross, *The Long Uphill Path*, p. 116).

<sup>82</sup> Maldonado, *Teodoro Moscoso*, 65-68, offers a vivid account of this negotiation process.

<sup>83</sup> *El Mundo*, October 4, 1950, pp. 1 and 15; *El Imparcial*, October 4, 1950, pp. 2 and 34.

<sup>84</sup> Notice that the PR Shoe and Leather had already been sold to Joyce in November 1949, well before this agreement was reached.

<sup>85</sup> PRIDCO, *Annual Report 1951*, p. 15 (Author's translation). The recovery of the capital used to establish the firms was later confirmed by Puerto Rico Planning Board, *Informe económico*, p. 38.

<sup>86</sup> I have made these computations based on the data in Puerto Rico Planning Board, *Economic development*, on Fiscal receipts (p. 79, table 46), and Gross Product (p. 162, appendix table 14).

the economic environment with the resumption of trade) as drivers of the sale.<sup>87</sup> However, in an article published in 1955, Lewis stressed managerial incapacity as one of the reasons for the sale, as well as the view that government-owned firms would produce a dangerous increase in the island's wage structure because they were paying higher wages than private firms.<sup>88</sup> Two years later, in 1957, Ross refuted Lewis's views by emphasizing that managerial incapacity was not an issue in the sale; Ross's reasoning was more in line with Ojuda's vision that the sale of the subsidiaries was due to problems related to the dimension of the local market and to the economic environment.<sup>89</sup> More recent studies of the Puerto Rican economy have not paid further attention to the reasons for privatization, and the economic analysis of privatization in recent decades ignores the Puerto Rican case entirely.

The analyses of more recent privatization experiences in the fields of economics and public policy have shown that privatization policies may pursue a multiplicity of objectives, among which three types stand out: Ideological motivations, political interests, and economic objectives (either financial or efficiency-related). By using these concepts and tools, a deeper and more systematic analysis of the objectives of privatization in Puerto Rico can be undertaken.

Ideology played an important role in the building of the state-owned enterprise sector in Puerto Rico. In line with the belief that was common in the late 1930s and early 1940s that private initiative would not effectively engage in the industrialization of Puerto Rico, Rexford Tugwell was firmly convinced of the importance of public intervention in the economy. Tugwell held important posts in the US Department of Agriculture in the mid-1930s, and the proposals he tried to put forward won him the nickname 'Rex the Red'.<sup>90</sup> Indeed, Tugwell's faith in public corporations and state-financed industry was one of the main drivers of the creation of the SOE

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<sup>87</sup> Ojuda, *The industrial development program*, pp. 161-162

<sup>88</sup> Lewis, "Puerto Rico", pp. 625-627.

<sup>89</sup> Ross, "Gordon Lewis", pp. 88-89. These views were further developed in Ross, *The Long Uphill Path*, pp. 108-117.

<sup>90</sup> Goodsell, *Administration of a revolution*, p. 165; Carr, *Puerto Rico*, p. 67.

sector in Puerto Rico.<sup>91</sup> To achieve his objective, Tugwell enlisted the support of Martín Muñoz, the leading local politician, and Moscoso, who became the leading local public servant in the industrial sector. However, Tugwell's views on industrialization were substantially to the left of those held by Muñoz and Moscoso.<sup>92</sup> Indeed, the fact that Tugwell left the governorship in 1946 was seen as one of the factors that made possible the industrial policy reorientation initiated after 1947.<sup>93</sup>

Particular attention should be paid to Muñoz Marín's views on the issue of public intervention and industrial development, because – besides being President of the Senate– he was also the undisputed leader of the PPD, and policy decisions were heavily dependent on him, particularly after Tugwell left Puerto Rico in 1946. The fact that Muñoz Marín did not share Tugwell's faith in nationalization is reflected in their disagreement over the uncompleted nationalization of the private telecommunications company. Nationalizing telecommunications was one of Tugwell's most cherished projects, but it failed because of the lack of support from Muñoz Marín. In 1947, Tugwell's public criticism of Muñoz Marín's position on the expropriation of telecommunications sparked fierce controversy. In a speech broadcast on 27 March, 1947, Muñoz Marín responded "I believe that investment of public funds directed to create more sources of production, or to stimulate them, should have priority over public investments...merely directed to transfer property ...I have never believed in the wisdom of investing public funds to merely transfer ownership to the government."<sup>94</sup>

More on Muñoz Marín's views on the private versus public debate in economics can be learnt from a speech given on the eve of the first election for Governor, in November 1948,

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<sup>91</sup> Carr, *Puerto Rico*, p. 65.

