THE ECONOMIC AND FINANCIAL CRISIS IN PUERTO RICO:
A PACKET OF BACKGROUND DOCUMENTS

This packet of background documents will provide the reader with some insights on the current debacle—the economic and financial crisis—in Puerto Rico and on what should be done once the debt crisis has been resolved. It includes materials prepared by independent researchers/analysts as well as the report of the bipartisan Congressional task force, established under the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), enacted on June 30, 2016. In addition to the "Introduction and Oversight" on the following pages,* the packet includes the following items, which can be obtained online as indicated:

1. "Puerto Rico: Continuing Socio-Economic Deterioration and the Need for Change" (October 2012) [will be available in late May at http://jdintl.econ.queensu.ca/discussion-papers/]

2. "Puerto Rico's Economic Debacle: Correctly Blame Washington" (April 2016) [will be available in late May at http://jdintl.econ.queensu.ca/discussion-papers/]

3. "Should the U.S. Government Do More? Why Puerto Rico's Economic Conditions Matters to the United States" (February 2017) [will be available in late May at http://jdintl.econ.queensu.ca/discussion-papers/]

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5. "Reviving the Puerto Rican Economy Requires A Big Push of Public Infrastructure Investment" (August 2016) [https://www.finance.senate.gov/imo/media/doc/Arthur%20MacEwan%20and%20J.%20Tomas%20Hexner%20(Submission%205).pdf]

6. "Puerto Rico: Quantifying Federal Expenditures" (August 2016) [https://www.finance.senate.gov/imo/media/doc/Arthur%20MacEwan%20and%20J.%20Tomas%20Hexner%20(Submission%204).pdf]

7. Congressional Task Force on Economic Growth in Puerto Rico: Report to the House and Senate (December 2016) [https://www.finance.senate.gov/imo/media/doc/Bipartisan%20Congressional%20Task%20Force%20on%20Economic%20Growth%20in%20Puerto%20Rico%20Releases%20Final%20Report.pdf]

The Economic and Financial Crisis in Puerto Rico: A Packet of Background Documents

Volume I

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ABSTRACT

This packet of background documents will provide the reader with some insights on the current debacle—the economic and financial crisis—in Puerto Rico and on what should be done once the debt crisis has been resolved. It includes materials prepared by independent researchers/analysts as well as the report of the bipartisan Congressional task force established under the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), enacted on June 30, 2016. In addition to this "Introduction and Oversight," the packet includes the items listed on the cover page; the sites where each can be obtained online are also on the cover page.*

JEL classification: O1, O2, Z32

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Volume I

1. "Puerto Rico: Continuing Socio-Economic Deterioration and the Need for Change" by J. Tomas Hexner and Arthur MacEwan - October 2012

2. "Puerto Rico's Economic Debacle: Correctly Blame Washington" by J. Tomas Hexner and Arthur MacEwan - April 2016

3. "Should the U.S. Government Do More? Why Puerto Rico's Economic Conditions Matters to the United States" by J. Tomas Hexner and Arthur MacEwan - February 2017

4. "Making Puerto Rico a State: A Win-Win Opportunity Working" by J. Tomas Hexner and Arthur MacEwan - April 2017

5. "Reviving the Puerto Rican Economy Requires A Big Push of Public Infrastructure Investment" by J. Tomas Hexner and Arthur MacEwan - August 2016

6. "Puerto Rico: Quantifying Federal Expenditures" by J. Tomas Hexner and Arthur MacEwan - August 2016

7. Congressional Task Force on Economic Growth in Puerto Rico: Report to the House and Senate - December 2016

INTRODUCTION AND OVERVIEW

By 2012, if not earlier, the emerging economic crisis of the Puerto Rican economy was there for all to see. The first item in this packet, "Puerto Rico: Continuing Socio-Economic Deterioration and the Need for Change," was released in October of that year and describes the dire situation in some detail.

The Puerto Rican recession, still ongoing in 2017, was in its sixth year, the unemployment rate had risen to 15.2% even while the labor force participation rate had fallen to 41.8%, gross domestic fixed investment had dropped to 15.1% of GNP (from 28.6% in 2000), and Puerto Ricans by the tens of thousands were departing to the states in search of employment and better economic lives.[1]

The Puerto Rican government was building an unsustainable level of public debt. In 2012, public debt stood at $64.8 billion, 95% as large as GNP, up from the already high of 69% of GNP when the recession emerged in 2006. The 2012 public debt amounted to $17,763 per person, greater than the per capita personal income that year of $16,966.[2] What's more, the government was failing to meet its obligations to public pension funds, building up tens of billions of dollars debt to those funds.

Since the onset of the recession, the Puerto Rican governments attempted to deal with its extreme debt burden and the weakening economy—which meant weakening tax collections—by austerity measures cutting government employment and expenditures. Between 2005, when the decline first

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* This "Introduction and Overview" will be available in late May online at http://jdintl.econ.queensu.ca/discussion-papers/.

[1] Unless otherwise indicated, data in this report are from Junta de Planificación, *Informe Económico al Gobernador Puerto Rico*, various years.

[2] The ratios of debt to personal income and population are much larger than the similar ratios for any state. For example, in 2012, all states had debt to personal income ratios less than 10%, and in 2016 no state had a higher debt per capita than Connecticut, for which the figure was $6,155. (Debt per capita figures are not readily available for 2012.) The state figures are from Moody's Investor Services, *State Debt Medians 2016*, 6 May 2016.

appeared, and 2012, real government final consumption spending fell by 12% and dropped from 18.35% of GNP to 15.84% of GNP, even as GNP was falling. Thus, the government actions were contributing to the decline.

Not surprisingly, bond rating agencies, which had already downgraded Puerto Rican bonds, downgraded them further by the end of 2012. Yet, beyond the bond companies and active bond investors, in the states little attention was given to the rising Puerto Rican economic and financial crisis.

Front Page News

By 2015 and 2016, however, Puerto Rico's economic debacle was front page news, and details and analysis were regular features on business pages. Not much had changed in Puerto Rico beyond simply continuation of the decline. GNP (inflation adjusted) fell by 3.6% between 2012 and 2016, and the Government Development Bank's Economic Activity Index fell by close to 8%. The unemployment rate did come down to 11.8% in 2016, but the labor force participation rate had dropped to 40.2. And the exodus had continued, with a population drop of 223 thousand, 6.1%, in this four year period. The public debt was virtually the same in 2016 as in 2012, as Puerto Rico had been largely excluded from the bond market, but the government's ability to pay continued to fall.

What had changed, however, was the recognition that the Puerto Rican government was unlikely to repay its debts. In late June, 2015, Puerto Rico's Governor Alejandro García Padilla announced, "The debt is not payable. There is no other option. I would love to have an easier option. This is not politics, this is math."

A Puerto Rican default would be costly for several U.S. investment funds and many U.S. individual investors and could bring instability to the whole municipal bond market. Under this financial threat, as well as the emerging financial crisis in Puerto Rico itself and the impact of Puerto Rican migration to the states (focused especially in a few states), Congress began to pay attention. The outcome was the enactment on June 30, 2016 of the Puerto Rico Oversight, Management, and Economic Stability Act—PROMESA.

As described by the Speaker of the House, Representative Paul Ryan, the Act "addresses the fiscal crisis in Puerto Rico and prevents a bailout for the island… The goals of PROMESA are to protect American taxpayers, stop Puerto Rico's debt crisis from becoming a major humanitarian disaster, and put Puerto Rico on a path to recovery."[3]

PROMESA established an Oversight Board to in effect control the Puerto Rican government's fiscal policy. It also created a Revitalization Coordinator, appointed by the Governor from a list of nominees provided by the Oversight Board. The Coordinator would have control over the selection and implementation of infrastructure projects, which are seen in PROMESA as an important foundation of economic recovery.

As to the public debt, PROMESA provided for the Puerto Rican government and the creditors to undertake negotiations to restructure the debt. And, most important, PROMESA established a temporary stay on litigation by creditors concerning payment on their bonds against the Puerto Rican government. Originally, this stay would have last until February 15, 2017. However, the termination of the stay was extended by the Oversight Board to May 1, 2017. Furthermore, if voluntary negotiations did not reach a resolution of the situation, Title III of PROMESA provided the possibility for Puerto Rico to enter a bankruptcy-type situation.

In addition, PROMESA created a Congressional Task Force on Economic Growth in Puerto Rico, charged with identifying "impediments in current Federal law and programs to economic growth in Puerto Rico" and to "recommend changes to Federal law and programs that would serve to spur sustainable long-term economic growth, job creation, reduce child poverty, and attract investment in Puerto Rico."[4]

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[3] From Speaker Ryan's website: http://www.speaker.gov/general/what-you-need-know-about-house-s-puerto-rico-bill

[4] PROMESA, Section 409, paragraph g, page 118.

On December 20, 2016, the Task Force submitted its Report, C*ongressional Task Force on Economic Growth in Puerto Rico: Report to the House and Senate*. The Report is included in this packet as the seventh item. Beyond the body of the Report, an appendix provides an extensive and very useful catalogue of federal programs under which Puerto Rico and Puerto Ricans receive different treatment than do the states and people in the states.

