



To: Bipartisan Congressional Task Force on Economic Growth in Puerto Rico

From: Center for a New Economy

Date: 22 August 2016

Re: Short-Term Recommendations for Restarting Economic Growth in Puerto Rico

We are writing in response to the request for “stakeholder input” issued by the Bipartisan Congressional Task Force on Economic Growth in Puerto Rico (the “Task Force”), which was established pursuant to Section 409 of the Puerto Rico Oversight, Management, and Economic Stability Act (“PROMESA”).¹

Jumpstarting and sustaining economic growth over the long-term is a complicated undertaking. Ever since the days of Adam Smith, economists have struggled to understand the process of economic growth. While this effort has produced a better understanding of the sources of growth, the subject has proven elusive and many puzzles remain unsolved.

At the beginning of the 21st century it has become clear that there is no “silver bullet” or “cookbook recipe” solution to the problem of economic growth. In other words, economic growth is not simply a function of exiguous regulation, low wages, or preferential tax treatment. Rather, the process of growth is quite complex, involving the interplay of many factors and variables that must be present if a country is to succeed.

Given the complicated nature of the economic growth process, the large amount of federal laws, rules and regulations that affect the Puerto Rican economy, and the tight deadline, we suggest the Task Force divide its efforts in two parts: (1) analyzing Federal policies that could be enacted relatively quickly to jumpstart the Puerto Rican economy and (2) setting the stage for a deeper examination, in conjunction with Puerto Rican stakeholders, of the structural constraints to growth in Puerto Rico.

In the short-term we recommend the Task Force focus on Federal policies to (1) provide Puerto Rico with some fiscal space; (2) incentivize participation in the formal labor force; (3) stimulate new economic activity and the demand side of the labor market through increased lending by the private sector to small and medium enterprises and new public investment in infrastructure; and (4) lay the foundation for strengthening innovation, research and development capabilities in Puerto Rico.

¹ Public Law 114-187.



Therefore, the Center for a New Economy (“CNE”) makes the following policy recommendations:

1. Parity in Medicaid Funding – The Commonwealth of Puerto Rico provides health insurance coverage to approximately 1,686,000 qualifying low-income residents of Puerto Rico at a cost of \$2.8 billion during fiscal year 2015.² Yet, Medicaid funding for Puerto Rico is limited in two ways. First, Puerto Rico receives the lowest Federal Medical Assistance Percentage (“FMAP”) rate allowed by the Medicaid law. Second, that amount is subject to a strict funding cap. The result is that the government of Puerto Rico bears an undue burden, relative to the states, of the cost of providing low-income residents with adequate health insurance coverage.³ These costs, in turn, have been a major driver of Puerto Rico’s chronic deficits.

CNE, therefore, supports the proposal included in the Administration’s budget for fiscal year 2017 that would (1) remove the cap on Medicaid funding in the territories, (2) gradually increase the Federal support territories receive through the Federal Medicaid match by transitioning them to the same level that is received on the mainland, and (3) expand eligibility to 100 percent of the Federal poverty level in territories currently below this level. To be eligible for maximum Federal financial support, the territories will have to meet financial management and program integrity requirements and achieve milestones related to providing full Medicaid benefits.

Providing Puerto Rico with equal treatment under the Medicaid program would give the Commonwealth some much-needed fiscal space and would allow it to re-program a significant amount of funds to provide short-term economic stimulus to jumpstart economic growth.

2. Create a Puerto Rico Earned Income Tax Credit – The decade-long recession has taken a toll on Puerto Rico’s finances, its economy, and its people. To reward work and break this vicious cycle, the Administration’s budget for fiscal year 2017 proposes establishing a federally funded EITC for Puerto Rico. The EITC is already available to Americans living in the 50 States and the District of Columbia, and providing the EITC in Puerto Rico would create incentives for work and increase participation in the formal economy.

In addition, the Federal EITC is the most effective anti-poverty program in the United States and recent research also shows that it encourages work, promotes savings, helps poor families smooth out the effect of unexpected financial shocks, and builds a strong sense of

² Commonwealth of Puerto Rico, *Financial Information and Operating Data Report*, November 6, 2015, p. 67.

³ A portion of these costs has been covered recently with non-recurrent funds allocated to Puerto Rico and other territories through the Affordable Care Act. These funds are currently scheduled to be depleted by early 2018—if not earlier.



future orientation among recipients.⁴ Extending this program to Puerto Rico, which would provide a significant wage supplement to low-income Puerto Rican working families, could be expected to stimulate aggregate demand in the short-run.

3. Increase Small Business Administration Lending – According to data recently published by the Federal Reserve Bank of New York commercial lending in Puerto Rico has declined significantly since 2006.⁵ According to the New York FED analysis, this credit contraction is partly due to a decrease in demand for credit due to weak economic conditions in the island and partly due to the general weakness of the financial sector, which is still recovering from the closing of several financial institutions over the last five years.

