

Growth⁺ Policy Summit 2021

CNE⁺
Puerto Rico's Think Tank

#CNEGPS

@grupocne

How to Achieve Inclusive Growth in Puerto Rico

Joseph Stiglitz

San Juan

CNE Growth Policy Summit

December 3, 2021

#CNEGPS

@grupocne

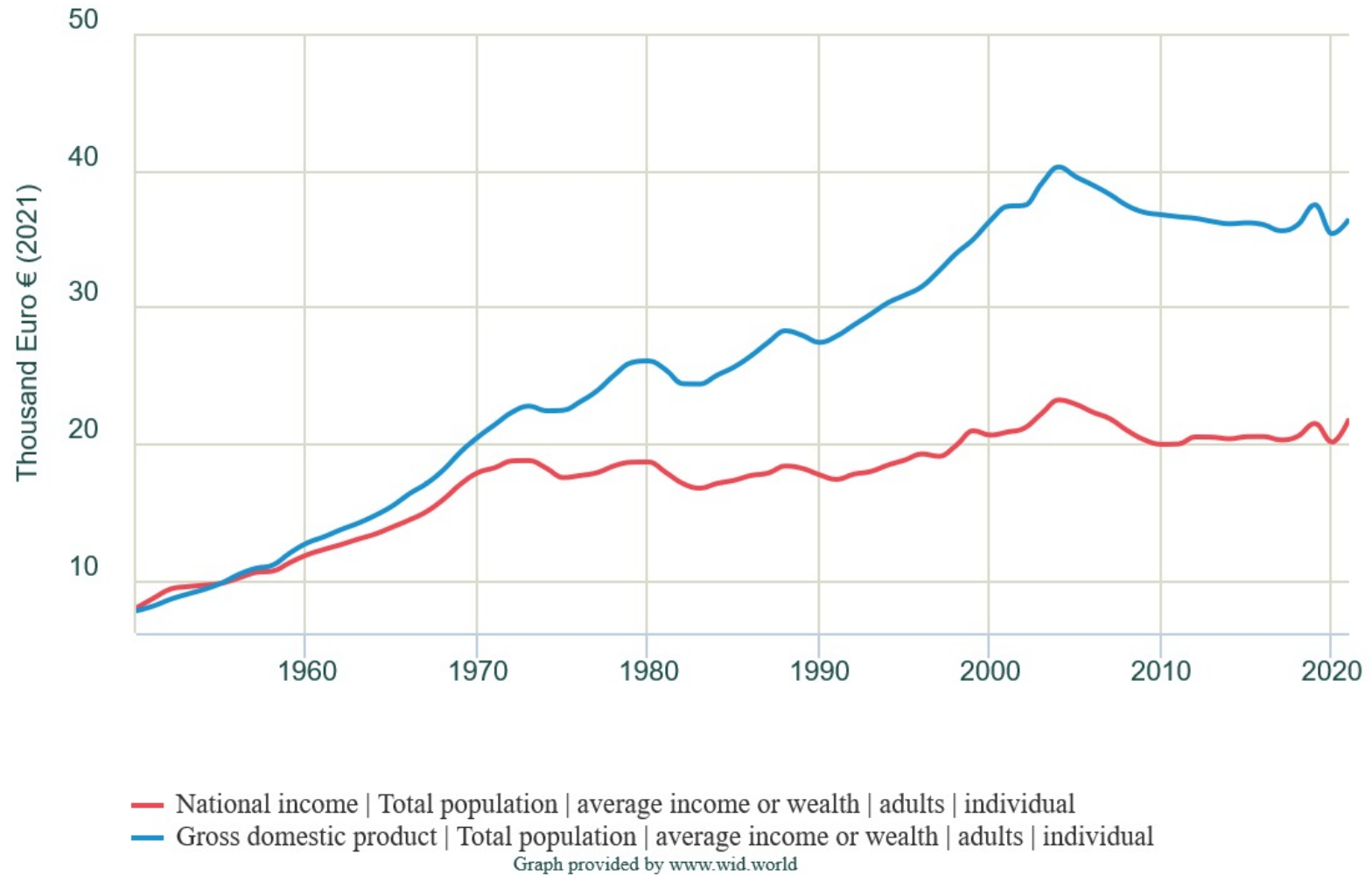
Outline

- I. Brief background on PR macroeconomic situation
- II. Debt crisis, its implications, and its resolution
- III. Principles of a growth strategy
- IV. Rethinking of development economics, and the implications for Puerto Rico

