



Restoring Growth **Puerto Rico: Update**

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Puerto Rico's Economy: A Glass Half-Full

- Relative to countries in Latin America:

Its achievements have been significant:

- Per capita income -- highest in the region
- Educational attainment comparable to the OECD (12.2 years)

BUT

- Relative to the U.S. mainland:
 - Per capita income is 1/3 the U.S. average and just half that of the poorest state.
 - Half of the residents live below the poverty line.
 - Growth has stalled since the 1970s
 - Recent evidence of substantial decline

Key Problems:

- Distorting legacy of U.S. tax provisions (Section 936)

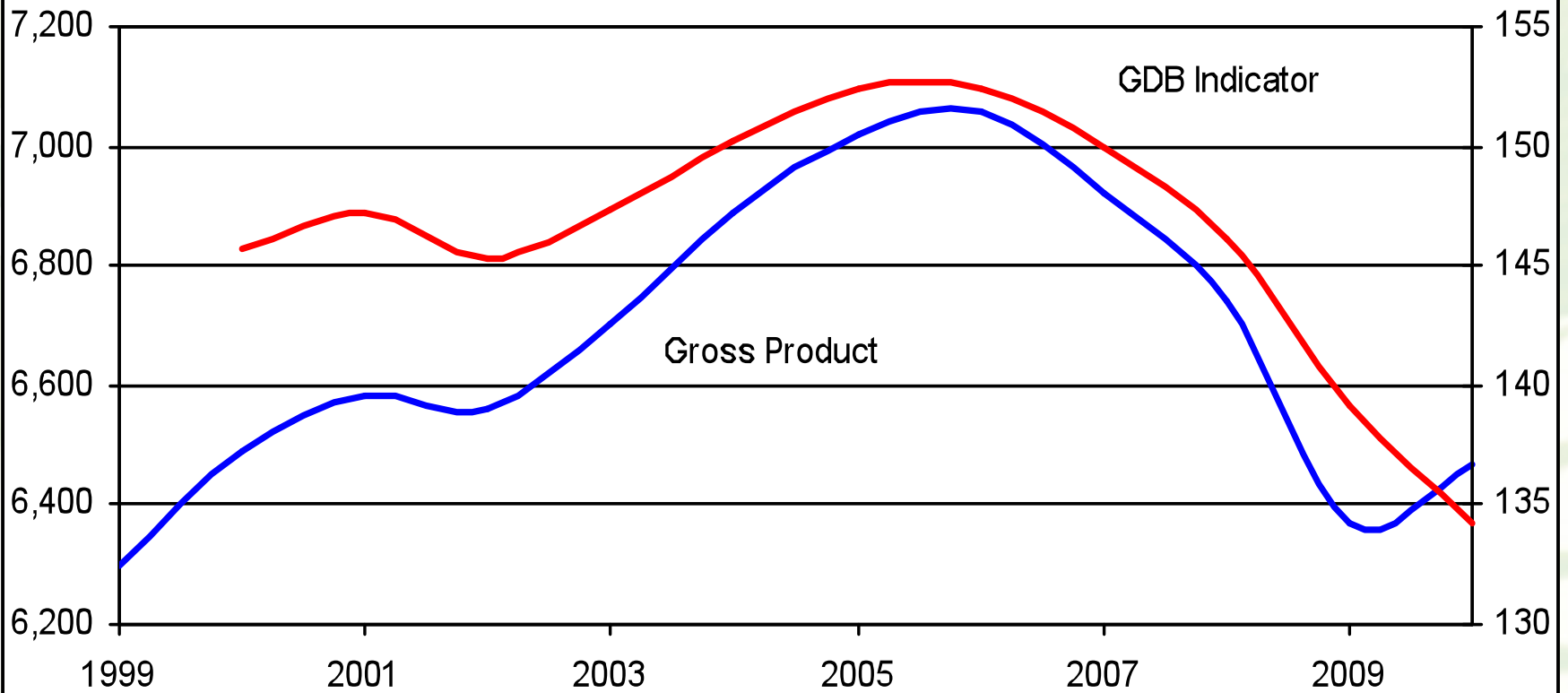
Restoring Growth

- Low Investment (incl. infrastructure) and slow labor productivity growth
- Surprisingly low employment
- Fiscal Deficits

Strengths and Concerns

- Stable currency, low inflation
- Extremely Open:
 - access to U.S. market
 - Free flow of labor & capital
- Educated, English- speaking workforce
- U.S. institutions
 - Legal system
 - Bank regulation
 - Social Safety Net
- Fiscal problems
- U.S. laws & treaties not designed for Puerto Rico
- School quality deteriorating. Low investment and weak infrastructure (vs. U.S.)
- Lack of transparency, complex regulatory environment, policy uncertainty