<sup>92</sup> Goodsell, *Administration of a revolution*, p. 190.

<sup>93</sup> Ross, *The Long Uphill Path*, p. 79.

<sup>94</sup> Muñoz Marín, "La compra de telefónica", pp. 321-322 (in Muñoz Marín, *Palabras*, pp. 321-324) [author's translation]

when he stated that<sup>95</sup> “Men in the entire world fight, some defending private initiative, others defending that government must make all....We cannot be doctrinaire .... The Puerto Rican government works based on both doctrines; applying whichever one is more helpful in a particular moment. The government has made stated owned factories. But it has helped to make many more private factories ....we are neither theoretical nor doctrinaire.” Indeed, the privatization policy itself provides clear proof that it did not emerge out of any ideological conviction concerning the systematic superiority of private ownership; not one agency owning and operating public utilities or other network services (such as electricity, water, or urban transportation) was privatized either between 1948 and 1950, or in the rest of Muñoz Marín’s tenure, which ended in 1964.

We should now turn our attention to the question of whether political interests might have been the drivers of the privatization policy. Recent theoretical literature has shown that governments can design and implement privatization to foster their partisan political interests.<sup>96</sup> Furthermore, the privatization policy that preceded the one implemented in Puerto Rico – the large-scale sale of government-owned enterprises in Germany between 1934 and 1937 – had political objectives as one of its main drivers (together with financial motivations). The Nazi government had come to power with limited parliamentary support<sup>97</sup> and faced great difficulty in

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<sup>95</sup> Muñoz Marín, “Mi propósito es que el pueblo resuelva los difíciles problemas de su vida”, pp. 660-661 (in Muñoz Marín, *Palabras*, pp. 644-667) [author’s translation].

<sup>96</sup> See Biais and Perotti, “Machiavellian privatization”, and Perotti, “Credible privatization”, for theoretical analyses; see Bel and Fageda, “Factors explaining”, and Bortolotti, Fantini, and Siniscalco, “Privatisation around the World”, for empirical information.

<sup>97</sup> When Hitler was appointed Chancellor in January 1933, the Nazi party had just 196 out of 584 seats (33.6%) in the German Parliament. In the following election of March 1933, the Nazis obtained 44.5% of the seats (Bel, “Against the mainstream”)

achieving stable support; it therefore used privatization as a tool to foster alliances with the great industrialists, as privatization was a policy favorable to private property.<sup>98</sup>

In Puerto Rico, however, there was no comparable scenario of political weakness and limited parliamentary support when the privatization program was implemented. In the first gubernatorial election ever held, in 1948, Muñoz Marín obtained 61.2% of the votes, and became the first elected Governor of Puerto Rico. The second most voted candidate (belonging to a coalition of the Statehood Party, the Socialist Party, and the Reformist Party) obtained just 28.6% of votes, and the third candidate (the Independence Party) received 10.2%.<sup>99</sup> As regards the elections to the Legislature, Muñoz Marín's PPD won all Senatorial and Representative districts. Muñoz Marín now held absolute control of both the executive and the legislative branches, and he had no need to give priority to new coalition building when designing and implementing his industrial policies.

Besides the government's political strength in 1948, there is another striking factor that makes the Puerto Rico experience very different from other large-scale privatization processes implemented to favor business and political elites and to benefit the government's allies, as in the case of Nazi Germany<sup>100</sup> or post-communist Russia.<sup>101</sup> The fact is that most of the privatized firms (cement, glass, paper, and clay products) were sold to the Ferré Group, a family holding run by several brothers. One of the brothers was Luís Ferré, a very important figure in the Statehood Party, and a long-standing opponent of the government's economic policy.<sup>102</sup> At no

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<sup>98</sup> Bel, "Against the mainstream".

<sup>99</sup> Data on the gubernatorial elections have been obtained from the Comisión Estatal de Elecciones of Puerto Rico (<http://www.ceepur.org/>, accessed on June 2, 2009).

<sup>100</sup> See Sweezy, *The Structure of the Nazi*, p. 27; Merlin, "Trends in German" p. 207; and Bel, "Against the mainstream".

