Memo to the Federal Government: Priorities for Puerto Rico

CNE
Puerto Rico's Think Tank

To: President-elect Joe Biden and Vice-President-elect Kamala Harris
From: Center for a New Economy, Puerto Rico's Think Tank
Subject: Recommendations to Restore Growth in Puerto Rico

As President and Vice-President, you and your team have a tall order ahead. The Biden-Harris Administration has the overwhelming task of rebuilding a weakened economy, investing in a crumbling infrastructure, restoring America's reputation abroad, dispelling conspiracy theories, and uniting a deeply divided society, all the while addressing a global pandemic that continues to kill thousands of people a day.

In Puerto Rico, the challenges are also quite daunting. For many years, the federal policy towards the island was mainly one of benign neglect. More recently, when the federal government opted for intervention, the work resulted in bankruptcy protections but failed to provide crucial economic development mechanisms. Four years after the enactment of PROMESA, Puerto Rico is still grappling with nearly 15 years of economic contraction and a bankruptcy process that appears to have no end in sight. Making matters worse, just a year after PROMESA was signed into law, Puerto Rico was struck by not one but two devastating hurricanes in a span of 14 days.

This year, it has gone through unimaginable hardships, especially after ringing in the new year with a series of earthquakes that affected the southwestern part of the island. Adding insult to injury, the past Administration gated the use of tens of millions of disaster aid appropriated by Congress and imposed overbearing conditions on reconstruction efforts, which for the most part, rendered them ineffective. And if Puerto Rico was limited in its capacity to meet debt obligations prior to all of this, the widespread destruction of the hurricanes, the earthquakes and now the pandemic has decimated any preexisting capacity to do so. One glimpse at economic indicators – where according to the latest Fiscal Plan, GNP has fallen 20 percent since 2008, labor force participation is at 39 percent, poverty for the population overall is at 43 percent and stands at an even higher rate for children at 57 percent – is suggestive of the challenges ahead.

A key problem of any new Administration – and now a slew of struggling economies in its purview – is that the list of priority issues is usually a mile wide and an inch deep. But it is important to highlight to you early on: any resolution to Puerto Rico's bleak economic problems requires mile-deep work. It obliges a profound commitment to correct systemic failings that have lingered for far too long. This memo seeks to inform you and your team of advisors on the state of play and the issues of priority for Puerto Rico as you transition into power and delineate your priorities for the next four years.

You're arriving at the White House at a good time to pursue policies for Puerto Rico that are long overdue. For far too long there has been limited knowledge and understanding in the federal sphere of the U.S.

role in Puerto Rico and the historical antecedents that preceded its current calamities. After years of an aggressive education and advocacy agenda by various policy groups, lawmakers and agency heads seem to have a better understanding (though not nearly to the extent they should) of the inherent programmatic inequities that stifle the island's ability to overcome its many challenges. In general, the federal government should focus its energy on providing the residents of Puerto Rico equal access to federal programs and funding so it can avoid poverty traps and spur economic growth. Significant long-term investments and funding decisions by the federal government will be required. Rebuilding Puerto Rico is a challenge that comes with as much privilege as great responsibility; you have an important opportunity before you.

The magnitude and depth of Puerto Rico's issues could instinctively move officials to tackle everything at once but it is our recommendation that in order to avoid some of the mistakes of the past, instead, you opt for a more targeted and strategic approach. First focusing on reconstruction efforts and access to adequate healthcare and economic programs which have been priority items for some time now and then shifting attention to other – also important – longer term industrial policies.

Reconstruction Efforts

As we enter 2021, the island's reconstruction efforts are far from over. Certainly, natural disasters stress-test the capacity of local governments to respond and advance reconstruction efforts in a prompt and equitable fashion. But Puerto Rico confronted yet another challenge. The Trump Administration imposed numerous provisions that impeded prompt access to recovery funds. Furthermore, if FEMA large permanent work projects are not approved by December 31, 2020, the Commonwealth is at risk of losing tens of millions of dollars appropriated by Congress to revitalize its infrastructure. The desire to punish Puerto Rico for perceived slights delays the restoration of economic growth and does nothing to increase its capability to respond to the COVID-19 pandemic. In that same vein, the continuing desire of the Oversight Board to pursue "right-sizing" measures of the island's government and subsequently filing any gaps with expensive consultants works against the objective of building state capacity in Puerto Rico.