Although action on recommendations in the Task Force report could make positive contributions to "sustainable long-term economic growth" in Puerto Rico, the focus of PROMESA is on restoring fiscal stability and providing a means for the Puerto Rican government to deal with its debt difficulties. As Rep. Ryan's statement quoted above indicates, a principal purpose of the Act is to prevent a bailout, and a major goal is to protect the American taxpayer. While fiscal stability and managing the debt could clear the way for economic growth, PROMESA does not give substantial attention to growth itself. Indeed, neither PROMESA nor the Report of the Task Force sets out what would be needed to establish a strong foundation for economic growth in Puerto Rico nor what would be the strong stimulus for that growth.

Critical Materials

The limits of PROMESA and the Report of the Task Force are addressed, often explicitly but sometimes only implicitly, in items included in this packet. The first item, "Puerto Rico: Continuing Socio-Economic Deterioration and the Need for Change," released in 2012, provides a broad and extensive consideration of many of these issues, especially the importance of history and status in understanding and in formulating proposals for Puerto Rico's economic development. Whatever has changed since 2012, the importance of history and status remain the same today as they were then.

Regarding the issue of the responsibility and role of the U.S. government in affecting the situation in Puerto Rico and in overseeing Puerto Rican government policy in the current situation, items 2, 3, and 4 in the packet provide useful discussion: "Puerto Rico's Economic Debacle: Correctly Blame Washington. (April 2016); "Should the U.S. Government Do More? Why Puerto Rico's

Economic Conditions Matters to the United States" (February 2017); and "Making Puerto Rico a State: A Win-Win Opportunity" (April 2017).

Item 3, "Should the U.S. Government Do More?", in discussing ways in which the federal government can begin to accept greater responsibility and begin to move matters forward on debt restructuring, points out the need for particular federal actions. First among these is a mechanism for de facto debt restructuring. Also, this paper suggest that progress could be obtained by U.S. Treasury guarantees for new Puerto Rico bonds and by Congress including Puerto Rico and Puerto Ricans in important federal programs on the same terms as people in the states are included—for example in the Earned Income Tax Credit, health care programs, the Child Tax Credit, and the Supplementary Nutritional Assistance Program.

These federal actions would be necessary parts of a foundation for economic growth in Puerto Rico. An effective stimulus for this growth could be provided by a large and meaningful public infrastructure investment program, which could be the basis for reigniting a renewal of private sector expansion and job creation. Item 5, "Reviving the Puerto Rican Economy Requires A Big Push of Public Infrastructure Investment" (August 2016) explains how such a program, a "big push," would work and, as an example, quantifies the impact of such an infrastructure project.

One objection to greater federal support for Puerto Rico is likely to be an argument based on the belief that Puerto Rico already receives a very high degree of federal support and that this support is an important factor causing the island's long-run poor economic performance.[5] Item 1 in this packet, "Puerto Rico: Continuing Socio-Economic Deterioration and the Need for Change", demonstrates that this argument is misleading if not simply wrong. It presents relevant data comparing federal expenditures received by Puerto Rico compared to expenditures received by the states. Especially relevant—and also presented in item 6, "Puerto Rico: Quantifying Federal Expenditures" (August 2016)—are data showing that Puerto Rico receives less net federal

[5] See, for example, chapters by Burtless and Sotomayor and by Enchautegui and Freeman in Susan Collins et al, editors, *The Economy of Puerto Rico*, The Brookings Institution and Center for the New Economy. The same argument is made in a May 27, 2006, article in *The Economist* that dubs Puerto Rico "welfare island."

expenditure per capita than do many states and the District of Columbia (i.e., federal expenditures going to a state less federal taxes from a state).

The Facts on the Ground

The enactment of PROMESA and the initiation of action by the Oversight Board were greeted with a degree of hostility in Puerto Rico. Many saw this law and the Board as violating the island's self-government and as a blatant declaration of its colonial status. The Puerto Rican journalist Rafael Matos expressed this view in a July 14, *New York Times* op-ed essay, stating, "In vulgar street talk here, Puerto Rico has been stripped naked and put on show to be shamed. This after we'd grown up being told we had a unique privileged relationship with the United States—we were full citizens, free to migrate north, and autonomous to govern our own affairs. A bit like a state, without surrendering our Latin personality. But now it is clear that was a charade."

Beyond people's views of this exercise of federal authority in Puerto Rico, relations between the Oversight Board and the Puerto Rican governments have had some complications. The Fiscal Plan presented to the Board by the outgoing government was rejected by the Board in December of 2016. The new government, however, presented its Fiscal Plan on February 28, 2017, and it was accepted by the Board.

Yet, in spite of the acceptance by the Board of the government's fiscal plan and in spite of the months of voluntary negotiations between the government and its creditors, no agreement was reached on rescheduling the debt. On May 3, the Oversight Board, at the request of the Puerto Rican government, initiated action under Title III provisions in PROMESA that established a bankruptcy-like procedure for the island's public debt. (These provisions call of the Chief Justice of the Supreme Court to appoint a federal judge to serve as an administrator for the de facto bankruptcy of Puerto Rico.)

At this writing in mid-May, the full implications of this action are not clear. Creditors have indicated their intention of going to court to block this action, arguing that under federal law, Puerto Rico does not have the right to this *de facto* bankruptcy procedure. Nonetheless, this action by the government and the Oversight Board establishes a new direction in handling the debt and holds out a real possibility for progress. Reduction of the debt burden does not assure that the economy of Puerto Rico can move forward, but it is a necessary first step.

Comments on the Task Force Report

The Report of the Task Force does provide some positive recommendations and extensive useful information, which draw attention to important issues that have generally received insufficient attention—particularly in Washington but also in San Juan.

Perhaps most important, the charge of the Task Force to identify "impediments in current Federal law and programs to economic growth in Puerto Rico" implicitly recognizes the responsibility of the federal government for economic affairs in Puerto Rico. By pointing out that in numerous federal programs Puerto Rico is treated differently—and in most cases worse—than the states, the Report implicitly acknowledges that federal government policies have at least contributed to the island's economic woes. (See item 2, "Puerto Rico's Economic Debacle: Correctly Blame Washington".) Recognizing the deleterious impacts of federal policies is a first step towards fixing them.

Examples of the useful discussion and positive recommendations in the Task Force Report include the following:

- The Report provides an extensive discussion of the different treatment of Puerto Rico (as compared to the states) in health care programs—Medicare and Medicaid, in particular. While stopping short of recommending that Puerto Rico be treated the same as the states in health care programs, the Task Force (p. 20) does recommend Puerto Rico "be treated in more equitable and sustainable manner under the Medicaid program" and some particular adjustments of the Medicare program in Puerto Rico are suggested.[6]

[6] In the health care discussion, one bit of information that might have been useful is that "Low-income patients are also hard hit by extremely low Medicaid ($1,571 per enrollee in Puerto Rico vs. $5,790 in the U.S.) and Medicare ($5,208 per enrollee in Puerto Rico vs. $10,365 in the U.S.) annual spending while cost of living remains comparable to that in the Nation. As a result, 92 percent of the Island's Municipalities have already been

- The recommendation that the Child Tax Credit be extended to families with one or two children as well as to those Puerto Rican families who have three or more children and are already covered.

- While the Report stops short of recommending that the federal Earned Income Tax Credit (EITC) be extended to Puerto Rico, "there is agreement [on the Task Force] that Puerto Rico's low labor force participation rate significantly contributes to the island's economic and fiscal problems. Studies have shown that the EITC increases labor force participation and reduces child poverty."[7] Consequently (p. 32), the "members of the Task Force agree that extension of the EITC to Puerto Rico both poses challenges and presents opportunities, and recommends that Congress explore ways to minimize the challenges and maximize the opportunities."[8]

- The Task Force not only recognizes the limitations of Puerto Rico's economic data systems, but also makes specific recommendations for a role of the federal authorities in managing aspects of important economic data. In particular, and especially important (p. 57), "the Task Force recommends that BEA [Bureau of Economic Analysis in the

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categorized by the U.S. Health Resources and Services Administration as Medically Underserved Areas due to physician shortages." Maria Levis, "Your Money Or Your Life: Federal Policies And Health Care Disparities in Puerto Rico," *Health Affairs Blog*, June 13, 2016, http://healthaffairs.org/blog/2016/06/13/your-money-or-your-life-federal-policies-and-health-disparities-in-puerto-rico/.

7 However, this statement continues stating that the EITC "may have other effects on work incentives in phase-out ranges," suggesting that concern for negative incentives by at least some members of the Task Force explains the lack of consensus on a recommendation that the EITC be extended to Puerto Rico.

8 The Report states (p. 15) at that beginning of the discussion of Puerto Rico's Treatment Under Federal Programs: "In those instances when Congress does choose to treat Puerto Rico differently than the states under a particular federal assistance program that is funded by appropriations made from the general fund of the United States, Congress often relies, either explicitly or implicitly, on the argument that such differential treatment is warranted because individuals and businesses in Puerto Rico do not contribute federal income taxes into the general fund to the same degree and extent as their counterparts in the states." This argument has been used to justify the exclusion of Puerto Rican from the EITC. As the report does note, however, Puerto Ricans do pay federal payroll taxes, and many people in the U.S. who are eligible for the EITC and other federal programs pay no federal income taxes simply because their incomes are too low. What the Report does not say is that the EITC was initiated precisely to offset the regressive nature of federal payroll taxes and to alleviate poverty—a point where consideration of history might have helped. Also, see item 5, "Reviving the Puerto Rican Economy Requires A Big Push of Public Infrastructure Investment".

> Department of Commerce] should calculate GDP for Puerto Rico just as BEA does for every other U.S. jurisdiction."

