



Asset Building in Puerto Rico: A Study of Children Development Accounts in Caguas

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Abstract

In this paper we examine the establishment and operations of a CDA program in Caguas, Puerto Rico. This program affords us an opportunity to test whether asset-building policies can provide a new approach to social welfare in Latin American countries and Hispanic communities in the United States, a middle way between paternalistic, government-based social programs on the one hand and so-called neo-liberal approaches on the other. First we provide a brief summary of Latin America and Puerto Rico's institutional heritage. We then make a case for implementing CDAs in Puerto Rico and Latin America based on and largely derived from John Rawls's influential Theory of Justice. We believe this approach could be useful for policy advocates in Latin American countries due to the historical influence of social contract theories, especially that of Rousseau's, in the political development of the region. We conclude with an analysis of the CDA program in Caguas and the lessons derived from our experience as advisors to the municipal government in setting up this program.

Introduction

Over the last decade or so, the concept of asset-building as a means for promoting economic development has gained widespread theoretic and empirical support. Within the broad field of asset-building, children development accounts (CDAs), in specific, have been the subject of significant academic research and various policy initiatives around the world.

One of the objectives of this policy focus on children accounts is to enable asset accumulation—and the related build-up in capacities for social and economic development it facilitates—to commence at the very beginning of life and to continue throughout the entire life cycle. The emphasis on children also affords policymakers an opportunity to break the cycle whereby inequality of results in one generation automatically translates into inequality of opportunities in the next.

In this paper we examine the establishment and operations of a CDA program in Caguas, Puerto Rico. This program affords us an opportunity to test whether asset-building policies can provide a new approach to social welfare in Latin American countries and Hispanic communities in the United States, a middle way between paternalistic, government-based social programs on the one hand and purely market-based approaches on the other.

Asset-building, however, does not occur in a vacuum, it takes place in the context of existing social institutions. That is the reason why we first provide a brief summary of Latin America and Puerto Rico's institutional heritage. We then proceed to make a case for implementing CDAs in Puerto Rico and Latin America based on and largely derived from John Rawls's influential Theory of Justice. We believe this approach could be

useful for policy advocates in Latin American countries due to the historical influence of social contract theories, especially that of Rousseau's, in the political development of the region. We conclude with an analysis of the CDA program in Caguas and the lessons derived from our experience as advisors to the municipal government in setting up this program.

The Institutional Heritage of Latin America and Puerto Rico

Puerto Rico was a Spanish colony for a little over 400 years until it was ceded by Spain to the United States at the end of the Spanish American War. Since then many academics have excluded the island from the definition of Latin America, a “decision which many find harsh but which has been justified by its very different pattern of development as a result of its special relationship with the United States.”¹ However, four centuries of institutional development cannot be undone overnight—scholarly debates notwithstanding.

Spain's principal interest in its colonies in the New World was to obtain gold and silver, “a mercantilist obsession that Spain retained long after that doctrine had become discredited in Europe.”² This enduring fixation with mercantilism, which equated a nation's wealth with a positive trade balance and the accumulation of metallic reserves, manifested itself in economic regulations that prevented Spanish colonies from producing manufactured goods for their own consumption because that would have reduced their need for imports from the Spanish mainland.³ Spain, thus, viewed its colonies largely as extractive enterprises and actively discouraged the establishment of indigenous

¹ Victor Bulmer-Thomas, *The Economic History of Latin America Since Independence*, (Cambridge University Press, 2003), p.2

² James Dietz, *Economic History of Puerto Rico: Institutional Change and Capitalist Development*, (Princeton University Press: Princeton, NJ, 1986), p.6.

³ Bulmer-Thomas, *supra*, n. 1 at 22.

agricultural or manufacturing production for export. So strong was this imperative that according to some observers by 1580 “Spaniards became a rentier race, a nation of gentlemen, living in parasitic dependence upon the gold and silver of the Indies and the industry of the Low Countries.”⁴ This lack of attention to productive activities highlights a fundamental failing of economic policy during the Spanish era and imposed enormous costs on Spanish colonies throughout the New World.⁵

Puerto Rico was not the exception to this rule and it is not until the 1830s, when Spain had already lost most of its colonies in the New World, that the island became a significant producer of coffee and sugar for export. Until that time, however, the island had been one of the Spanish Empire’s poorest colonies and it lacked any significant savings, accumulated profits, or agricultural surplus to finance its economic development.⁶

The lack of financial capital posed a significant constraint for the development of the island’s economy, an institutional weakness compounded by two other factors. First, there were no banks or lending institutions capable of mobilizing financial resources from abroad. This financial intermediation failure was caused in large part by powerful landowners and large merchants who had a monopoly on lending to smaller producers, often at usurious rates.⁷ This monopoly would last well into the 19th century, and it is not until the 1880s that the first financial institutions are established in the island.