Accelerating disbursement and access to disaster recovery funds is important to ensure families can finally restart their lives – three years later - in secure households. The ability to rebuild other public infrastructure and the energy grid will determine how transformative reconstruction will be. According to the Leadership Group of the FEMA Recovery Support Function, by the end of the 2020 federal fiscal year, approximately $60 billion has been allocated, mostly to FEMA ($29.7 billion) and HUD ($20.2 billion) to address the damages caused by Hurricanes Irma and Maria. Of the total allocated amount, only $14 billion has been spent.

The biggest increase in funding came in mid-September after the local and federal government announced an allocation of $9.4 billion for the Puerto Rico Electric Power Authority's (PREPA) permanent work projects and another $2.29 billion for Puerto Rico's Department of Education to repair and rebuild public schools. While these amounts should not be minimized, what is clear and most important is that the longer it takes to disburse and distribute the federal disaster dollars, the harder it is for individuals to recover from their losses – potentially resulting in harsh consequences for broader economic recovery. If aid lags behind a bureaucratic government process, it could instead, erode the capacity of government to manage other large-scale disaster recovery processes, give rise to additional outmigration and decrease the government's revenue collection capacity.

Existing local government funding is also at risk. Puerto Rico law imposes a four percent excise tax under Act 154 on sales by Puerto Rico-based Controlled Foreign Corporations to their offshore affiliates. In turn, the local duty can be used to reduce the parent company's federal tax liability. For years the IRS has turned a blind eye on the creditability of this local excise tax for federal tax purposes. The Trump Administration, however, was vocal in expressing its discontent with the local law. In 2019 former Secretary of the Treasury Steven Mnuchin went as far as meeting with government officials on various occasions to discuss a phase-out of the tax credit at the federal level, which could lead to some U.S. companies to relocate their Puerto Rico operations abroad. This excise tax makes up $1.8 billion of general fund revenues a year. The elimination or significant reduction of nearly 20 percent of the island's general fund poses a serious threat to its government's capability to provide much needed essential services. It is important to carefully study and mitigate any negative consequences of any changes to Puerto Rico's tax base.

U.S Safety Net Programs

Healthcare

Puerto Rico, just like the world at large, continues to battle a killer pandemic but with the added pressure of lacking enough funding to sustain an already crumbling healthcare infrastructure. Even prior to the healthcare epidemic, 72 of Puerto Rico's 78 municipalities were designated as medically-underserved areas. This is primarily because Puerto Rico and the other U.S. territories have been treated differently under the Medicaid program since its inception. In the case of Puerto Rico, the federal share of the cost of the program, known as the Federal Medical Assistance Percentage (FMAP), was set for many years at 50 percent, the lowest statutory federal share — originally intended to be applied to the wealthiest states. This notwithstanding the fact that Puerto Rico is one of the poorest jurisdictions in the United States. If the FMAP were calculated using the same formula applied to the states, Puerto Rico's share would be 83 percent. This limitation alone severely constrains program delivery, as evidenced by lower eligibility levels, fewer mandatory benefits, lower provider payments, and lower spending per enrollee. The FMAP for Puerto Rico was eventually increased to 55 percent with the enactment of the Patient Protection and Affordable Care Act. However, in addition to the arbitrarily set FMAP, the federal cost share is applicable only until a spending ceiling amount is reached. This cap is arbitrarily set at a very low level. The combination of the low FMAP and ceiling means the Medicaid program in Puerto Rico works essentially as a block grant and for decades the effective FMAP for Puerto Rico was 15 percent or less.

The inadequacy of this funding structure requires congressional action. For too long, Congress' approach has been to provide limited, temporary supplemental funding. Funds for Puerto Rico's Medicaid program were appropriated through the American Reinvestment and Recovery Act of 2009, followed by the Patient Protection and Affordable Care Act of 2010, the Consolidated Appropriations Act of 2017, the Bipartisan Budget Act of 2018, and most recently, the Further Consolidated Appropriations Act of 2020.