<sup>101</sup> See Desai, "Russian Retrospectives", p. 97; Guriev and Rachinski, "The Role of Oligarchs", pp. 138-139.

<sup>102</sup> In 1968, Luís Ferré became the first non-PPD Governor of Puerto Rico, after twenty years of PPD dominance (Muñoz Marín between 1948 and 1964, and Sánchez Vilella between 1964 and 1968).



other time in the history of privatization has a government sold the bulk of the state-owned manufacturing sector to an opposition political leader. This clearly shows that the sale of the PRIDCO subsidiaries in Puerto Rico was far from being a story of crony capitalism or of transferring government ownership to close political allies in order to foster the government's political interests.

Given that ideological biases and partisan political interests did not play a relevant role in privatization in Puerto Rico, the island's government might have used privatization to advance its economic policy. In this connection, we should mention the fact that financial restrictions in the Treasury (a key factor in most privatization policies)<sup>103</sup> did not seem to play a role in privatization in Puerto Rico. The public debt of the island's government fell steadily throughout the 1940s, from US\$27.2 million in 1940 to US\$12.8 million in 1949 (this last figure being 47% of the 1940 level).<sup>104</sup> Interestingly, the lowest level of public debt was reached in 1947 (37% of the 1940 figure), the year in which the first negotiations for privatizing the PR Shoe and Leather began.

As for industrial policy – the core of economic policy in Puerto Rico – its main characteristics were the desire to promote industrialization, and the desire to attract foreign capital for the industrialization process, particularly from the continental US.<sup>105</sup> According to the Puerto Rican leaders of the construction of the state-owned manufacturing sector, it soon became clear that Puerto Rico would never have enough money to build government factories able to increase production and opportunities to the level needed and expected.<sup>106</sup> Furthermore,

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<sup>103</sup> In recent experiences (Bortolotti and Milella, "Privatization in Western Europe"; Yarrow, "A Theory of Privatization"), as well as in Germany 1934-1937 (Bel, "Against the mainstream,")

<sup>104</sup> Puerto Rico Planning Board, *Economic development*, p. 81, table 48. Note that very large new bond and long-term issues of the public corporations were made in 1949-1950, most of which consisted of obligations of the Water Resources Authority and the Aqueduct and Sewer Authority.

<sup>105</sup> Perloff, "Transforming the Economy", p. 51.

<sup>106</sup> Muñoz Marín, "Development through democracy", p. 7; Moscoso, "Industrial Development", pp. 61-62.

it was thought that if the government engaged in a wider program of publicly owned manufacturing plants, this “would probably seriously hinder eliciting the participation of outside capital in most cases”.<sup>107</sup>

Together with the growing impression that the government’s main objectives could not be accomplished by means of a full policy of building and operating publicly owned manufacturing firms, the increasing dissatisfaction with the performance of PRIDCO’s subsidiaries was probably another key driver of privatization. Taken as a whole, PRIDCO’s subsidiaries were in the black, but only one corporation, PR Cement, was making a profit, and the four other subsidiaries were making heavy losses. In table 3 I have gathered information on the profits and losses incurred by each corporation between 1945 and 1950. It is plain to see that only the cement plant recorded profits, and that all the other corporations recorded major losses in each of the years studied.

Furthermore, there was also considerable dissatisfaction with the performance of PR Cement. A comparison of its performance with that of Ponce Cement, a private factory owned by the Ferré Group which had began production in 1942, is particularly revealing. In 1943, Ponce Cement’s first year of full operation, its production had been 70.4% of that of PR Cement, and Puerto Rico had become an exporter of cement in that year. In 1948, the year in which the decision to privatize was firm, Ponce Cement’s production figures were 38.1% higher than those of PR Cement.<sup>108</sup> In addition to the lead Ponce Cement had achieved in production, the differences in price were also an important factor: While Ponce Cement was selling cement at US\$0.75 per sack, PR Cement charged Puerto Rican government a price of US\$0.95.<sup>109</sup>

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<sup>107</sup> Moscoso, “Industrial Development”, p. 67.

<sup>108</sup> Data taken from Baralt, *La Vida*, p. 127.

<sup>109</sup> Baralt, *La Vida*, p. 177.