⁴ Gerald Brenan, *The Spanish Labyrinth: The Social and Political Background of the Spanish Civil War*, (Cambridge University Press, 2006)(originally published in 1943), p. 11.

⁵ John H. Coatsworth, “Economic and Institutional Trajectories in Nineteenth-Century Latin America” in *Latin America and the World Economy Since 1800*, John H. Coatsworth and Alan M. Taylor, editors, (Harvard University Press: Cambridge, MA, 1998), p. 31.

⁶ Dietz, *supra*, n. 2 at 25.

⁷ *Id.* at p. 29.

Second, there was a shortage of generally accepted and widely circulated currency in the island. In 1813, the Crown authorized Venezuelan coins to circulate as legal tender in Puerto Rico. This was the state of affairs until 1857, when Venezuelan currency was replaced by the Mexican peso. Nonetheless, the continuing shortage of currency forced some haciendas and commercial houses to issue their own coins and paper money. It is not until 1895 that the Crown allowed for the minting, in Spain, of Puerto Rico's own currency, a development that facilitated commercial transactions in the island.⁸

The Spanish also brought with them a whole host of social and cultural institutions. At the time of the conquest the Spanish mainland had been recently reunited, barely, under one monarchy and its society was organized in a hierarchical, organicist, and corporatist fashion, with the Monarchy and the Church at the top. Political and civil rights accrued to groups that openly declared their loyalty to the Crown (aristocrats, merchants, artisans, landowners, etc.) instead of to the people as a whole or to individuals as citizens.

This form of social organization, originally rooted in the thought of Saint Thomas Aquinas, was updated through the work of 16th and 17th century Spanish neo-scholastics such as Francisco Suárez. According to Howard Wiarda, a perceptive observer of Spain and Latin America,

There is in these jurists a sense that government operates on the basis of a contract between royal authority and the community. This is what was meant in earlier writings when Spain and Portugal were referred to as "contract states," governed in their state-society relations by a variety of organic laws, concordats, ordinations and regulations linking central authority to a variety of societal groups (Church, military,

⁸ *Id.* at p. 89. The Puerto Rican peso remained in circulation until 1900, at which time it was retired by the United States at the rate of 60 U.S. cents to the peso.

guilds, towns, universities, regional entities, eventually business and labor) in a system of mutual, community rights and obligations.⁹

The social organization of Spanish colonies in the New World reflected this strong tradition of centralized authority, class hierarchy, and group rights. This explains why it is difficult to characterize the Latin American Wars of Independence (1807-25) as truly popular revolutions. There was no Lockean emphasis on individualism, limited government, pluralism, and property rights, as in the United States in 1776; nor were there many voices clamoring for equality, fraternity, and liberty, as in France in 1789.

Indeed, most of the constitutions established in the newly independent countries of Latin America were deeply influenced by Rousseau's vision of the social contract, which Latin American elites viewed as a "secular, rationalist, and updated vision of the state and state-society relations that was extremely close to Latin America's hallowed, historic Thomistic tradition."¹⁰ Rousseau stressed the organic unity of society, the coming together of all social groups, and the subordination of private individual rights to the "general will". This system gave fundamental importance and priority to the powerful sovereign, who was the sole interpreter of both the general will and the collective good.

In Puerto Rico, which remained a Spanish colony until 1898, the main effect of the Wars of Independence was a large influx of royalist supporters (both Spanish and Creole) who fled the newly independent countries. Ironically, perhaps, Puerto Rican society became more conservative and the island came under closer supervision of the Spanish Crown after the independence of the other colonies. In sum, by the time U.S.

⁹ Howard J. Wiarda, *The Soul of Latin America: The Cultural and Political Tradition*, (Yale University Press, New Haven, CT, 2001), p.93.

¹⁰ *Id.* at p. 129.

troops disembarked in 1898, Puerto Rico was an agricultural, conservative, traditional, and extremely poor society, little more than a crumbling colonial backwater of the terminally weak Spanish Empire. It is in this institutional context that we have to analyze asset-building policies in Latin America, in general, and in Puerto Rico, in specific.