The island cyclically faces the hard choice of cutting services or people from its Medicaid program unless additional federal funding is appropriated. Cutting services is hardly an option since the island provides only 10 out of 17 mandatory services offered in U.S states. Further, limiting eligibility is not only unfair, but also morally reprehensible, especially considering Puerto Ricans have just recently survived the destruction of two hurricanes, many of whom lost their jobs and fell below the poverty line.

After much deliberation and hard negotiations, on December 6, 2019, Senate Finance Committee Chairman Chuck Grassley and Ranking Member Ron Wyden announced an agreement that would substantially fund Puerto Rico's Medicaid program with $12 billion in funding over the span of four years. The deal, regrettably, was rejected by the Executive. The final package was reduced to $5.7 billion over a two-year window. While Puerto Rico has enjoyed an improved funding formula at an FMAP rate of 76 percent, a new funding cliff is already looming. Federal funding, once again, expires in September 2021. Your Administration has the potential to advance a permanent fix to Puerto Rico's Medicaid funding stream, one that allows for a stable healthcare system for years to come.

SSI

Another critical component of the U.S. safety net is the Supplemental Security Income (SSI) program. The SSI is a federal program created by Congress in 1972 to replace the Aid to the Aged, Blind, or Disabled (AABD) program and provides cash assistance to the aged, blind, and disabled individuals with limited resources to meet basic living expenses. It is available to residents of the U.S. states, the District of Columbia, and the Commonwealth of the Northern Mariana Islands. However, the old AABD program continues to operate in Puerto Rico, Guam, and the U.S. Virgin Islands (USVI), precluding the three territories from access to the SSI program.

It is important to note the AABD program provides far less benefits to its beneficiaries than the SSI program. Based on data from fiscal year 2011, the Government Accountability Office (GAO) estimated that if Puerto Rico participated in the SSI program, beneficiaries in the island would be eligible to receive between $1.5 billion and $1.8 billion each year. This, in contrast with actual federal expenditures on Puerto Rico's AABD program in fiscal year 2017 of $23.7 million in benefit payments. As the numbers clearly demonstrate, the block grant Puerto Rico received is insufficient to meet increasing needs. Precisely at a time when the elderly have been the hardest hit, Puerto Rico residents are unfairly discriminated from access to the SSI program. According to CNE estimates, allowing Puerto Rico into the

SSI program would provide an estimated $2.58 billion in cash aid to over 435,000 disadvantaged individuals.

There is an ongoing legal dispute regarding the application of SSI to residents of Puerto Rico before the Supreme Court of the United States. In *United States v. Vaello-Madero,* Jose Luis Vaello-Madero argues that the exclusion of Puerto Rico from the SSI benefits program violated the Constitution's Fifth Amendment's equal protection guarantees. The U.S., on the other hand, asserts that the denial of SSI disability payments to Puerto Rico does not violate the Fifth amendment. A U.S. District Court Judge granted Vaello-Madero's motion for summary judgment, essentially agreeing with the plaintiff. Months later, the U.S. Court of Appeals in Boston issued a ruling affirming the decision of the lower court. The Trump Administration, through the Department of Justice's Acting Solicitor General Jeffrey B. Wall, submitted a petition this fall for a writ certiorari to the Supreme Court as to the applicability of such policy changes. Your Administration can retract DOJ's position and withdraw the legal petition.

Another case, *Peña Martínez v. U.S. Department of Health and Human Services,* expands on the Vaello Madero arguments, addressing not only SSI benefits but other safety net programs provided to residents of the United States. Plaintiffs similarly argue that the exclusion of nine residents of Puerto Rico from the Supplemental Security Income program, the Supplemental Nutrition Assistance Program and the Medicare Part D Low-Income Subsidy program solely because of their residency in Puerto Rico violates the equal protection component of the Fifth Amendment's Due Process Clause. Federal Judge William Young granted and ordered requested remedies with respect to the nine Plaintiffs and extended them to all similarly situated residents of the Commonwealth of Puerto Rico. In response, the Department of Justice sought a stay of order in Pena-Martinez. Your Administration has the opportunity to change DOJ's position. Keep in mind that in doing so, the Social Security Administration will have to fast-forward its work and adjudicate thousands of disability cases at once. Congress will inevitably have to appropriate the funds in order to allow for administrative changes that make the decision effective.