Puerto Rico Economic Indicators



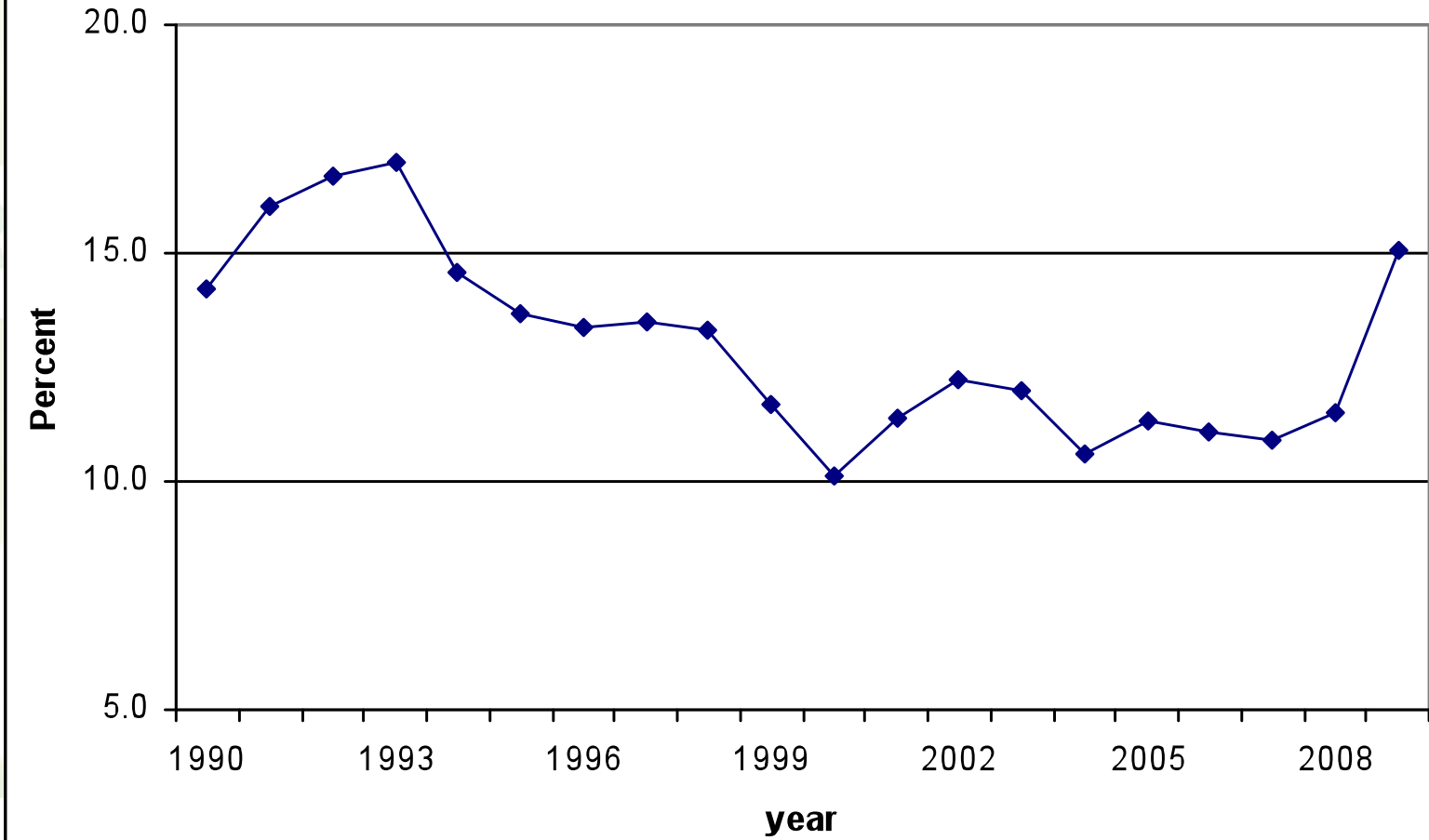
An Employment Shortfall of Stunning Dimensions

- Puerto Rico's employment rate is:
 - 40 percent (% of the population over age 16)
 - 2/3rds that for the U.S. overall
 - Closing this gap would raise Puerto Rican per capita incomes by 50% (given real wage rates)
 - Main problem is low labor force participation, though unemployment rate is high (15%)