Asset Building as Fairness

We base our analysis on one of the most important, and influential, of the contemporary theories of justice, namely, that of John Rawls. His theory has many elements and we will be able only to summarize it in a schematic way in this paper. We begin with his own admission that he saw himself writing in the tradition of Locke, Rousseau, and Kant.¹¹ His objective was to generalize and carry “to a higher level of abstraction” the familiar social contract theory elaborated by those philosophers. In order to accomplish this objective he stressed that the subject matter of the original social contract was “not to enter a given society or to adopt a given form of government, but to accept certain moral principles.”¹²

In specific, the principles of justice that Rawls sets forth in his theory are those that free and rational persons would accept, or agree to, in an initial position of equality. This original position corresponds to the state of nature in traditional social contract theory. According to Rawls, “among the essential features of this situation is that no one knows his place in society, his class position or social status, nor does any one know his fortune in the distribution of natural assets and abilities, his intelligence, strength, and the like...the principles of justice are chosen behind a veil of ignorance.”¹³ People

¹¹ John Rawls, *A Theory of Justice*, revised edition, (Belknap Harvard University Press: Cambridge, MA, 2003), p.10.

¹² *Id.* at p.14.

¹³ *Id.* at p.11.

deliberating behind this veil of ignorance would determine the principles of justice that would govern how social institutions should distribute fundamental rights and duties and determine the division of the advantages realized from social cooperation. Since the relevant principles of justice were derived in an initial situation of strict fairness, the resulting society in which those principles are to be applied is also, by definition, just.

After substantial elaboration, Rawls boiled down his theory to two principles of justice. The final formulation of these precepts is as follows:¹⁴

1. **First Principle:** Each person is to have an equal right to the most extensive total system of equal basic liberties compatible with a similar system of liberty for all.
2. **Second Principle (the “difference principle”):** Social and economic inequalities are to be arranged so that they are both:
 - a. To the greatest benefit of the least advantaged, consistent with the just savings principle, and
 - b. Attached to offices and positions open to all under considerations of fair equality of opportunity.

The first principle of justice guarantees equality of citizenship by securing certain basic liberties for all. Among these liberties Rawls enumerates political liberty; freedom of speech and assembly; liberty of conscience and of thought; freedom of the person (from oppression and physical assault); the right to hold personal property; and the freedom from arbitrary arrest and seizure.

The second principle of justice applies in general to the distribution of primary goods and to the design of organizations “that make use of differences in authority and responsibility.” Rawls emphasized that “while the distribution of wealth and income need not be equal, it must be to everyone’s advantage, and at the same time, positions of

¹⁴ Rawls, *supra*, n. 11 at 266. Rawls also set forth two priority rules to resolve conflicts between the principles of justice but these are not relevant to our discussion here.

authority and responsibility must be accessible to all.”¹⁵ Thus, while the distribution of income and wealth and positions of authority may vary, such distribution is not left to the vagaries of nature, chance, or the market, but rather it is subject to the explicit constraints set forth in the second principle.

This second principle becomes of central importance in making a social contract argument in favor of asset-building policies. Rawls’s theory of justice allows for social and economic inequalities so long as they are structured “to the greatest benefit of the least advantaged, consistent with the just savings principle.” This requirement that each generation put aside its share of “just savings” arises directly from the premises that govern Rawls’s original position.

When the parties to the social contract analyze the problem of justice between generations “they do not know to which generation they belong, or the stage of civilization of their society. They have no way of telling whether it is poor or relatively wealthy, largely agricultural or already industrialized, and so on. The veil of ignorance is complete in these respects.”¹⁶ They do understand, however, that if they are to guarantee the existence of their society over successive generations, then they must “preserve the gains of culture and civilization, maintain intact those just institutions that have been established, and put aside in each period of time a suitable amount of real capital accumulation.” Rawls also assumes that the parties “represent family lines, who care at least about their more immediate descendants and that the principle adopted must be such that they wish all earlier generations to have followed it.”¹⁷ Based on those assumptions, Rawls concludes that since society is conceived as a scheme of cooperation over time, a

¹⁵ *Id.* at p. 53.

¹⁶ Rawls, *supra*, n. 11 at 254.

¹⁷ *Id.* at p. 255.

certain amount of savings is a necessary condition for bringing about the full realization of just institutions and equal liberties over time.