However, access to affordable credit is extremely important to support the creation and expansion of business enterprises, especially small and medium businesses that form the backbone of any economy. CNE therefore proposes amending the Small Business Act to establish a Puerto Rico-specific program to lend and/or guarantee loans to new, existing, or expanding small and medium businesses in Puerto Rico.

4. Invest in New Infrastructure – Puerto Rico needs to repair and upgrade its electricity grid, undertake several large water treatment projects, and increase broadband access. The Rural Utilities Service of the United States Department of Agriculture provides loans/guarantees for these kinds of investments. We propose amending the applicable laws, rules, and regulations so the entire island qualifies for these loans and/or guarantees. This is the kind of smart public investment that in addition to creating jobs and providing a short-term stimulus to the economy also promotes long-term economic growth by establishing a strong platform the private sector can use to generate new economic activity, increase private sector employment, and prompt income growth.

5. Promote Innovation – Promoting technological change and innovation are important to sustaining economic growth over the long-term. That is why CNE supports proposals made last year to establish a Caribbean Biomedical and Health Sciences Center as well as a

⁴ See Bruce D. Meyer, “The Effects of the Earned Income Tax Credit and Recent Reforms” in *Tax Policy and the Economy*, Volume 24, Jeffrey R. Brown, ed., (University of Chicago Press, 2010); Sara Sternberg Greene, *The Broken Safety Net: A Study of Earned Income Tax Credit Recipients and a Proposal for Repair*, New York University Law Review, Vol. 88, No. 2, May 2013; V. Joseph Hotz, Charles H. Mullin, and John Karl Scholz, *Examining the Effect of the Earned Income Tax Credit on the Labor Market Participation of Families on Welfare*, NBER Working Paper 11968, (National Bureau of Economic Research: Cambridge, MA, 2006); and Chuck Marr, Chye-Ching Huang, and Arloc Sherman, *Earned Income Tax Credit Promotes Work, Encourages Children at School, Research Finds*, (Center on Budget and Policy Priorities: Washington, DC, 2014), among others.

⁵ See Meta Brown, Andrew Haughwout, Donghoon Lee, Joelle Scally, Magali Solimano, and Wilbert van der Klaauw, *Puerto Rico’s Evolving Household Debt*, August 12, 2016, available at <http://libertystreeteconomics.newyorkfed.org/2016/08/puerto-ricos-evolving-household-debts.html#.V7MzmtUzI0o>



Center for Manufacturing Innovation in Puerto Rico.⁶ These institutions would generate new learning that, in turn, would lead to new investment in R & D, increased productivity, the identification of new areas of comparative advantage for Puerto Rican firms, higher economic growth and the creation of high-quality jobs, which is what will categorically end Puerto Rico's economic stagnation.

6. Establish a Permanent Federal Task Force to Assist Puerto Rico in Dealing with Structural Constraints to Growth – In order for Puerto Rico to benefit from new learning and innovation efforts, it needs to effectively address structural constraints to growth by developing and executing a medium-term economic strategy based on (1) implementing a set of coherent horizontal policies, such as reforming an unnecessarily complicated permitting and licensing system that stifles innovation, lowering energy and other costs of doing business in the island, and substantially improving educational standards; (2) restructuring obsolete institutions; (3) eliminating rampant rent seeking and corruption; (4) discovering new sectorial opportunities through a process of dialogue and consultation with key stakeholders in the private and civic spheres; and (5) “identifying spillovers, externalities, and other areas where [Puerto Rican] society could learn more.”⁷

The process of developing this new economic strategy will require continuous interaction with Congress and the Executive Branch of the Federal government beyond December 31, 2016. Therefore, we suggest that before the work of the Task Force is completed at the end of the current calendar year, a permanent growth commission or working group be established at the Federal level, which could serve as a liaison between Puerto Rican stakeholders, Congress, and Federal agencies on issues related to economic growth. We at the Center for the New Economy have established a Puerto Rico Growth Commission to convene local stakeholders, develop the new economic strategy, and—to the extent Federal action is necessary or required—collaborate with the Permanent Federal Task Force to implement it.

CNE may make additional recommendations in the future but we hope the policy proposals set forth herein are useful to the Task Force. Please feel free to contact us if we can be of further assistance and thank you for the opportunity to participate in this important policymaking process.

⁶ See sections 204 and 301 of the “Puerto Rico Opportunity for Growth, Recovery, and Economic Success and Sustainability Act of 2015” authored by Rep. Nydia Velázquez (D-NY).

⁷ Joseph E. Stiglitz and Bruce C. Greenwald, *Creating a Learning Society: A New Approach to Growth, Development, and Social Progress*, (Columbia University Press: New York, 2014), p. 489.