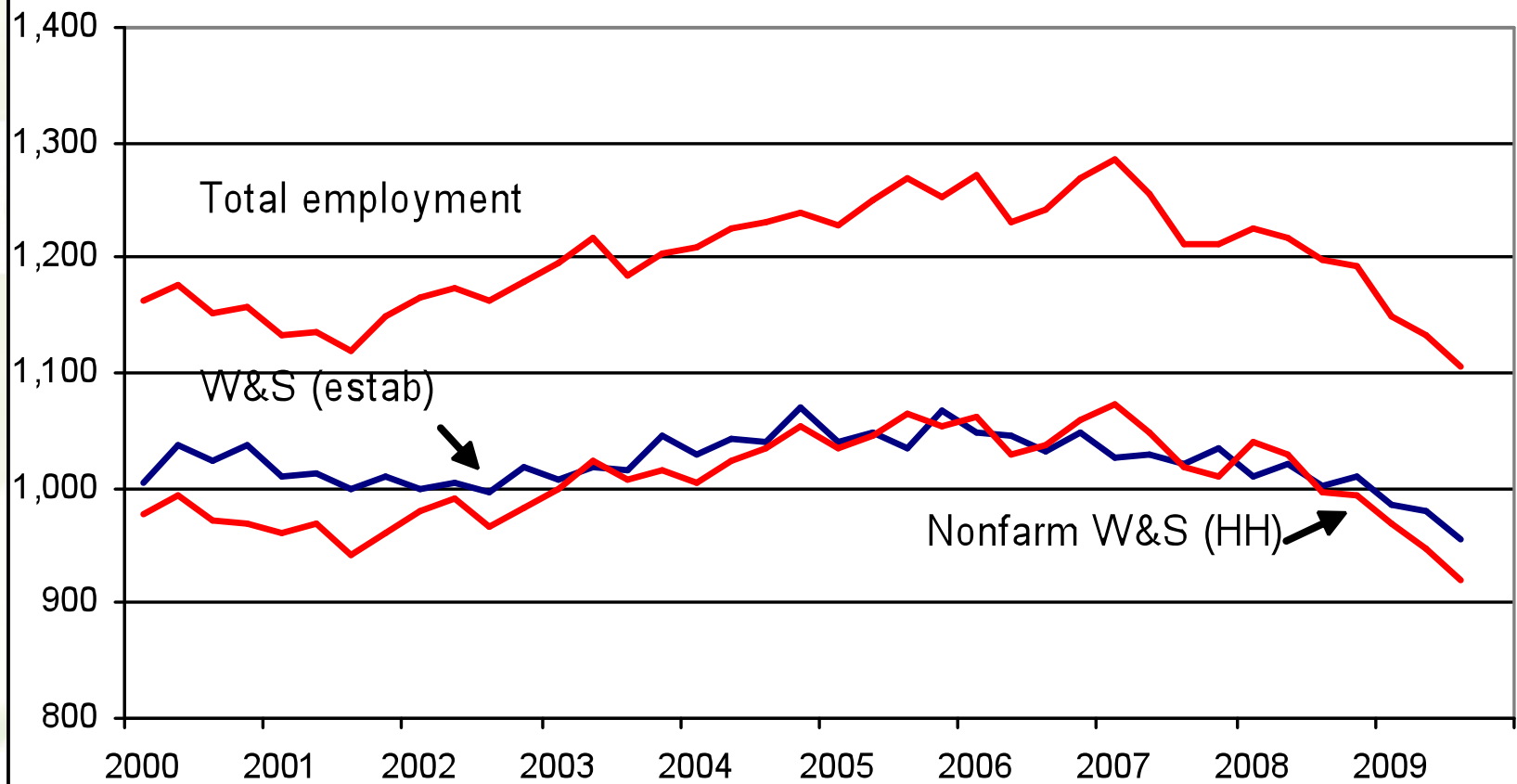
Employment Shortfall: Supply & Demand Side Problems

- Structure and generosity of government transfer programs ⇒ disincentives for work
- Underdeveloped Private sector, esp. in services
 - Only 30% of Puerto Ricans work in the private sector vs. 60% for U.S.
 - Missing jobs are primarily for less educated workers
- U.S. Minimum Wage
 - Limits downward wage flexibility and reduces job opportunities for the less skilled
 - Since Puerto Rican wages are just $\frac{1}{2}$ of U.S. wages, \$7.25/hour is equivalent to a minimum of \$15.00 on the mainland.