It is in light of the two principles of justice and the considerations set forth above that we must consider asset-building policies in general and of CDAs in particular. First, asset-building policies fully satisfy the requirements of the first principle of justice. Indeed, it could be argued that the social capabilities enabled by asset-building policies are a necessary requirement for “each person to have an equal right to the most extensive total system of equal basic liberties.” This is, in general terms, the approach favored by economists such as Amartya Sen.

Second, asset-building policies allow each generation to pass on to the next a fair amount of capital (broadly defined) as required by the just savings principle. These cultural, human, and financial assets enable the sustainability of just institutions over time. Indeed, these assets could be interpreted as the payment owed for what the current generation received from previous generations and enables later generations to enjoy a better life in a more just society.¹⁸ In addition, many advocates for asset building agree that development occurs across generations.¹⁹ In this sense, asset building policies can help break down the “sediment of past discrimination” that weighs down unfairly on the backs of successive generations through no fault of their own and help bring about the

¹⁸ See Bruce Ackerman and Anne Alshott, *The Stakeholder Society*, (Yale University Press: New Haven, CT, 1999), pp. 77-93.

¹⁹ Yunju Nam, Jin Huang, and Michael Sherraden “Asset Definitions” in *Asset Building and Low-Income Families*, Signe-Mary McKernan and Michael Sherraden, eds., (Urban Institute Press: Washington, DC, 2008), p.25.

institutions needed for individuals to develop their capabilities to the fullest extent possible.²⁰

Third, children development accounts, especially those designed to be universal (available to every child at birth) and progressive (children from poor households receive a larger initial deposit) satisfy the just savings requirement. Children development accounts of this type take account of existing social and economic inequalities and are structured “to the greatest benefit of the least advantaged.”

Finally, although Rawls explicitly argued that the content of the original social contract was limited to first principles, a reasonable argument can be made for the proposition that once the parties to the original social contract agreed to a just savings principle, a rational and fair way of implementing it would be through children development accounts set up at birth. The initial parties would have realized that it was in their own best self-interest, as defined by themselves and not some paternalistic government, to use such an instrument since the very beginning. In other words, it would be rational for free and equal people, acting behind a veil of ignorance, to freely agree to asset building principles and policies in an initial situation that was substantially fair. That is why we conclude that asset building policies can be properly described and justified in terms of a fair social contract.

The actual implementation of asset building policies, however, does not occur under objectively fair conditions. To the contrary, these policies oftentimes must be

²⁰ Robert E. Friedman and Ray Boshara, “Going to Scale: Principles and Policy Options for an Inclusive Asset-Building Policy” in *Inclusion in the American Dream: Assets, Poverty, and Public Policy*, Michael Sherraden, ed., (Oxford University Press, New York, NY, 2005), p. 242, quoting Melvin Oliver and Thomas Shapiro.

implemented in societies where there is pervasive inequality and poverty. That, unfortunately, appears to be the case of modern day Puerto Rico.

The Puerto Rican Political Economy Today

When the United States colonial administrators took over the island, they overlaid a series of *ad hoc* economic, political, and social reforms on top of the traditional society they found in 1898. Through a series of federal laws Puerto Rico obtained free trade with the U.S., the dollar as currency, U.S. citizenship, legislative elections, the New Deal, and a Lockean bill of rights included in the Puerto Rican constitution, which was drafted by Puerto Ricans and adopted by Congress in 1952.

Today, people born in Puerto Rico are U.S. citizens and the residents of Puerto Rico enjoy many of the rights enjoyed by U.S. citizens residing in the fifty states. However, some rights, which under the U.S. Constitution are reserved for citizens residing in the states, have not been extended to residents of Puerto Rico. For example, residents of Puerto Rico cannot vote in national elections, nor do they have voting representation in the final approval of legislation by the full Congress.²¹

Nonetheless, pursuant to a Presidential directive, all departments, agencies, and officials of the executive branch are currently required to treat Puerto Rico administratively “as if it were a state.”²² In addition, Puerto Rico is treated today as a state for purposes of almost all federal legislation, with three important exceptions: (1) federal income taxes (but please note that Puerto Ricans do pay U.S. payroll taxes in full); (2) income support and welfare programs (some of which are capped); and (3)

²¹ For a more detailed discussion of the applicability of the provisions of the U.S. Constitution to Puerto Rico, see Government Accountability Office, *U.S. Insular Areas: Application of the U.S. Constitution*, GAO/OGC-98-5 (Washington, D.C.: November 7, 1997).

²² Memorandum of the President, November 30, 1992, Federal Register, Vol. 57, No. 232, Wednesday, December 2, 1992, p. 57,093.

federal health care programs, specifically Medicaid which applies to Puerto Rico subject to a strict cap on benefits.