I. Background

- Puerto Rico has been experiencing slow growth and a declining population for more than 15 years
 - GDP per capita (real 2010 dollars) 2004, \$30,376; 2019, \$30,191; 2020, \$29,010
 - Population has declined: 2004, 3.8 million; today, 3.2 million
- Many explanations
 - End of tax incentives
 - NAFTA and other trade agreements eroded some of PR's advantages
 - Economic mismanagement, huge debt (both consequence and cause), lack of framework to resolve
 - More recently, hit by hurricanes, pandemic, debt crisis
- Big question: What can be the strategy to restore growth?

Evolution of average income, Puerto Rico, 1950-2021



II. Debt crisis

- Excessive debt, and the failure to restructure, typically leads to an economic crisis
 - Restructuring is always difficult
 - Fights among creditors often lead to delays: restructuring typically occurs late, at great cost both to debtor and creditor
 - Resistance of creditors to restructuring—to admitting that they made bad loans—leads to too little debt restructuring
 - In large fraction of cases, debt restructuring is followed by another within a few years
- In the case of Puerto Rico, problems have been compounded
 - Lack of applicable bankruptcy law (excluded from section 9)
 - When a framework was finally adopted by Congress, badly flawed
 - Some of debt of questionable legality
 - Some of debt hypothecated government tax revenues
 - Resolution of debt may weaken further Puerto Rico's economy

Current proposals almost surely leave Puerto Rico with an unsustainable level of debt

- Debt sustainability analysis is complex, but framework used is questionable
 - Critical to recognize that what Puerto Rico is forced to pay and forced to do affects its growth rate—can't assume *exogenous* growth rate
 - High level of payments to creditors reduces growth—reduces ability of government to engage in expansionary policies
 - Even reduction in pensions has macroeconomic consequences; lowers domestic aggregate demand, adversely affecting especially non-tradeable sector
 - Reduced growth reduces island's capacity to repay
 - Especially true because there is unrestricted migration to mainland—so if the economy is weak, there will be outmigration, making the economy even weaker, and further reducing ability to repay
 - Rosy scenarios about benefits of “structural reforms”—standard prescriptions almost never deliver, and especially almost never deliver sustained higher growth rates

Before hurricanes and pandemic, it was evident that a deep restructuring was needed

- Even more evident now
- Creditors attempting to effectively get some of the money that the US government is providing to repair the damage
- Extra spending for rebuilding is just getting PR back to where it was before the crisis
- This is true even though GDP is increased
 - GDP is not a measure of well-being
- If *any* of that money is effectively captured by creditors, will further ensure that PR will not get back to where it was, and will continue on the trajectory of stagnation

See Pablo Gluzmann, Martin Guzman and J. E. Stiglitz “An Analysis of Puerto Rico’s Debt Relief Needs to Restore Debt Sustainability,” NBER Working Paper No. 25256, November, 2018, accessible at <https://www.nber.org/papers/w25256>

III. Principles of a growth strategy

- Taking advantage of one's comparative advantage
- Amplifying that through industrial policies and learning, creating even stronger dynamic comparative advantage
- Begin by analyzing PR's distinct advantages and disadvantages
- Advantages:
 - Location
 - Sun—should provide cheap energy, attractive tourist destination (including potentially health tourism)
 - Human capital—good universities, engineering, bilingual
 - Links with the US—including extensive financial assistance, free movement, some aspects of legal framework
 - Social solidarity—shown in response to pandemic

Some disadvantages

- Links with the US (including political status)
 - Can't control its own destiny
 - Currency linked to the dollar—"fixed exchange rate"
 - Jones Act
 - Other regulations that may disadvantage PR, certain aspects of its legal framework
 - Free migration—potential brain drain
- High level of indebtedness
- Other Caribbean islands—and many other developing countries—are finding it difficult devising a 21st century growth strategy