Beyond these examples, the Task Force Report provides much other discussion and several recommendations that are useful, not only because the recommendations might be acted upon, but also because the discussion and recommendations contribute to an understanding of the current economic situation in Puerto Rico.

Nonetheless, shortcomings in the Task Force Report remain important. Perhaps most important, the report abjures a consideration of the causes of the crisis, stating on page 9, "The crisis has multiple root causes, and a discussion of those causes is beyond the scope of this report." Without an analysis of the causes of the crisis, including examination of the historical development of the economy and the impact of the status issue, the Report is seriously lacking. Its recommendations tend to be limited to symptoms rather than causes of Puerto Rico's economic difficulties.

One small example appears when the Report deals with the problems of the Puerto Rican government's tax collections system and other aspects of its financial management. The Report approaches these problems as though they are "technical" issues and calls upon Congress (p. 69) to "provide the U.S. Department of the Treasury with authority to provide technical assistance" to help the Puerto Rican government deal with these matters. Yet, any examination of the history and politics of tax collection issue, in particular, would bring out that it is largely a political issue, a failure of the Puerto Rican government to use its authority to pursue tax evaders, individuals and businesses. Technical assistance could be helpful, but would be most effective only if the power relations were altered in a way to lead the Puerto Rican government to deal with tax evasion. An understanding of these power relations would require an examination of history and the status issue.

1. Puerto Rico: Continuing Socio-Economic Deterioration and the Need for Change

by
J. Tomas Hexner and Arthur MacEwan

ABSTRACT

The long-run decline of the Puerto Rican economy, predating the recession of the last decade, is evident in the relative stagnation that emerged from 1980 onward. The roots of both the relative stagnation and the long recession lie in the political status of the island. The option of statehood, however, can be the foundation for a new era of economic expansion.

The long-lasting economic problems of Puerto Rico are evidenced by several measures: the low rate of economic growth, the high unemployment rate and the low labor force participation rate, the falling investment rate, the high poverty level, the extreme degree of economic inequality, and the massive exodus to the states. And, of course, there is the very high—crisis level—amount of public debt.

In addition and of central importance, the poor treatment of Puerto Rico relative to the states by the U.S. government has contributed to the economic situation on the island and demonstrates the role of status in bringing about economic weakness and decline. The popular belief that Puerto Rico receives "generous" treatment from Washington is belied by the data. Moreover, while many observers viewed Puerto Rico as an economic success story during the late 1900s, this view erred in measuring success by the growth of GDP instead of GNP, the former including the profits of firms based off the island (mainly in the U.S.) and not providing a measure of economic conditions of Puerto Rican people of firms.

The detrimental impact of Puerto Rico's political status as a U.S. territory—or, if one prefers, a U.S colony—shows up clearly in the unequal treatment of Puerto Rico relative to the states in certain important federal programs. For example, Puerto Ricans have not been eligible for the federal Earned Income Tax Credit (EITC) and only partially eligible for the Child Tax Credit (CTC). A Puerto Rican family with two parents and two children and with earnings of $25,000 would have had a net income in 2011 of $23,587 after all federal taxes. It would not receive the EITC and CTC. An identical family in the states with earnings of $25,000, after all federal taxes and the EITC and CTC would have a net income of $30,013—$6,426 more than the Puerto Rican family.

Beyond these vary tangible negative impacts of the current status, and more fundamental, is the broad economic dependency of Puerto Rico. This dependency has led to an underdevelopment of Puerto Rican based economic activity and to government policies that have always looked outward for special favors from Washington and investment from abroad. The results show up in an excessive reliance on manufacturing and a failure to develop economic activity in areas where Puerto Rico has clear advantages—e.g., tourism and specialized business services linking the states to Latin America. The results of dependency also have included a weak and distorted financial sector and a failure to invest sufficiently in infrastructure, education, and science.

Keywords: Puerto Rico bankruptcy, debt obligations, level playing field

I. INTRODUCTION

In the summer of 2012, the sad story of economic life in Puerto Rico continues. The severe recession of recent years, with its high unemployment rate and sharply declining rate of investment, is only the beginning of this story. Economic growth has been weak for decades, and a staggering poverty rate and extreme income inequality have characterized life on the island.

In Washington, however, the Puerto Rican situation is ignored. In San Juan, during the early months of 2012, an election year, the Puerto Rican government focused on a slight improvement in its index of economic indicators and attempted to portray the economy as on the road to recovery and growth. A report from Wells Fargo Securities, however, stated:

> "…the Fortuño administration or administration officials have tried to override the truth by talking about how the economy is better today [May 2012] than several years ago. However, the best they can claim is that the economy seems to not be falling off a cliff any more…"[9]

The island's continuing economic difficulties are reflected in financial markets. In March 2012, Breckinridge Capital Advisors issued a White Paper on the Puerto Rican situation, stating:

> "…the Commonwealth today is flirting with insolvency, and the risk is growing that someday, Commonwealth investors may not be repaid in full. Puerto Rico's financial condition is far worse than any U.S. state's, and default—though unlikely in the immediate future—is a possibility over the next few years… Breckinridge has long avoided obligations of Puerto Rico, but we believe all municipal bond investors should now be cognizant of its problems."[10]

A May 29, 2012, Reuter's report noted that:

> "…some professionals, including specialists in riskier, high-yield municipals, won't go near Puerto Rico debt. Some seem to be betting against the island, judging by trading in Puerto Rico municipal credit-default swap contracts."

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[9] Eugenio J. Alemán, *Puerto Rico: Failure of the State*, Wells Fargo Securities, Economics Groups, Special Commentary, May 24, 2012, p. 10. Available at http://mediaserver.fxstreet.com/Reports/f94cca42-c3fa-47e4-88dd-b4c17a0cdced/d8b5822a-a0a2-4400-88cc-dbc573a21a9e.pdf.

[10] Breckinridge Capital Advisors, *Puerto Rico's Challenge*, Special Commentary, March 2012. Available at http://www.breckinridge.com/pdf/whitepapers/March_2012_Puerto_Ricos_Challenge.pdf

> "Since early January, the cost for one-year CDS on 10-year Puerto Rico debt has shot up to 482 basis points from 391, according to data-services group Markit. That adds $91,000 to fees now close to half a million dollars to secure shelter against a possible default on $10 million of Puerto Rico debt."[11]

And on June 11, 2012, *Bloomberg News* told its readers that in the previous week, "Standard & Poor's said it may cut the island's general-obligation rating, now two steps above junk."[12]

But it is not only the financial markets that have lost confidence in Puerto Rico. According to the U.S Census, between 2000 and 2010 the population of the island declined by more than 2%. Only one state experienced a population decline in this period—Michigan, with a decline of 0.6%. Taking full advantage of their U.S. citizenship, it appears that many Puerto Ricans are voting with their feet, seeking improved economic conditions by moving to the mainland.[13]

Why is the Puerto Rican economy in such miserable shape—not just in 2012 and in the immediately preceding years, but as will be pointed out shortly, over the past several decades? There is, after all, wide agreement on many good policies that would improve the island's economy: improvement of the schools and support for "high tech" investments; improvement of the physical infrastructure; a better and more effective tax system; inclusion of the island in federal programs designed to reduce poverty (most especially the Earned Income Tax Credit); better support for the tourist industry; and the list goes on. Yet, rhetoric aside, policies of change are not thoroughly implemented. Why?

A. Economic Malaise and the Need for Statehood

The explanation for Puerto Rico's economic malaise presented here is that the island's economic condition is intimately connected to its political status as a "territory" of the United States.

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[11] Michael Connor, "Puerto Rico bets on American tourists to repay debt," Reuters, May 29, 2012. Available at http://uk.reuters.com/article/2012/05/29/uk-puertorico-debt-idUKLNE84S00T20120529.

[12] Michelle Kaske, "Puerto Rico Borrowing Costs Rise on Rating Concerns: Muni Credit," Bloomberg News, June 11, 2012. Available at www.businessweek.com/news/2012-06-11/puerto-rico-borrowing-costs-rise-on-rating-concern-muni-credit.

[13] Official Puerto Rican data do not report a decline, but instead show an increase in the 2000 to 2010 period of 4.3%, from 3.814 million to 3.979 million. These data are reported in the *Statistical Abstract of the United States 2011*, Table 1313. The 2000 U.S. Census reports a basically similar figure, 3.809 million, for 2000, http://www2.census.gov/geo/maps/special/profile2k/PR_2K_Profile_eng.pdf. However, based on the American Community Survey for Puerto Rico, the U.S. Census reports a 2010 figure of 3.722 million, http://factfinder2.census.gov/faces/tableservices/jsf/ages/productview.xhtml?pid=_ACS_10_1YR_DP02PR&prodType=table.

Territorial status creates uncertainty, a short-run approach to economic policy, a practice and ideology of reliance on special treatment by the U.S., and continual failure to build up bases for economic development within the island's own society. Under these circumstances good policies, while recognized and advocated in many quarters, waste away in government reports and statements of good intentions.

Continuation of territorial status will mean continuation of economic stagnation and instability. Statehood for Puerto Rico could be the foundation for economic progress, the route for the Puerto Rican people to enjoy a better quality of life in the 21st century. While there is no likelihood that statehood will be established in the near future, interim steps are both possible and desirable. Short of statehood, Puerto Rico must be put on a level playing field with the states, treated the same as the states, insofar as possible, in all federal legislation, executive orders, and programs. Ultimately, however, the island's economic development will depend on the integrity of becoming a state.