In terms of economic affairs, federal legislation applies in all the important areas: agricultural standards, antitrust, aviation, banking, bankruptcy proceedings, food and drug regulation, interstate commerce, environmental laws, intellectual property, international trade, labor standards, maritime issues, securities, telecommunications and so on. However, Puerto Rico differs from the states in terms of its local economic institutions. Specifically, areas such as business permits, contract law, mortgage law, professional regulation, real property transactions, and land use zoning reflect a strong influence from the Spanish civil law system. It could be said, then, that while the hardware of Puerto Rican social institutions is Rousseauian, the operating system of its political economy is Lockean, a structural mismatch that has adversely affected the island's economic development to this day.

Given this history, it should not be surprising that some scholars consider Puerto Rico to be “an extraordinary case study for those interested in the process of economic development and its determinants.”²³ Unfortunately, the economy of Puerto Rico has not been performing well. The island is well into the third year of a recession that shows no signs of abating. Puerto Rico's real GNP decreased by 1.9% during fiscal year 2007 and 2.5% in 2008. Most private sector forecasters expect the economy to shrink by a further 3.1% in 2009 and by about 2.0% in 2010. Positive growth is not projected to resume until 2011.

²³ Barry P. Bosworth and Susan M. Collins, “Economic Growth” in *The Economy of Puerto Rico: Restoring Growth*, Barry P. Bosworth, Susan M. Collins and Miguel A. Soto Class eds., (Brookings Institution Press: Washington, DC, 2006), p.17.

According to the 2007 Puerto Rico Community Survey conducted by the U.S. Census (the local version of the ACS), the median family income in the island was \$20,900, roughly about a third of the \$61,173 reported for the United States. Furthermore, the distribution of that income is extremely uneven, and for certain quintiles even worse than in the United States. As shown in Table 1 below, the bottom 40% of earners in Puerto Rico obtained 8.1% of total income, while the top fifth earned 56.2%. In the United States, the bottom two quintiles received 11.2% of all income, while the top twenty per cent received 50.3% of all income.

	Puerto Rico	US
Lowest Quintile	1.5%	3.4%
Second Quintile	6.6%	8.8%
Third Quintile	12.8%	14.7%
Fourth Quintile	22.8%	22.8%
Fifth Quintile	56.2%	50.3%

Source: Puerto Rico Community Survey 2007

Finally, the Gini index, as calculated by the U.S. Census, was 0.544 for Puerto Rico and a slightly better 0.467 for the United States in 2007.

Unemployment in Puerto Rico has traditionally been significantly higher than in the United States, with double-digit rates being the norm for the past 30 years or so. According to the Puerto Rico Labor Department, the unemployment rate in the island was 12.2% in August 2008, while the labor force participation rate was 44.7% (one of the lowest in the world) and the employment rate was 39%. In the United States the

unemployment rate was 6.1%, while the labor force participation rate was 66.0%, and the employment rate was 62% in September 2008.

Wages in the island have also been traditionally lower than in the United States. An estimate done in 2003 found that the average wage in Puerto Rico was 54% of the mainland average, a ratio that is maintained, with some minimal variation, across all occupations. This difference is attributed largely to lower productivity levels in the island, with labor productivity being estimated at 58% of the U.S. level.²⁴

It should not be surprising then that poverty in Puerto Rico is widespread. The 2007 Puerto Rico Community Survey estimates that 41.4% of all families, 45.5% of all people, and 55.3% of all children living in Puerto Rico reported income below the federal poverty level during the past 12 months. The respective figures for the United States were 9.5%, 13.0%, and 18.0%.

This measure, which uses the poverty thresholds developed by the U.S. Census, probably underestimates the economic distress of Puerto Rican families as it does not take into account the higher cost of living in the island. Calculating cost of living differences among different geographic areas is difficult. However, the federal Office of Personnel Management calculates cost of living allowances (COLAs) for federal employees living in offshore non-foreign areas, including Puerto Rico. These adjustments are based on an index which uses the cost of living in the DC-area as its base (DC = 100). For 2007 the cost of living allowance for federal employees living and working in Puerto Rico was 14%.²⁵ Thus, according to the federal government it is 14%

²⁴ Bosworth and Collins, *supra*, n.23, at 45-46.

²⁵ Federal Register, Vol.73, No.165, Monday, August 25, 2008, p. 50,177.

more expensive for a federal employee to live the same lifestyle in Puerto Rico as in the DC area.