Table 3. US\$ Net profit / (loss) of PRIDCO corporations, 1945-1950 (Fiscal year July 1-June 30)

Corporation	1945-46	1946-47	1947-48	1948-49	1949-50
PR Cement C. <sup>a</sup>	457,477	499,643	1,107,308	1,271,735	758,051
PR Glass C.	(138,615)	(138,634)	(518,949)	(316,367)	(174,573)
PR Pulp and Paper C.	-	(41,492)	(271,328) <sup>b</sup>	(228,670) <sup>c</sup>	in liquidation <sup>d</sup>
PR Shoe and Leather C	-	(47,580)		(123,596)	(24,505)
PR Clay Products C.	-	-	(155,000)	(112,538)	(114,900)

Notes: <sup>a</sup> Until 1944-45 the only subsidiary fully in operation was PR Cement C. Its profits had been US\$493,865.78 (1942-43), US\$492,674.47 (1943-44), and US\$247,908.78 (1944-45).

<sup>b</sup> No specific amount of loss for PR Pulp and Paper C. and PR Shoe and Leather C. in 1947-48 was provided. This figure is my own computation for the joint losses based on data in PRIDCO, *Annual Report 1948*. I have found out that net loss between July 1 1947 and April 30 1948 for each company was: 173,462 - PR Pulp and Paper – and 20,751 – PR Shoe and Leather – (data from Travieso, *Information on Subsidiaries' results*). Actually, the loss for the whole fiscal year must have been higher, as the joint computation made for the two subsidiaries shows.

<sup>c</sup> This figure is my own computation built upon the information in *PRIDCO Annual Report 1949*, pp. 20, 22, 26, 28 29, and 36.

<sup>d</sup> In August 1949 the Board of directors of the PR Pulp and Paper Corporation decided to close down the plant and the Corporation went in liquidation.

Sources: Author, based on PRIDCO *Annual Reports*, 1947, 1948, 1949, 1950.

Puerto Rican policymakers were fully aware of the differences in efficiency and productivity between the cement factories, and of the overall inefficiency of PR Cement, as shown by a confidential Report produced by PRIDCO in September 1947 (a copy of which was addressed to Muñoz Marín)<sup>110</sup>:

- 1) Whereas the cost of living increased by 53.8% between 1941 and 1947, the average hourly wage at the Puerto Rico Cement Plant increased by 192% in the same period. While the average weekly wage increased by 164% [p. 3], (monetary) labor productivity increased by just 48.5% in the period [page 4].
- 2) The annual salary paid in the PR Cement was higher than that paid to the island's policemen (first class) (25.23%), to the island's firefighters (first class) (by 87.8%), and to school teachers (by 30.68%) [p. 6].
- 3) The hourly wage at PR Cement was around 25% higher than in other industrial sectors in the island [p. 9].
- 4) The hourly wage at PR Cement was around 35.85% higher than at PR Glass, and 87.88% higher than at PR Pulp and Paper [pp. 10-11].

<sup>110</sup> PRIDCO, *Report on Puerto Rico Cement performance and productivity*.

- 5) The average weekly wage paid at PR Cement was 20.96% higher than at the Ponce Cement plant. PR Cement employed 160 workers, compared to 129 at Ponce Cement (even though Ponce produced more cement). Efficiency measured as labor productivity at Ponce Cement was 31% higher [p. 12].

The points stressed in this report provide a depressing image of PR Cement's efficiency and productivity, which must have had an important effect on Puerto Rican policymakers. The situation raised two particular concerns. First, the wage policy in PRIDCO's subsidiaries needed to be reformed in order to make them profitable, but PRIDCO's managers could never satisfactorily deal with this issue because of its political repercussions.<sup>111</sup> Second, there was the fact that wages paid to PRIDCO's manufacturing workers, especially those in PR Cement C., were pushing industrial salaries in Puerto Rico upwards, with negative effects on the island's competitiveness and its ability to attract foreign investment.<sup>112</sup>

In stark contrast to the government's plants, the Ferré Group's companies had a fine record of productive efficiency.<sup>113</sup> Furthermore, Muñoz Marín saw José Ferré, the brother in charge of

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<sup>111</sup> Moscoso, "Industrial Development", p. 61. Moscoso also stressed the fact that, even though the government factories were organized as corporations, PRIDCO had many responsibilities to different government agencies. Because of the lack of co-ordination between the departments of the government, the burden of compliance was excessive (p. 68).