It is sometimes asserted that good economic policies could improve economic conditions on the island regardless of political status. Good economic policies, according to this view, can be "status neutral," implemented regardless of whether Puerto Rico remains a territory, becomes a state, or opts for independence. Certainly there are many positive policies that could, at least in principle, be introduced regardless of status. This "status neutral" approach, however, has little connection to the historical and social reality of Puerto Rico, and it fails to address the question of why economic policies that are good in principle have so seldom actually been adopted and implemented. It ignores the fact that policy makers on the island have been mired in a history of dependence on Washington. Working in a position of subordination in the U.S. polity, they have been unable to extricate themselves from a pattern of short-run and misdirected economic policies. It is, at best, naïve to separate economics from politics, and the "status neutral" approach can only lead to continued poor policy and stagnation.[14]

The approach, pursued by both major political parties, has advocated special treatment from Washington as the driver of economic success in Puerto Rico. Special provisions in the U.S. tax code—Section 931, Section 936, the treatment of Controlled Foreign Corporations, and the proposed H.R. 3020—would, supposedly, provide incentives for foreign firms (most often U.S. firms) to come to Puerto Rice, invest, and generate growth and jobs. Advocates of special

[14] An example (which will be noted further below, pp. 54-55) of the "status neutral" approach to Puerto Rican economic policy is the 2005 volume published by the Center for the New Economy in San Juan and the Brookings Institution in Washington, *The Economy of Puerto Rico: Restoring Growth*, edited by Susan Collins, Barry Bosworth, and Miguel A. Soto-Class.

treatment have often provided the rationale that it would create the basis for Puerto Rico to "catch up" and thus qualify to become a state.

The relatively rapid economic expansion of the Puerto Rican economy in the 1950s and 1960s, based in part on this approach, created an aura of success and generated the idea that income levels on the island would steadily converge towards those in the states. The wider bases of success in that era, however, were ephemeral and were gone by the mid-1970s. Since then, although an illusion of economic success persisted, the reality evaporated and there has been no further convergence; indeed, there has been a divergence between income levels in Puerto Rico and the states. Yet many policy makers in Puerto Rico have clung to both this "special treatment" approach and the illusion of success.

This illusion of success has been promoted by both of the major political parties, as each has tried to present economic problems as short-run and the result of the other's economic mismanagement. Yet the malaise of the Puerto Rican economy is enduring, continuing in spite of changes in which party controls the government. Each government has generated its own sets of particular problems, but all appear to ignore the fundamental problems plaguing the economy.

Although the malaise of the Puerto Rican economy has several particular causes, at the foundation of the island's poor economic performance is its political status. The b'twixt and b'tween status as a U.S. "territory" has undermined the economy, distorted economic policy, created continuing uncertainty, and prevented Puerto Rico from establishing sustained economic development. While the short-lived economic growth of the 1950s and 1960s led some people to claim that economic convergence with the states would create the foundation on which the island could become a state, it is now clear that in order for sustained convergence to take place it is first necessary for Puerto Rico to become a state.[15]

[15] In fact, in that period of success in the 1950s and 1960s, under the rubric of "Operation Bootstrap" (*Operación Manos a la Obra*), Puerto Rico was taken by many observers to be a model of proper economic development. Even as late as the 1990s, when the success was long over, Puerto Rican was held out by some analysts as in the same league with the "East Asian Tigers." These points will be give attention below in Section IV and elsewhere.

Statehood for Puerto Rico could break the historical inertia at the core of poor economic policy and poor economic performance, and statehood could dramatically eliminate the option of special treatment. Moreover, statehood could exert a policy discipline that is missing in Puerto Rico under its territorial status. Overall, with statehood Puerto Rico would no longer be treated differently—more poorly—than the states. Instead, Puerto Rico, as a state, would be on a level playing field with the other states. The same policies provided to the other states would be applied to Puerto Rico, which would provide substantial economic benefits to the people on the island. Improvement of economic conditions on the island would, in addition, be in the interests of the entire United States.

Independence for Puerto Rico does provide a theoretical option. The Wells Fargo report quoted above, avows that lack of viability of a continuation of the current status, and states:

> "It is clear that Puerto Rico needs to solve its status problem… An objective and impartial analysis of the current situation of the island would indicate that Puerto Rico should have only two alternatives: either it becomes a state of the United States or it becomes independent. … [The] current "no-status" of the Commonwealth is unsustainable."[16]

Some small, independent countries have achieved economic progress, and for many in Puerto Rico independence is attractive for non-economic reasons. Independence, however, is not a practical option. All indications are that independence does not have the support of a significantly large portion of the Puerto Rican population, and it is virtually certain that independence would not be allowed by the U.S. government—surely not without a much stronger showing of support for independence among Puerto Ricans. Statehood is the only option, the only foundation on which economic progress, the prosperity of the people of Puerto Rico, can be firmly established.

B. A Bad Situation, An Ignored Situation

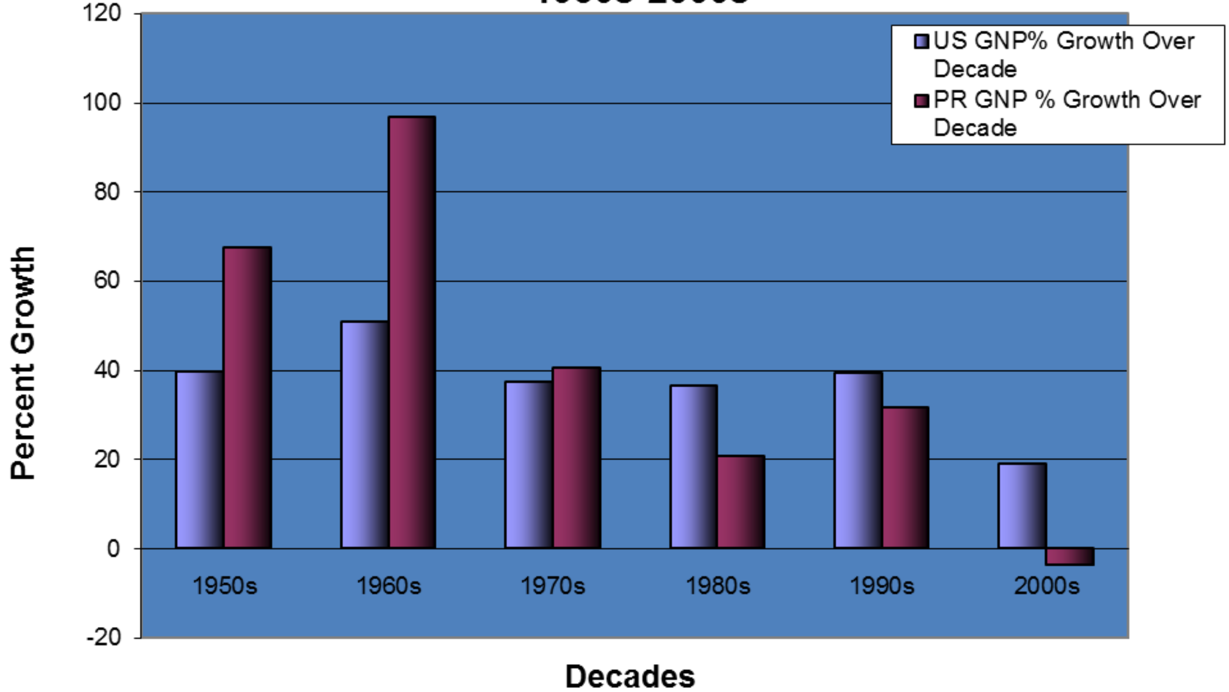
Two graphs dramatically illustrate the economic situation in Puerto Rico. The first, Figure 1, shows decade-by-decade economic growth rates since 1950 for the Puerto Rican and U.S. economies. The rapid growth of the Puerto Rican economy in the 1950s and 1960s is shown to

[16] As cited in footnote 1.

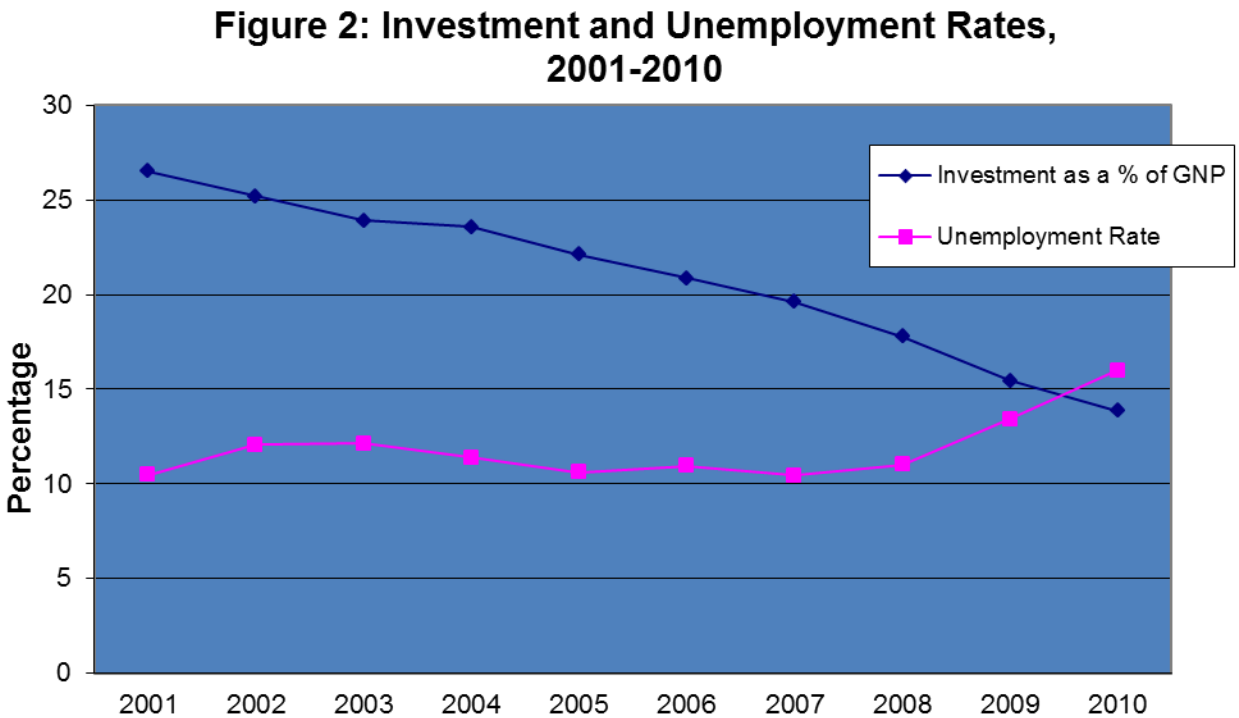
drop off substantially from the 1970s onward, and during the last three decades has been less than that of the United States. Convergence shifted to divergence. The second graph, Figure 2, shows the unemployment rate and the investment rate in Puerto Rico over the 2001 to 2010 decade. With the former rate rising and the latter rate falling, in 2010 the investment rate was below the unemployment rate—a stark indication of an economy in severe trouble. (These figures will be discussed further in subsequent sections.)