The following analysis gives us an idea of the level of economic stress in Puerto Rico. The Economic Policy Institute calculates that a family of four (two adults, and two children) living in the DC area would need to make \$67,652 a year just to meet its “basic needs” budget. According to the analysis by the federal Office of Personnel Management cited above that same family would need to make \$77,123 to maintain the same lifestyle in Puerto Rico, yet the median family income in the island is only \$20,900.

In terms of education, in 2007, 66% of the population 25 years and over in Puerto Rico had at least graduated from high school; 16% had a bachelor’s degree; and 6% had completed a graduate or professional degree; while 34% reported not finishing high school. The relevant figures for the United States were 85% (high school), 17% (bachelor’s degree), and 10% (graduate or professional degree), while 16% were reported as high school dropouts.

In sum, Puerto Rico is a relatively poor country, where income distribution is fairly uneven, and with growth, employment, education, and income levels significantly below those in the United States.

Children Development Accounts in Caguas

During 2004 and 2005 the Center for the New Economy (CNE), a San Juan-based, non-partisan, nonprofit, independent think tank, published policy briefs and opinion pieces in the local press in support of the establishment of children savings accounts in Puerto Rico. These efforts yielded some positive results. For example, in 2004 one of the candidates for governor adopted a version of children development

accounts in his platform. Unfortunately, this idea was not implemented after he took office.

In the summer of 2006, the visionary Mayor of Caguas, through his advisor for economic development, contacted CNE with the idea of establishing a city-based CDA program. CNE drafted a policy memorandum for the mayor outlining some suggestions for establishing such a program. In October 2006, the Federal Reserve Bank of New York held a symposium on CDAs in Caguas, with the participation of Ray Boshara, from the New America Foundation and representatives from the Center for Social Development at the Washington University in St. Louis. The city of Caguas and CNE then executed a Memorandum of Understanding in December 2006, through which CNE agreed to advise and help the city of Caguas with the design and implementation of the CDA program on a *pro bono* basis.

Early in 2007, members of the Mayor's staff, with CNE's input, drafted a municipal ordinance to authorize the CDA program and the rules and regulations setting forth the procedures for administering the program within the bureaucracy of the city of Caguas. These tasks were substantially completed by March 31st, 2007.

The next step was to negotiate with Banco Popular the structure of the accounts. These negotiations took longer than expected for two reasons. First, the mayor wanted to create a master trust (the "Trust") to hold aside the funds for initial deposits to be made by the city. This Trust would receive annual deposits from the municipality in the amount of \$500,000, which is equal to \$250 for each of the 2,000 births reported annually to residents of Caguas. The mayor's intent in doing this was to preserve the political

viability of the program by forcing any successor to actually dismantle the trust in order to end the program.

The second complication arose from the initial structure of the accounts. The idea was that Caguas would open individual savings and/or investment accounts under the Trust for every child born as a resident of Caguas. In order to qualify, the parent or legal guardian of the child had to apply at the Caguas Office of Children's Affairs for an initial funding voucher by signing an agreement. The voucher provided by Caguas would be used to buy an initial participation in the trust (the "Trust Interest") and open an individual account for and in the name of the child (the "Beneficiary").

After individual accounts were set up, parents and others could make additional contributions to individual accounts and to the program in general, thus increasing the Beneficiary's Trust Interest. The city of Caguas would also make additional contributions to the individual accounts during the life of the program. The corpus of the trust would have been invested in various mutual funds and low risk securities to insure capital preservation. The Trust Interests could only be redeemed and its proceeds would be disbursed to the Beneficiary for eligible educational expenses and/or qualified entrepreneurial plans when the Beneficiary completes his or her secondary education and fulfills the requirements established by the program pursuant to the enabling statute and/or program rules and regulations.

This initial structure was discarded because, after consultation with legal counsel, Caguas determined that the Trust Interests were likely deemed to be "securities", as such term is defined under Section 2(a)(1) of the Securities Act of 1933 ("1933 Act"). Although corporate counsel determined that the Trust Interests were probably exempt

from registration under §3(a)(2) of the 1933 Act, the municipality of Caguas decided to change the account structure in order to avoid any risks associated with securities laws, rules, and regulations.

The city of Caguas and Banco Popular agreed then that the voucher issued by the city to the parent in the amount of \$250 would be used by the bank to open a “Baby Bonds Savings Account”, specifically designed by Banco Popular for the city of Caguas.