<sup>112</sup> The effect of wages on industrial competitiveness was an important concern for PRIDCO's top management. Following the Democratic victory in the 1948 US Presidential and legislative election (supported by PPD), Moscoso sent a Memorandum to Piñero, Muñoz Marín, and Fernós Isern (Resident Commissioner of Puerto Rico) stating that "the industrialization program may be absolutely destroyed if Puerto Rico is not allowed to maintain the privilege held until now of establishing minimum wages through industrial committees". Taking for granted that the Democratic victory would result in an increase of the minimum wage in the US, Moscoso added "there will be pressure to fully include Puerto Rico in the federal law. Should this happen, the industrialization program would be immediately terminated." (Moscoso. *Memorandum to Jesús T. Piñero, Luis Muñoz Marín, and A. Fernós Isern*) [author's translation].

<sup>113</sup> Muñoz Marín, *Luis Muñoz Marín. Memorias*, p. 253.

the family business, as an exemplary Puerto Rico entrepreneur, the very opposite of the widespread model of absentee owner that – to his mind – had been one of the main obstacles to the success of local industrialization.<sup>114</sup> These factors, together with the fact that the bid submitted by the Ferré Group was the best received for the PRIDCO subsidiaries, explains why and how the sale of the four remaining factories was decided in October 1950.

In 1950, the industrial development program was reorganized. The Economic Development Administration (EDA) was created as a regular department of the Puerto Rico government, operating with funds assigned annually by the Legislature.<sup>115</sup> The proceeds obtained from the sale of PRIDCO's subsidiaries were used to promote EDA's activities, and a new phase of industrial policy in Puerto Rico became consolidated.<sup>116</sup>

## CONCLUSION

A large state-owned enterprise (SOE) sector was built in Puerto Rico in the 1940s, a period in which the Island Governor was still appointed by the US President. Several public services were nationalized and manufacturing SOEs were created to produce cement, glass, shoes, paper, and clay products. Between 1948 and 1950, the first elected government in Puerto Rico privatized the manufacturing SOEs, thus implementing the first large-scale privatization policy in a democracy.

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<sup>114</sup> This can be seen through Muñoz Marín, *Memorias*. I owe this insight to Silvia Alvarez Curbielo.

<sup>115</sup> Moscoso, "Industrial Development", p. 64.

<sup>116</sup> It soon delivered very successful results, as emphasized by most of the papers published in the monograph "Puerto Rico. A study in Democratic Development" (*Annals of the American Academy of Political and Social Science*; vol. 285, January 1953). These results probably contributed to Muñoz Marín's performance in the 1952 gubernatorial election: 64.9% of the votes, an all-time high. The Independent Party came second, with 19%. The two parties which had come second in 1948 running as a coalition fared very badly in 1952: the Statehood Party obtained only 12.9%, and the Socialist Party 3.3%. Muñoz Marín retained strong electoral support through his entire career as Governor: in the 1960 election, the last one in which he ran, he obtained 58.2% of votes. In 1964, his successor as PPD candidate, Sánchez Vilella, obtained 59.2%.

This work contributes to the literature by documenting the privatization process in Puerto Rico, and by analyzing the roles played by ideology, political interests, and economic objectives in the decision to privatize. Ideological bias and partisan political objectives do not appear to have driven privatization in Puerto Rico. Pragmatic economic concerns, related to the performance of the government's manufacturing firms, together with the need to attract private investment to foster industrialization in the island, seem to have been the main forces behind it.

At the end of the 1940s, Puerto Rico policy makers applied a highly practical approach to their policies for promoting industrialization. Increasing dissatisfaction with the performance of the manufacturing SOEs, together with improved opportunities for stimulating privately induced industrialization, suggested that the experiment of government-owned manufacturing firms should be terminated. A strong political leadership was able to deliver this policy reform.

To conclude, it is worth stressing that privatization in Puerto Rico was far from being a story of crony capitalism or of coalition building to foster the government's political interests. It diverged radically from the previous instance of a policy of privatization implemented between 1934 and 1937 by the Nazi government in Germany. Democracy, which implies checks and balances, transparency, and public scrutiny, may well provide an environment much less prone to corruption and less politically tainted privatization than a Dictatorship. Future research should undertake a more thorough study of the differences between privatization under Democracy and privatization under Dictatorship.

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