What is not a development strategy

- Act 22—attracting tax avoiders
 - Tax policy can help—but only if it is well designed
 - Often costs exceed benefits
 - Often benefits short-term
 - Businesses big beneficiaries of race to bottom
 - New global agreement will make this strategy more difficult, more temporary

IV. Rethinking of development economics

- Old theory
 - Leave it to the market—shun industrial and labor policies
 - Just make sure there are good “pre-conditions”—“rule of law”
 - Promote education
 - Foreign capital will flow in
 - There will be natural convergence
- Critique of old theory
 - Skeptical of natural convergence
 - Matters worse: skilled bias technological change reducing value of main asset in developing countries
 - Only development model that has worked—manufacturing export-led growth—not likely to work in 21st century
 - There will be natural divergence

New theories

- Markets on their own often fail to generate development transition
- Government played an important role in most successful cases
- Industrial policies have worked
 - In US, industrial policies largely “buried” in defense department
 - In response to competition with China, bipartisan consensus in favor of necessity of industrial policy
 - Global consensus in favor of industrial policy to address climate change, pandemic, and inequality
- Development is about structural transformation
 - Markets are not good at structural transformation
 - Need active labor market policies to help move workers from old sectors to new

Multiple instruments

- Development banks, and now, especially, green development banks
- Redirecting local finance—Community Reinvestment Act
- Government-sponsored research (could PR persuade more US government research to occur in PR? Create new research centers as part of development strategy?)
- Appropriately designed infrastructure
- Education
- Taxes

Key design issues

- A focus on learning/spillovers
 - Not only from technology but from institutional development
 - Not only formal education, but on-the-job training—taking advantage of new technologies
 - Trade-offs—easier to move to “nearby technologies”; may be bigger benefits from big leaps (Korea took latter strategy)
- Identifying potential sources of comparative advantage
 - One of hardest questions
 - Look to history and to other countries
- Think deeply and skeptically about special interests
 - Capture agenda for purposes of their own rent-seeking
 - Capture is not inevitable—many governments have succeeded not only in avoiding capture, but “picking winners”
 - But task is not *just* to pick winners, but to identify areas where there are likely to be large externalities
 - Optimal policies entail risk-taking; risk-taking means that there will be some failures; that there are failures is thus not evidence either of capture or of flawed decision-making

Cheap energy should be one of PR's big advantages

- A focus on learning/spillovers
 - Not only from technology but from institutional development
 - Not only formal education, but on-the-job training—taking advantage of new technologies
 - Trade-offs—easier to move to “nearby technologies”; may be bigger benefits from big leaps (Korea took latter strategy)
- Identifying potential sources of comparative advantage
 - One of hardest questions
 - Look to history and to other countries
- Think deeply and skeptically about special interests
 - Cheap energy should be one of PR's big advantages
 - Capture agenda for purposes of their own rent-seeking
 - Capture is not inevitable—many governments have succeeded not only in avoiding capture, but “picking winners”
 - But task is not *just* to pick winners, but to identify areas where there are likely to be large externalities
 - Optimal policies entail risk-taking; risk-taking means that there will be some failures; that there are failures is thus not evidence either of capture or of flawed decision-making

Some strategies being pursued around world

- New import substitution strategies—not capital intensive strategies of Latin America sixty years ago, but often consumer-oriented domestic market-sensitive production
 - Part of the agenda of on-shoring
 - Including local food/resuscitating agriculture
- Linking with internet
 - One can be part of global supply chain even from more remote places
 - Location may be less important

Some countries grow, others don't

- Market change in perspective since Adam Smith's *Wealth of Nations*
- Focus on learning, knowledge
- Natural endowments may even be a disadvantage—natural resource curse
- PR's political status has mixed effects
- Challenge is to take advantage of the advantages it presents and manage its disadvantages
 - Do as best as one can in resolving the debt in a way favorable to PR
- But now, focusing on what can be done to create a long-term growth strategy