Procedure for Opening the Baby Bonds Savings Accounts

- The parent of the newborn baby applies for a voucher at the Caguas Office of Children's Affairs. The application process requires the parent to submit a birth certificate for the baby and proof of residence in Caguas.
- After reviewing the documents, the Caguas Office of Children's Affairs issues a voucher to the parent, in the name of the child, and a letter addressed to Banco Popular, notifying the bank that the person bearing the voucher complies with the program requirements.
- The parent takes the voucher and the cover letter to any Banco Popular branch in Caguas to open the account.
- At the branch, the parent executes an account agreement with Banco Popular and authorizes the bank to open an account in the children’s name.
- The bank branch takes the voucher, debits the Caguas Trust for \$250, and credits the new account in the same amount. This is a process internal to Banco Popular since both the Trust and the child account are held at Banco Popular.

Account Characteristics

The Baby Bonds Savings Accounts are:

- **Universal** – The parents of all children born to bona fide residents of Caguas can apply to receive a \$250 voucher that can be used to open a Baby Bonds Savings Account at Banco Popular.
- **Supplemented** – By the city of Caguas in an amount to be determined, probably when the beneficiary finishes sixth grade.
- **Restricted** – Access to the funds deposited in the account and the interest thereon will be restricted until the child reaches the age of 18. At that time he/she can access the funds to finance higher or vocational education or to open a small business. The only exemption is for a withdrawal, of up to 20% of the account balance, when the child finishes 6th grade in order to purchase a computer or other educational equipment.
- **Insured** – By the FDIC to the full extent permitted by applicable federal laws, rules, and regulations.
- **Private Sector Friendly** – The accounts will be opened at Banco Popular, which is a private financial institution. Banco Popular charges 75 basis points on an annual basis for managing the accounts.
- **Integrated** – With financial education for the children and the parents. The city of Caguas has agreed to promote the teaching of financial education in Caguas’s public schools.
- **Taxable** – Income taxes in Puerto Rico are under the jurisdiction of the state government. Interest income on the accounts will be taxable, but under current Puerto Rico law the first \$2,000, on an annual basis, in interest income from savings accounts is exempt from taxation. In addition, there will be no

contribution limits or caps because the accounts are not tax privileged. This feature allows recipients to leverage contributions from all sources.

Other important characteristics of the Baby Bonds Savings Accounts are:

- **Ownership** – The account is in the child’s name and the parent agrees, in the initial application, to comply with all account restrictions. Parents cannot transfer account balances to other accounts or use the account as collateral.
- **Initial Deposit** – The city of Caguas makes the initial seed deposit of \$250. The HIMA hospital is supplementing the city’s initial deposit with an additional \$25 for those babies born in their hospital in Caguas. Other institutions are also considering supplementing this initial deposit.
- **Additional Deposits** – Banco Popular requires the first additional deposit to be at least \$25. Subsequent deposits must be in amounts of at least \$10.
- **Distribution upon Death of the Beneficiary** – Private contributions pass on to the beneficiary’s legal heirs or successors according to applicable law, rules and regulations of the Commonwealth of Puerto Rico, while the public contribution reverts to the city of Caguas.
- **Interest Rate** – The accounts bear interest at the same rate that Banco Popular pays on its basic Individual Retirement Accounts. It is set annually and credited quarterly to the account. The current annual interest being paid on the Baby Bonds Savings Accounts is 4.71%.
- **Management Fees** – Banco Popular charges 75 basis points to be paid from the annual return on the account. Thus, if the accounts are currently yielding 4.71%, Banco Popular keeps 0.75% and credits the rest to the account.

Program Results

The first account vouchers were distributed in February 2008, so there is very little information available with which to evaluate the program's effectiveness. Some thirty-five vouchers were distributed at that date. These accounts reflected the following activity:

1. Additional Deposits	
March	14 deposits of \$50.00 4 deposits of \$75.00 1 deposit of \$150.00
April	5 deposits of \$50.00 1 deposit of \$25.00
May	1 deposit of \$50.00
August	1 deposit of \$120.00
2. Interest Rate	4.71%
3. Average Account Balance as of August 31, 2008	\$306.58

The city distributed an additional 79 account vouchers on October 1st, 2008. Information with respect to these accounts is not yet available.