In fact, the problems of the Puerto Rican economy run deeper. Not only has economic growth been poor as illustrated in Figures 1 and 2, but the levels of poverty and economic inequality are extreme. The conditions are such that they could generate outrage and political instability. The outrage among the Puerto Rican populace has been limited, however, because, as U.S. citizens, Puerto Ricans can without restriction take up residency in the states. Instead of outrage and the action that often comes with outrage, Puerto Ricans experience a cynical frustration that leads many to abandon the island. While this mobility provides a safety valve that limits political conflict over economic issues, it is not a solution to Puerto Rico's fundamental economic problems.

Figure 1: U.S. and Puerto Rico GNP Growth by Decade, 1950s-2000s



Source: See Table 5.



Note: The investment rate is gross fixed investment as a percentage of GNP.
Source: Junta de Planificación de Puerto Rico, http://www.jp.gobierno.pr/; click on Apéndice Estadístico.

In fact, the safety valve of migration to the states has been an obstacle to change, allowing those fundamental economic problems to be largely (and conveniently) ignored by political authorities in Washington and also by the great majority of the U.S. population. The economic conditions of Puerto Rico—the stagnation, the poverty, the inequality—are non-issues in the political discourse of the United States, swept under the rug, so to speak. But like dirt that is swept under a rug, the reality of Puerto Rico's economic situation is still there. And that reality will not stay under the rug forever.

C. Leveling the Playing Fields: Simulating Statehood

Although statehood could be the foundation of economic progress in Puerto Rico, there is little likelihood that statehood will be achieved in the near future. The Puerto Rican population remains divided on the issue, with roughly equal numbers supporting statehood and the territorial status quo. What's more, there is no substantial support in the U.S. Congress for statehood, and economic conditions in the states along with the sharp partisan divisions do not bode well for attention being devoted to the Puerto Rican issue, let alone for the emergence of a consensus.

This political reality calls for interim action, a set of policy changes that would both bring positive economic developments for Puerto Rico and lay the foundation for a move toward statehood. These policy changes would level the playing field by treating Puerto Rico, whenever possible, the same as the states in all federal legislation, executive orders, and programs. For example, Puerto Ricans should be made fully eligible for the Earned Income Tax Credit and the Child Tax Credit. Also, on all programs that involve the disbursement of federal funds, Puerto Rico should be treated in the same manner as the states. The collection of these policies would have the effect of "simulating statehood" for the island. They would generate significant economic improvement, first, through providing a substantial stimulus and, second, by actively encouraging positive policy changes within Puerto Rico—including greater transparency and greater accountability. These changes, which would simulate statehood, would not, however, alter any of the conditions under which the private sector operates.

This leveling of the playing field would be justified simply on the basis of fairness and by the positive impacts it would have for economic conditions on the island. In addition, the consequences would demonstrate—within Puerto Rico, within Congress, and among the U.S. public—the desirability of statehood for Puerto Rico.

Before proceeding, it is necessary to emphasize that economic issues dealt with in this report are far from the only issues that determine the well-being of Puerto Ricans. There are also, in particular, issues of human rights. With continued territorial status, even while Puerto Ricans have U.S. citizenship, they are second class citizens. When residing on the island, they have no vote in congressional or presidential elections. Although the government of Puerto Rico has a good deal of authority over internal matters, it is ultimately under the authority of the laws and courts of the United States. This condition, as discussed below, especially in Section VI, has detrimental economic impacts, but it is also abrogates fundamental human rights. Only statehood or independence can repair this situation.

D. The Plan of This Report

Overall, this report will:

- describe the continuing economic deterioration of the Puerto Rican economy;

- explain how Puerto Rico's status as a territory of the United States has been the major factor at the root of the economic difficulties—inhibiting the adoption of policies that would promote economic progress, preventing the establishment of firm social foundations for good economic programs, and placing the island on an un-level playing field with regard to the states; and

- argue that statehood for Puerto Rico could provide a strong foundation for economic progress.

The first several sections are largely descriptive. Section II explains how Puerto Rico is treated more poorly than the states by federal policy—which is to say that Puerto Rico is operating on an unlevel playing field. Puerto Rican's lack of access to federal tax credits means that most Puerto Rican families are much worse off in Puerto Rico than they would be earning the same income in the states, and the island's economy lacks the stimulus that would come from those tax credits. Also, in terms of federal expenditures, Puerto Rico—contrary to the wide-spread image—is treated poorly relative to the state. There is no level playing field.

Sections III, IV, and V describe in some detail the performance of the Puerto Rican economy, both over the long-run and in recent years. Section III focuses on poverty and income inequality, first presenting the data showing both the very high level of poverty on the island and the extreme degree of inequality—greater than that of any state. This section also points out how poverty and inequality are not simply problems in themselves, but can also have negative ramifications for many social outcomes—health, crime, the environment, and even democracy and economic growth.

Section IV discusses the economic growth experience of Puerto Rico since the middle of the last century. After the rapid growth of the 1950s and 1960s, the island has increasingly lagged behind the states. Although some prominent commentators touted the idea of Puerto Rico as similar to the so-called "Asian Tigers," in fact the particular conditions that generated the early success were gone by the mid-1970s. Not only did the global economy change in a way that removed Puerto Rico's special advantages, but the island's position as a territory meant that the social foundations of growth—the establishment of a strong, local class of business people and the creation of a highly skilled labor force—did not take place. An illusion of success was maintained, however, partly by a focus on the growth of Gross Domestic Product (GDP). Yet the growth of GDP was largely accounted for by the rising profits of firms based outside of Puerto Rico, and Gross National Product (GNP), which measures the growth accounted for by and the income coming to Puerto Ricans, did not increase apace. (This important GDP-GNP gap and its significance are explained in Box 2 below, pp. 31-33.)

Section V deals with Puerto Rico's experience of recent years, the severe and lasting recession that began in 2006. This experience is described in terms of the decline in income and output, the rising unemployment rate, the low (and falling) labor force participation rate, and the severe decline of the index of economic indicators. Yet, conditions of the period since 2006 are not only bad in themselves, but they portend a longer term malaise of the Puerto Rican economy, as the underpinnings of progress have been eroded. Furthermore, the huge build-up of government debt—both before and during the recession—will continue to be a burden on the economy for years to come. That debt rose above 100% of GNP in 2010 and that ratio continued to rise in subsequent years.

One of the problems in describing the Puerto Rican economy is that the official data are quite poor. Moreover, there is every reason to believe that Puerto Rican governments have viewed these data as political tools, sometimes simply withholding them or preventing their improvement for political gain. These data difficulties are explained in Box 1 (pp. 25-26).

Although the connections between Puerto Rico's status and economic deterioration are evident throughout the first several sections of this report, they receive direct focus in Section VI. The discussion begins with a review of an important earlier study demonstrating that over long periods there has been a general convergence of income levels among the states of the United States. Puerto Rico, however, has failed to converge. The data certainly suggest a positive causal connection between statehood and economic progress—and between the lack of statehood and the lack of progress.

The remainder of Section VI examines various ways in which Puerto Rico's current status, as opposed to statehood, has inhibited economic progress. Of central importance has been the impact of status on investment, both curtailing investment—especially locally-based investment—and making the island more reliant on externally-based investment. The current status hampers investment because it generates both uncertainly and a view by potential U.S. investors of Puerto Rico as "foreign." Perhaps most important is the complex, cumbersome regulatory regime on the island. While regulation can serve positive social functions, regulations in Puerto Rico appear to have as their major impact an excessive restriction of production. There are, of course, many programs of the Puerto Rican and U.S. governments that have encouraged investment on the island. This investment, however, has had limited positive, job-creating impacts. Moreover, it has created a dependence on external sources of capital and undermined the establishment of bases for progress within Puerto Rican society. Many of the investment problems can be seen within the distorted financial structure that has evolved among Puerto Rican banks, and problems are also evident in the public-private partnerships that are often touted as a basis for growth. Each of these issues, each of the problems with investment in Puerto Rico, is tied to the island's status.