Unemployment Rate



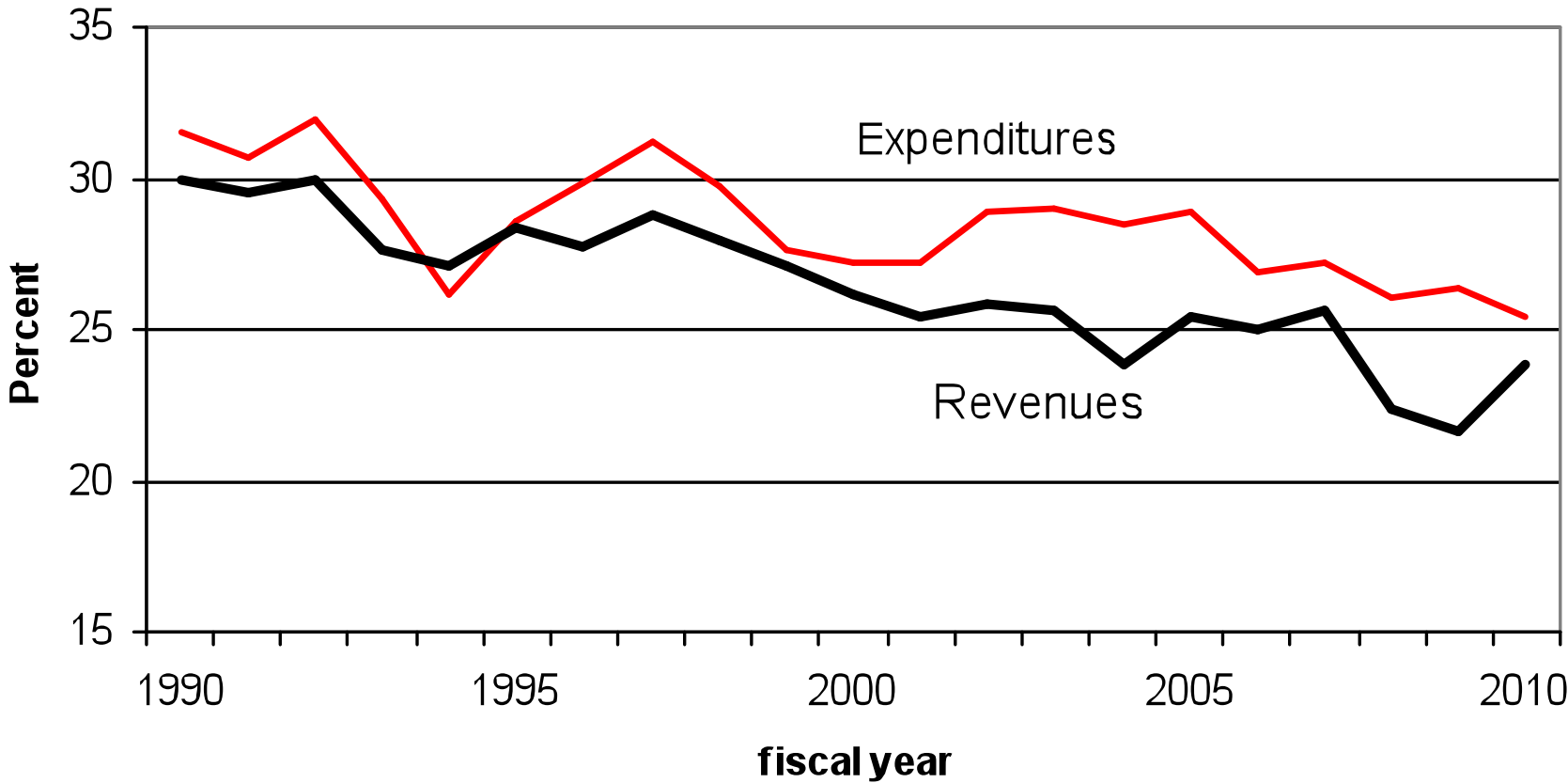
Employment Situation



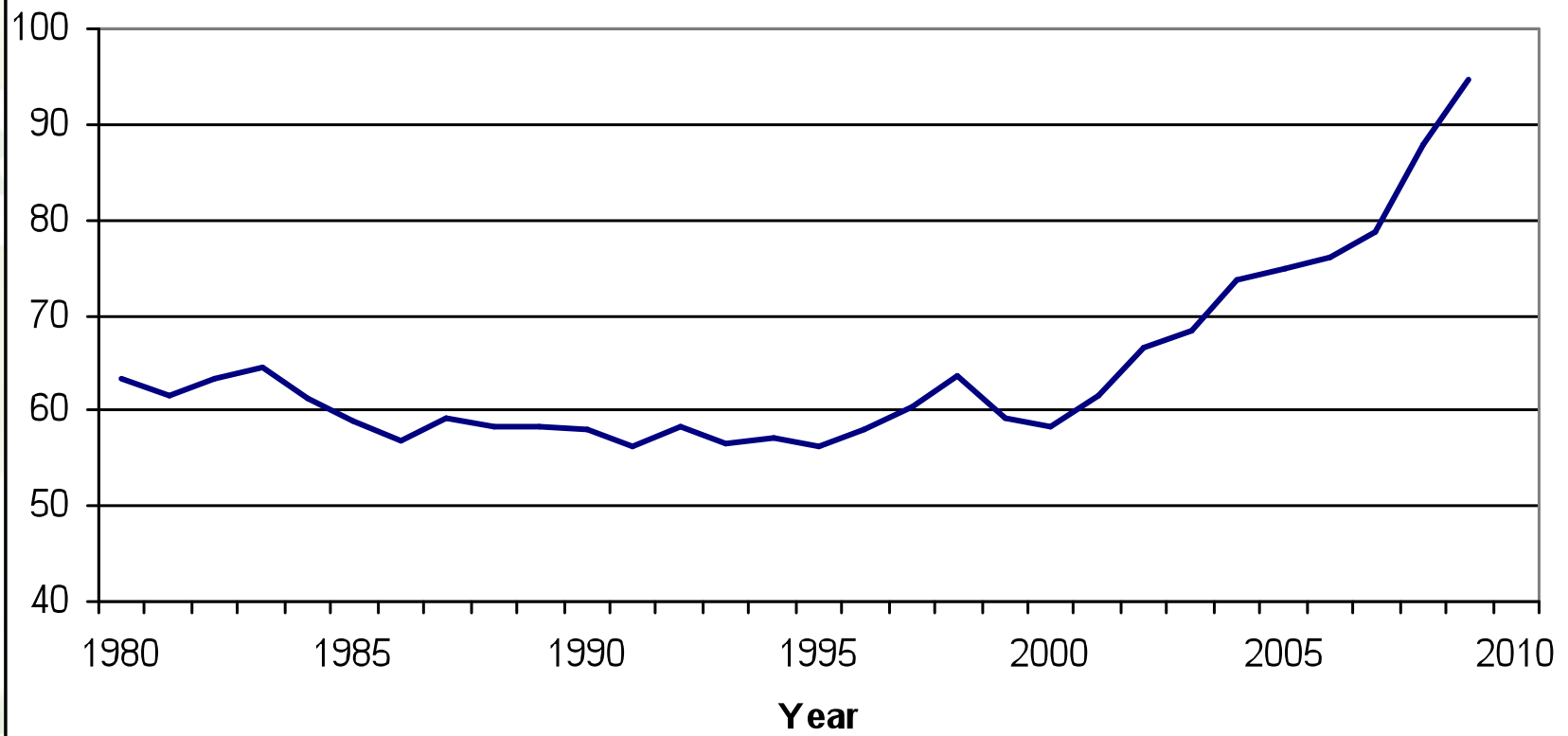
Fiscal Situation

- Long history of budget deficits
 - Modest before 2000
 - Much larger in recent years
- Revenues and expenditures are falling shares of PR incomes
 - Expenditures have fallen from 30 to 25 percent of GNI
 - Revenues from 30 to 22 percent of GNI
- Public debt growing at unsustainable rate
 - Increased by 20 percent of GNI in past two years
 - Deteriorating bond ratings

Revenues and Outlays, 1990-2008 (Percent of Gross Product)



Public Debt (%GNP)



COFINA

- New bond issuance entity
 - Dedicated sales-tax revenue shifted from the general fund
 - Half of sales tax
 - Guaranteed revenue stream for 50 years
- Issue debt in anticipation of revenue and transfer back to the general fund
 - No net gain, but circumvents limits on GF borrowing.

Credit Problems

- PR banks damaged by involvement in mainland mortgage market
- Loan defaults in PR due to severity of economic crisis
- Dangers of contagion effects
- Severe constraint on economic recovery

Development Program

- Lack of continuity
 - programs change with every new administration
 - Programs do not appear to be designed in line with Puerto Rico's strength
- Central problem is jobs, jobs,
- Making Puerto Rico a good place to do business
- Need for tax reform
- Regulatory reform