Nutrition

The federal government created the Supplemental Nutrition Assistance Program (SNAP) to provide low-income families financial assistance to purchase food. Unlike nutrition funding provided to the States, Guam and the U.S. Virgin Islands under SNAP, Puerto Rico receives a fixed amount of annual federal funding to run its own Nutritional Assistance Program (NAP). Congress and President Reagan replaced Puerto Rico's food stamp program with a block grant (eventually morphing into NAP). The block grant capped funding at about 25 percent below what households in Puerto Rico would have received under the regular Food Stamp Program and did not include automatic annual adjustments for inflation, resulting in a greater gap over time. Since it functions as a block grant, when crisis strikes, Puerto Rico has no flexibility to expand the program to provide for increased needs, as it would under emergency circumstances. At a time when nearly half of the population needs these benefits to put food on the table, its reform cannot be understated. The time has come to orchestrate a careful transition to the same nutritional assistance the U.S. government provides to other jurisdictions – a step that can be taken when the next Farm Bill heads to Congress for consideration.

Economic Development

The Earned Income Tax Credit (EITC) was created in 1975 to reduce the tax burden for low- and moderate-income working families and promote participation in the formal workforce. By providing a tax credit for working families, the EITC has become one of the federal government's largest antipoverty programs. For Puerto Rico, however, the situation is much different. That is because it is excluded from participation in the federal EITC. With a persistent poverty rate of 43 percent – and a dismaying 57 percent child poverty rate - it seems logical to extend EITC benefits to reduce poverty levels in Puerto Rico and increase workforce participation. But extending the program to the residents of Puerto Rico has been subject of political conflict for many years. In December 2016, the bicameral, bipartisan Congressional Task Force on Economic Growth in Puerto Rico remarked the importance of the EITC as an important policy tool to increase labor force participation and reduce poverty, but, even then, members could not reach consensus on whether or not to extend the Federal EITC to Puerto Rico.

President Obama's FY17 budget request included a proposal to extend federal funding for an earned income tax credit in Puerto Rico, managed by the Commonwealth. At that time, it included $601 million for FY2017, increasing steadily to $734 million by FY2026, at a cost of $6.642 billion over 10 years. The plan was rejected by Congress.

In lieu of congressional action, Puerto Rico established a local earned income tax credit that is intended to grow the economy. While this is a step in the right direction, on its own, the Puerto Rico EITC is small compared to what similar working-poor households receive on the mainland. And it is not enough. Relying on this program to offset the negative consequences of other FOMB-imposed austerity programs on the island is negligent and dangerous.

Recent proposals included in the House-passed emergency supplemental appropriations package in 2019 and the House Ways and Means Committee Economic Mobility Act of 2019, would supplement the Puerto Rico EITC with a federal funding boost. The federal supplement would serve as an incentive for Puerto Rico to increase the size of its EITC, on a three to one ratio based on the $204 million annual cost estimate prepared by Puerto Rico's Treasury and certified by the federal Oversight Board, and amplify the credit's beneficial effects.

Conclusion

Despite all the hardships of 2020, Puerto Ricans can find solace in the comprehensive plan you laid out for the island. The time is now to put these policies to work for the people of Puerto Rico. Key to the effectiveness of any plan for Puerto Rico is the capacity to coordinate efforts among all relevant actors, especially the inclusion of residents and community leaders. Unilaterally imposing recovery solutions on the affected population (the overarching policy thus far) creates mistrust, encourages stakeholders to evade rules, and undermines a shared commitment to successfully recover from the hurricanes, earthquakes and the pandemic. We look forward to working with your Administration for the well-being of Puerto Rico and its people.