Section VI also discusses the Puerto Rican tourist industry and its failure to progress in a manner that might be expected given the island's natural geographic and climatic conditions. A comparison with the Dominican Republic demonstrates the poor performance of tourism on the island. Here too the difficulties, while involving policy errors and other factors, can be seen largely as a consequence of the island's status. Were Puerto Rico a state, it is likely that things would be very different, and a comparison with Hawaii's experience underscores the point.

Section VII, then, examines the issue of policy directly, giving attention to the questions: Why are widely recognized good policies not adopted and effectively implemented by Puerto Rican governments? Why is policy so dysfunctional? And what are the structural consequences of these dysfunctional policies? A large part of the answer to these questions is facilitated by recognition that "territory" is a euphemism for "colony." In many ways the structures and ideas that dominate policy in Puerto Rico are characteristic of colonial and post-colonial societies. Policy makers are stuck in a vision of development that focuses on manufacturing (which was the basis of success in the 1950s and 1960s). They tend to take a very short-run view of the economy, failing to implement policies that would sustain long-run development. And they rely heavily on external sources of investment, adopting policies that would attract external investment but would also weaken the basis of internally-sourced investment. While this dysfunctional policy is well-rooted in the outlook of Puerto Rican authorities, it also receives strong impetus from the large externally-based firms—e.g., the pharmaceuticals—that benefit from these sorts of policies. Moreover, the U.S. government (in both its particular operations and its constitutional structure), by limiting the "policy space" of Puerto Rican governments and by its role in shaping policies for Puerto Rico, has contributed importantly to the economic problems on the island.

Yet, while statehood could set Puerto Rico on the road to economic progress, there is little if any likelihood that the island will become a state in the near future. So section VIII sets out some steps that could be taken short of statehood that would both contribute positively to the Puerto Rican economy and that would simulate statehood. These steps address, in particular, the tax credit issue and federal expenditure issue raised in Section II and also the data problem raised throughout the report. The general basic principle of these steps is that, insofar as possible, in federal legislation, executive orders, and programs, Puerto Rico and Puerto Ricans should be treated in the same manner as the states and people living in the states. The result would be, in effect, a level playing field. Immediate progress could be accomplished with tax credits, federal expenditures, and the handling of statistical reporting.

Some opponents of statehood in Puerto Rico have argued that with statehood Puerto Ricans would become liable for federal income taxes and, along with Puerto Rico's own taxes, this would be an unreasonable burden. Section IX, however, points out that this argument is simply wrong. The great majority of Puerto Ricans have incomes that are so low they would pay no federal income tax. Moreover, it is possible that upon becoming a state Puerto Rico's own taxes could be reduced.

(Puerto Ricans now pay federal Social Security and Medicare taxes, so those would not change were the island to become a state.)

The final section, Section X, elaborates some basic arguments of this report by examining three cases: the schools, high-tech development, and the physical infrastructure. In each case, the weaknesses of these foundational aspects of the Puerto Rican economy are pointed out, and, most important, those weaknesses are explained in significant part by the continuing status of Puerto Rico as a territory of the United States, by the island's lack of statehood.

II. THE UN-LEVEL PLAYING FIELD

The U.S. government does not treat the territory of Puerto Rico in the same manner as it treats the states—which is to say that the federal government does not treat the U.S. citizens of Puerto Rico as it treats the U.S. citizens of the states. In the political realm, of course, the different treatment of Puerto Ricans is very clear. Their lack of full political rights and powers has direct implication in the economic realm, where, in relation to people in the states, Puerto Ricans do not operate on a level playing field. The negative impacts of this treatment are most evident in the way Puerto Ricans are excluded from certain federal programs and are denied a fair share of federal government expenditures.

A. The Earned Income Tax Credit and the Child Tax Credit

The Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC) are programs that play a significant role in alleviating poverty in the states. The EITC was originally put in place and later expanded to offset regressive payroll taxes (Social Security and Medicare) and to alleviate poverty. The CTC was established to address the concern that the tax structure did not adequately reflect a family's reduced ability to pay taxes as its size increased (i.e., with children). The design of the CTC is such that it contributes to poverty reduction. Although Puerto Ricans pay Social Security and Medicare taxes and although the poverty rate in Puerto Rico is substantially higher than on the mainland, with close to half of Puerto Ricans living below the poverty line, Puerto Ricans are not eligible for the EITC and are eligible for the CTC only if they have three or more children (though residents of the states are eligible with one, two or more children).[17]

The exclusion of Puerto Ricans from these programs is dramatically unfair. Consider a married couple with two children in Puerto Rico earning $25,000 before taxes. In 2011, this family ended up with $23,587.50 after paying federal taxes—i.e., Social Security and Medicare taxes. Yet the identical family in the states, after paying all federal taxes, would also receive an EITC of $4,426.00 and a CTC of $2,000.00, and would thus end up with an income after federal taxes and credits of $30,013.50—$6,426.00 more than the Puerto Rican family.[18]

Were Puerto Ricans fully eligible for the EITC and CTC, over half the families on the island would be positively affected. Moreover, beyond the impacts on individual families—or, more precisely, through having impacts on individual families—the full extension of these two programs to Puerto Rico would provide a major economic stimulus to the island's economy. During the first year that Puerto Ricans would be fully eligible for the EITC and CTC, these programs would provide a stimulus of close to $600 million (over $500 million from the EITC alone). Within a few years, the two programs would be injecting some $1.25 billion annually into the Puerto Rican economy, and over the first ten years of their operation the stimulus would amount to more than $10 billion (again, with most attributable to the EITC). The primary and secondary impacts of this injection of funds would (when compared to the situation in 2012) yield a level of GNP in Puerto Rican more than 1% higher in the early years and roughly 3% higher as the program would become fully utilized.[19]

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[17] Insofar as Puerto Ricans earn their income in the states and are then liable for the federal income tax, they would be eligible for these tax credits. But this is the situation of relatively few people on the island and involves a small amount of payments. Data on the amount of these credits received by the people in the various states, DC and Puerto Rico are not readily available. However, for the EITC, data are available showing the "excess" EITC paid to people in the various states, DC and Puerto Rico. This is the amount actually paid out by the federal authorities, but does not include the amount of reduction in people's federal income tax obligations when on net they still owe something (or when the credit exactly equals the tax obligation). In 2010, in the states and DC, the per capita payment of "excess" EITC was $164. In Puerto Rico, the figure was $1. See *Consolidated Federal Funds Report for Fiscal Year 2010, State and County Areas*, U.S. Department of Commerce, Economics and Statistics Administration, U.S. Census Bureau, Issued September 2011.

[18] Similar disparities exist with other family structures and other levels of income. These figures were obtained using TurboTax 2011.

[19] GNP is used as a reference basis throughout this report instead of the more commonly used GDP because in Puerto Rico the former is a better measure of economic activity on the island. Unlike in the states and in most other countries,

Even greater benefits would accrue because of the impacts of these programs on participation in the paid labor force. The EITC and CTC create incentives for people to take part in paid labor because eligibility for these credits requires that people report earned income. Thus Puerto Rico could obtain an especially important benefit from these programs, as the economy suffers from a quite low labor force participation rate—41.9% on the island in 2010 as compared with 64.7% for the states. Also, Puerto Rico has a very large underground economy (about 25% of economic activity), and the full implementation of the EITC and CTC on the island would bring some of this activity into the regulated economy, increasing the tax base.

Past efforts to extend the EITC and CTC fully to Puerto Rico have sometimes been opposed with the argument that Puerto Ricans should not be eligible for these programs, which are tied to the federal income tax, because Puerto Ricans do not pay the federal income tax (except on income obtained in the states). This argument, however, lacks validity. The EITC, as noted, was created in large part to offset the regressive payroll taxes that Puerto Ricans do pay, and the CTC is already available to Puerto Ricans with more than two children. Moreover, both programs are designed to alleviate economic hardship, of which Puerto Rico has far more than its share. In any case, many—perhaps a majority—of people who live in the states and are eligible for these programs pay no federal income tax simply because their incomes are too low. (The connection of these programs to the federal income tax does facilitate their handling by the IRS, but this is a technical problem that could be readily solved.)

The exclusion of Puerto Ricans from the EITC and CTC is a poignant example of the way Puerto Rico is placed on an unlevel playing field by the U.S. government, of the unfair treatment of the territory. U.S. citizens living on the island are excluded from these important benefits which are provided to citizens living in the states. Further, the economy of Puerto Rico is prevented from receiving the significant stimulus that these programs would provide. Yet the costs to the U.S. treasury would not be excessive (especially when compared to tax incentives, such as those that were embodied in the Section 936 program and those available in 2012 through the Controlled

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in Puerto Rico there is a very large difference between GNP and GDP, with the former running about two-thirds of the latter. See Box 2 for discussion of the important GNP-GDP gap.

Foreign Corporations program, which have provided large benefits to U.S.-based firms in return for the creation of relatively few jobs; see below pp. 41-43).

B. The Distribution of Federal Government Expenditures

The U.S. government spent some $3.3 trillion in 2010 on everything from Social Security payments to weapons procurement, from support for public schools and health programs to agricultural subsidies and the salaries of government workers. While these expenditures are directed towards particular needs, they also provide economic stimulus, both to the country as a whole and to the particular regions where the money is spent. Of course, determination of the location of the expenditures is not simply a technical budgetary matter, but is also a political process, a process from which Puerto Rico is excluded. Although it is often alleged that Puerto Rico is treated "generously" by the federal government, the reality is rather different.