Lessons from the Caguas Experience

Although the program has been in operation only for a brief period of time, we can draw some preliminary lessons from our experience working with Caguas. First, in our view, cities face considerable challenges in implementing these types of programs. Significant administrative and financial resources need to be allocated to design, establish, and administer a CDA program. Many cities may find it difficult to assign their scarce resources to programs of this kind. In our opinion, state-level governments could perhaps offer better platforms from which to deliver CDA programs, as they probably have the requisite resources to adequately manage these programs, while preserving enough connections with local communities to be able to conduct effective outreach efforts aimed at potential beneficiaries.

Second, we believe CDA programs should be located in agencies dedicated to economic development and not in welfare administration departments. CDAs should be seen as an economic development tool not as welfare. In Caguas, the CDA program is located under the Office of Children's Affairs which is structured as a social welfare outreach operation. We understand that welfare offices may have better access to community networks than economic development agencies, but, in our view, for a CDA program to have the proper focus; it should be located within economic development agencies. In addition, locating CDA programs in social welfare offices may adversely affect the take up rate among middle and upper income families who are not familiar with these bureaucracies or their procedures.

Third, community outreach is essential for the success of the program. One of the deficiencies of the Caguas program is precisely its lack of funding for outreach and marketing purposes. The city is aware of this problem but it simply does not have the resources to dedicate to this task right now. Perhaps, partnerships with financial institutions could be established to help with this phase of the program.

Finally, during the course of our advocacy efforts we noticed that arguments based on stakeholding had a particularly positive resonance with the Puerto Rican public, politicians, and policymakers. Stakeholding is a concept that is relatively easy to explain. It basically means that each citizen should have the opportunity to commence his or her life with a small endowment of economic or financial resources and they should be able to use those resources to advance their own interests, as defined by them and not by some government bureaucrat. In this way social cohesion is promoted, given that all persons

have their own stake, their share of the social capital, since birth, and presumably they will undertake significant effort to preserve and increase it over time.

We believe that arguments based on stakeholding were particularly effective in Puerto Rico because it is a concept that bridges the gap between its Spanish, Rousseauian social institutions and its Lockean political economy. On one hand, stakeholding with its emphasis on bringing together all social groups by giving each member of society a piece of the pie, fits together well with Rousseau's vision of the social contract. On the other hand, as professors Ackerman and Alstott have noted, stakeholding recognizes that "no person is inherently better than any other, and thus everyone has a right to a fair share of initial resources with which to begin and plan her adult life, regardless of whether her parents were rich or poor, frugal or improvident."²⁶ In this sense, then, stakeholding, with its emphasis on individual equality, also fits neatly with Lockean and Rawlsian conceptions of the social contract. Thus, arguments based on stakeholding could be successful in promoting children development accounts in other Latin American countries.

Conclusion

Asset-building policies provide a new approach to social welfare, a middle way between paternalistic, government-based social programs on the one hand and simply letting the chips fall where they may, according to the ruthless logic of the all-powerful market, on the other.

The asset-building alternative is firmly based on the principle of equality of life chances. According to this principle, a person "should not be able to enter a hospital

²⁶ Ackerman and Alstott, *supra*, n. 18, at 32.

ward of healthy newborn babies and, on the basis of class, race, sex, or other arbitrary native characteristics, predict the eventual positions in society of those children.”²⁷

In furtherance of that principle, asset-building advocates explicitly reject the notion that natural chance or social contingencies, which from a moral standpoint are equally arbitrary, should govern the distribution of opportunities for development and determine social and economic outcomes. Asset-building policies, in this sense, represent the best of the classical liberal tradition, which asserts that “liberalism, in its noblest and also in most essential sense, had always meant (and, faintly, here and there it still means) an exaltation, a defense of the fundamental value and category of human dignity.”²⁸

This is not to say that enactment of asset-building policies or the implementation of children development accounts automatically will solve the thorny social problem of inequality of opportunity. Unfortunately, it will take time and improvements in many other areas (education and health care come to mind) before we can walk into a maternity ward and be unable to predict, without any degree of accuracy, where most of those children will finish in the social scale at the end of their lives. The asset-building movement, however, represents some of the best thinking of the current generation about the intractable problem of social inequality; makes a significant contribution to the never-ending dialogue about the relative importance of liberty and equality; and advocates for a social welfare approach that is certainly worth pursuing.

²⁷ James Fishkin, *Justice, Equal Opportunity and the Family*, (Yale University Press: New Haven, CT, 1983), p. 5.

²⁸ John Lukacs, *Democracy and Populism: Fear and Hatred*, (Yale University Press: New Haven, CT, 2005), p. 49.

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