Both overall and in several particular ways, Puerto Rico is treated relatively poorly in terms of the dispersal of federal funds.[20] Consider the data in Table 1. In fiscal year 2010 Puerto Rico received $5,307 per capita from the federal government, less than any state or the District of Columbia (DC). In that year, the average per capita funds going to the states, DC, and Puerto Rico was $10,612—i.e., in per capita terms, Puerto Rico received 50% of the average.

[20] The discussion in this section builds on Arthur MacEwan and Angel Ruiz, "Washington Dollars and the Puerto Rican Economy: Amounts, Impacts, Alternatives," *Ensayos y Monografías*, No. 135, febrero 2008, Unidad de Investigaciones Económicas, Departamento de Economía, Universidad de Puerto Rico, Recinto de Río Piedras. More extensive discussion is presented there. On line at http://economia.uprrp.edu/ensayo%20135.pdf.

Table 1
Federal Government Payments to Puerto Rico Per Capita; Rank of Puerto Rico Among States, DC, and Puerto Rico; and Payments to Puerto Rico as a Percentage of Average of States, DC, and Puerto Rico. Fiscal Year 2010

Category of Payments	Amount per Capita	Rank	Percent of Average
Retirement, Disability & Medicare	$1,998	52	67.4
Other Direct Payments[a]	1,247	52	47.0
Grants[b]	1,587	49	71.7
Salaries and Wages	214	52	19.3
Procurement	262	52	15.7
Total	**$5,307**	**52**	**50.0**

Source: *Consolidated Federal Funds Report for Fiscal Year 2010, State and County Areas*, U.S. Department of Commerce, Economics and Statistics Administration, U.S. Census Bureau, Issued September 2011; and *Statistical Abstract of the United States 2011* for population data.

Notes:
[a] Other Direct Payments consist primarily of direct payments for individuals other than retirement, disability, and Medicare. Major categories of such payments include unemployment compensation, "food stamp" payments, federal employees' life and health insurance, and agricultural assistance.
[b] Grants include both Formula Grants (allocation of money to states and subdivisions according to a distribution formula prescribed by law and not related to a specific program) and Project Grants (funding of either specific projects or the delivery of specific products and services). Principal funders include the departments of Health and Human Services, Transportation, HUD, Education and Agriculture.

The only area of federal government funds in which Puerto Rico rises from its position below all of the states and DC is in the "grants" category, which includes several programs that are explicitly designed—either by formula or discretionary policy—to support low-income areas. In terms of grants per capita, Puerto Rico, an area which has an income far below any of states or DC, ranks 49th. Categories of federal funds dispersal where Puerto Rico's receipts are especially low compared to the states are procurement (15.7% of the average) and salaries and wages (19.3% of the average).

Regardless of the fact that procurements and federal employment (salaries and wages) have their particular purposes, it is well known that the location of such activity is often designed to alleviate poverty and unemployment. Probably more important, the location of federal procurement and employment is highly influenced by the political process, whereby members of congress bring about the location of this activity in their districts or states. Over the years, particular members of congress have become famous for their ability to obtain high levels of federal funds for their states or districts; consider the examples of three now deceased figures: Senator Robert Byrd of West Virginia was able to use his seniority to garner extensive federal spending for his home state; John Stennis parlayed his chairmanship of the Senate's armed services committee into large amounts of federal spending in Mississippi; and Congressman John Murtha, as chairman of the House Appropriations Defense Subcommittee, was able to direct many millions to his home district in Pennsylvania. As a territory, Puerto Rico has no congressional representatives or senators, only a non-voting "resident commissioner."

If the dispersal of federal funds is viewed in relation to the per capita personal income of the states, DC, and Puerto Rico, the situation might be subject to a different interpretation. After all, in 2010, per capita personal income in Puerto Rico was only 37% of per capita personal income in the states (and DC)—$15,180 as compared to $40,584.[21] Yet, Table 2 shows that in 2010, in relation to personal income per capita, Puerto Rico—with federal funds amounting to 35% of per capita person income—ranked below six states and DC in terms of the funds it received from Washington; each of those states and DC had a level of per capita personal income more than twice as high as does Puerto Rico.[22] Of course, in some of these states, and especially DC, wages and salaries and procurement play an especially large role. But, again, federal wages and salaries and procurement expenditures are used to support jobs and incomes (though DC and perhaps Virginia are special cases).

There is, however, little rationale behind the idea that states and Puerto Rico should receive less federal funds if they have low levels of personal income per capita. Federal payments are designed to serve multiple functions, ranging from providing income and employment in relatively low-income regions to building infrastructure (e.g., highways), to establishing military bases and purchasing military equipment. Because of an implicit federal commitment to support regional income convergence, it is to be expected that low-income regions would have relatively large

[21] But see below p. 24 and footnote 26 regarding the comparison of income levels in Puerto Rico and the states.

[22] The six states were, in order (after DC which was first), Alaska (40%), New Mexico (40%), Kentucky (40%), Virginia (38%), Hawaii (37%), and West Virginia (36%). For the states and DC as a whole, the figure was 26%.

receipts. Yet Puerto Rico, with a level of income far lower than any of the states, still receives an allotment in relation to income well below several states.

Table 2
Federal Government Payments to Puerto Rico Per Capita as a Percentage of Per Capita Personal Income; Rank of Puerto Rico Among States, DC, and Puerto Rico; and Payments to Puerto Rico as a Percentage of Average of States, DC, and Puerto Rico. Fiscal Year 2010

Category of Payments	Percent of per capita personal income	Rank	Percent of Average
Retirement, Disability & Medicare	13.2	1	180.3
Other Direct Payments	8.2	11	125.7
Grants	10.5	3	191.6
Salaries and Wages	1.4	47	51.5
Procurement	1.7	48	4 1.3
Total	**35.0**	**8**	**133.7**

Source: *Consolidated Federal Funds Report for Fiscal Year 2010, State and County Areas*, U.S. Department of Commerce, Economics and Statistics Administration, U.S. Census Bureau, Issued September 2011; and for personal income for the states *Statistical Abstract of the United States 2012*, and for Puerto Rico Junta de Planificación de Puerto Rico, Apéndice Estadístico, www.jp.gobierno.pr.

Notes: See Table 1 notes.

It might be argued that Puerto Rico should receive less funds from Washington than do the states because Puerto Ricans do not pay the federal income tax. Yet, Puerto Ricans do pay Social Security and Medicare taxes to Washington (as well as some other payments), and when Puerto Rico, DC, and the states are ranked by net receipts per capita from the federal government—that is, receipts from the federal government less federal taxes—Puerto Rico is far from the top of the list. In 2010, net federal receipts to Puerto Rico were $4,697 per capita, while seventeen states and DC received larger amounts of net federal receipts per capita, as shown in Table 3. Even when net federal receipts are computed in relation to personal income per capita, Puerto Rico does not move to the top of the list. With net federal receipts per capita amounting to 29% of Puerto Rican per capita personal income, this 29% level is still below that for New Mexico (and DC). Moreover, for seven other states, net federal receipts per capita amounted to more than 20% of per capita personal income.[23]

In any case, as with the relation between the distribution of federal funds and per capita personal income (of Table 2), there is no rationale behind the idea that federal funds should be dispersed to the states in connection with payments (taxes) by the states to the federal authorities. Again, federal fund disbursements are designed to serve multiple functions, and there is no reason that the expenditures in a state or region should equal the tax payments from that state or region. It is to be expected that low-income regions, which make relatively low payments to the federal government, would have relatively large receipts from the federal government.

[23] The figures appear to have been similar for earlier years. See MacEwan and Ruiz as cited in footnote 12 on p. 14 above for an analysis of the data for 2004.

Table 3: Net Federal Expenditures Per Capita (Expenditures Minus Taxes), States, DC, and Puerto Rico, 2010

	Net Fed Ex	Rank		Net Fed Ex	Rank
District of Columbia	72,292.40	1	Utah	3,618.10	27
Alaska	11,123.10	2	Kansas	3,575.04	28
Hawaii	10,732.90	3	Iowa	3,545.22	29
New Mexico	9,906.86	4	North Carolina	3,481.73	30
Virginia	9,761.25	5	Pennsylvania	3,463.92	31
Maryland	8,417.70	6	Oregon	3,367.20	32
West Virginia	8,364.84	7	Connecticut	3,357.49	33
Kentucky	7,812.20	8	Georgia	3,292.85	34
Alabama	7,657.33	9	Washington	3,271.60	35
Mississippi	7,515.26	10	Wisconsin	2,936.53	36
Montana	6,872.75	11	Nevada	2,555.03	37
Vermont	6,712.04	12	Indiana	2,359.73	38
Maine	6,549.42	13	New Hampshire	2,202.86	39
North Dakota	6,541.87	14	Colorado	2,067.92	40
South Dakota	6,386.79	15	Massachusetts	1,695.27	41
South Carolina	6,313.02	16	California	1,621.30	42
Idaho	5,167.19	17	Texas	1,455.53	43
Arizona	5,115.76	18	Rhode Island	1,235.08	44
Puerto Rico	4,696.73	19	Arkansas	240.06	45
Wyoming	4,258.14	20	New York	108.37	46
Louisiana	4,102.91	21	Ohio	-8.67	47
Missouri	4,057.49	22	Illinois	-77.94	48
Oklahoma	4,025.22	23	Nebraska	-602.30	49
Florida	4,005.04	24	New Jersey	-4,310.79	50
Tennessee	3,829.12	25	Minnesota	-4,449.54	51
Michigan	3,753.68	26	Delaware	-8,018.41	52

Source: Source: *Consolidated Federal Funds Report for Fiscal Year 2010, State and County Areas*, U.S. Department of Commerce, Economics and Statistics Administration, U.S. Census Bureau, Issued September 2011; and for personal income for the states *Statistical Abstract of the United States 2012*, and for Puerto Rico Junta de Planificación de Puerto Rico, Apéndice Estadístico, www.jp.gobierno.pr. Tax revenue from *Internal Revenue Service Data Book, 2010*, Department of the Treasury, IRS, http://www.irs.gov/pub/irs-soi/10databk.pdf

A level playing field would mean, at least to a large extent, that states (and Puerto Rico) would receive funds from Washington in response to their needs—or at least in response to an equitable distribution of political influence. Quite clearly, Puerto Rico is not treated fairly. Not only is fairness important in itself, but fair treatment would both improve the economic conditions of

Puerto Rican families and provide a major boost to the island's economy. Yet, without effective (i.e., voting) power in Washington, Puerto Rico does not play on a level field.

III. POVERTY, INEQUALITY, AND THE CONSEQUENCES

The impacts of Puerto Rico's poor economic condition show up most starkly in the poverty and economic inequality that characterize life on the island. The way those at the bottom of society are faring and the way that income is distributed are important indicators of economic conditions. Moreover, measures of poverty and income distribution are indications of economic prospects as well as of current conditions. In Puerto Rico, both poverty and economic inequality have long shown, and continue to show, an economy with very serious problems in meeting the needs of the people.[24]

A. The Level of Poverty

The poverty rate for Puerto Rico—the percentage of the population living below the poverty line (which is the same absolute figure for Puerto Rico as for the states)—was 45% in both 2009 and 2010. This is roughly three times the 2010 poverty rate for the whole United States, which was 15.3%, and more than twice as high as the 22.4% 2010 poverty rate for Mississippi, the state with the highest level of poverty.[25]

Given the poor growth performance of the Puerto Rican economy (which will be examined shortly), it would seem reasonable to expect that over the last decade the poverty rate would have increased. Available data, however, do not support this expectation.[26] The 45% rates for 2009

[24] Of course economic growth is also an important indicator of economic conditions and will be examined shortly.

[25] The figures are for the "percentage of people in poverty in the past 12 months," and are from Alemayehu Bishaw, *Poverty: 2009 and 2010*, American Community Survey Briefs, U.S. Census Bureau, Issued October 2011, http://www.census.gov/prod/2011pubs/acsbr10-01.pdf.

[26] Available data may be no good, but they are the only data that exist. Data problems in Puerto Rico will be commented on shortly and are taken up more extensively in Box 1. Although the poverty rate data are from the U.S.

and 2010 are below that reported (also from the Census Bureau) for 1999 of 48.2%.[27] This apparent anomaly is explained in large part by the importance of federal government transfers in the incomes of low-income families. Even while GNP fell in recent years, these transfer payments bolstered the incomes of those at the bottom, reflected in the fact that personal income rose from 89.6% of GNP in 2006, the peak year in terms of real GNP, to 95.4% in 2010. (Although these federal transfers provided some relief for low-income families during this period of poor economic conditions in Puerto Rico, a level playing field would provide both more effective short-term relief—especially for those families below the poverty line—and a longer-term stimulus.)[28]

Even though Puerto Rico's poverty rate has fallen slightly over the last decade, the rate remains exceeding high and would be higher still were it not for the substantial federal transfers. This high poverty rate, in addition to indicating the poor conditions under which many Puerto Ricans live, suggests that, by failing to support the living conditions of a large segment of its population, Puerto Rico is failing to lay the foundations for future economic progress.

B. Income Inequality

Not only are many Puerto Ricans living below the poverty line, which is to say that their absolute income levels are very low, but in addition income is distributed very unequally on the island. In 2010, the Gini ratio measuring the degree of income inequality for Puerto Rico was 0.537. For the United States, this ratio was 0.469. No individual state had a Gini ratio in 2010 higher than 0.499 (which was the figure for New York).[29]

Census, they derive from Puerto Rican information and thus are likely to have some of the problems that are endemic to the Puerto Rican data.

[27] Government Accounting Office, *Puerto Rico: Fiscal Relations with the Federal Government and Economic Trends during the Phaseout of the Possessions Tax Credit*, May 2006, Table 5, p. 78.

[28] In this regard, even though Puerto Rico is not treated as well as the states (not on a level playing field), the experience in the states was similar following the economic downturn that began in 2007. The poverty rate did rise in the states, but the social safety net, while having uneven impacts, did prevent many law income families in the states from falling even deeper into poverty. See Keith Gunnar Bentele, "Evaluating the Performance of the U.S. Social Safety Net in the Great Recession," Center for Social Policy Working Paper, University of Massachusetts Boston, April 20, 2012.

[29] Amanda Noss, *Household Income for States: 2009 and 2010*, American Community Survey Briefs, U.S. Census Bureau, Issued September 2011,

The degree of income inequality in Puerto Rico was somewhat higher in 1999, when the Gini ratio was 0.588, having risen from 0.499 a decade earlier.[30] Thus, as with the poverty rate, the poor economic growth of the last decade has not led to a worsening of income inequality. During periods of slow or negative growth of GNP, sometimes income from capital declines most in percentage terms, and income from capital goes disproportionately to high income individuals. (Of course, even if incomes at the bottom fall by a smaller percentage than those at the top, by any reasonable standard the people at the bottom suffer much greater hardships as a result of the declines.)

Also, in the same way that transfers from the federal government make the Puerto Rican poverty rate lower than it would otherwise be, the degree of income inequality is also reduced by those transfers. Estimates of the Gini ratios for incomes and earnings show a substantial difference, with the latter much higher than the former. Unfortunately, data are not available for the recent years, but the figures in Table 4 show the situation for 1990 and 2000.

Table 4
Gini Coefficients for Puerto Rico on Income and Earnings, 1990 and 2000

	Income	Earnings
1990	0.506	0.663
2000	0.564	0.691

Source: Eileen V. Segarra Alméstica, "What happened to the distribution of income in Puerto Rico during the last three decades of the XX century? A statistical point of view," *Ensayos y Monografías*, Número 129, julio 2006, Unidad de Investigaciones Económicas, Departamento de Economía, Universidad de Puerto Rico, Recinto de Río Piedras.

http://www.census.gov/prod/2011pubs/acsbr10-02.pdf. Washington, DC, did have a 2010 Gini ratio for income distribution of 0.532. The Gini ratio is a measure of the distribution of income, ranging from 0, all people having the same income, to 1.0, all income going to one person. Almost all countries have Gini ratios for the distribution of income between 0.250 and 0.650.

[30] Orlando Sotomayor, "Development and Income Distribution: The Case of Puerto Rico," *World Development*, Vol. 32, No. 8, pp. 1395–1406, 2004, Table 1. Sotomayor's Gini ratios are also from the U.S. Census Bureau.

The data in Table 4 not only indicate the importance of transfer payments in affecting the distribution of income in Puerto Rico. In addition they show that the functioning of the economy aside from transfer payments generates an extremely high degree of inequality. Without the substantial transfer payments that Puerto Ricans receive, it would appear that Puerto Rico's economy would be one of the most unequal in the world. (However, how the economy would actually operate without those transfer payments is an open question.) In any case, it should be kept in mind that Puerto Rico's degree of income inequality falls in the general category of inequality in Latin America rather than that of the U.S. and other relatively high-income countries.[31]

C. The Impacts of Poverty and Inequality

The direct and immediate impact of Puerto Rico's high rates of poverty and economic inequality is relatively obvious: a very large share of the population is living in poor conditions in both absolute and relative terms. This fact alone should make economic conditions on the island of great concern to authorities in both San Juan and Washington.

In addition, however, a wide range of experiences from many countries and regions indicates that the impacts of poverty and inequality on a society go far beyond the obvious:[32]

- Both poverty and inequality tend to be associated with high crime rates. Societies with high levels of economic inequality suffer especially high rates of crimes of violence, which seems to reflect a breakdown of social bonds that comes with the inequality.

[31] For example, for 2009 the World Bank reports Gini ratios for Costa Rica, Chile, and Brazil of 0.507, 0.521, and 0.5477, respectively. See http://data.worldbank.org/indicator/SI.POV.GINI.

[32] Much of the analysis regarding the negative social impacts of inequality is developed in Richard Wilkinson and Kate Pickett, *The Spirit Level: Why Greater Equality Makes Societies Stronger*, New York: Bloomsbury Press, 2009. Also, see James K. Boyce, "Is Inequality Bad for the Environment?" *Research in Social Problems and Public Policy*, Vol. 15, pp. 267-288, http://www.peri.umass.edu/Publication.236+M5b18b9f7e4c.0.html; and Arthur MacEwan, "An End in Itself and a Means to Good Ends: Why Income Equality is Important," in *Development, Equity And Poverty: Essays in Honour of Azizur Rahman Khan*, L. Banerje et al., eds., Macmillan Publishers India, New Delhi, 2010, http://scholarworks.umb.edu/csp_pubs/25/.

- Poor health—not only for those in poverty, but at all levels of society—is associated with high rates of inequality. There is considerable evidence that the level of stress associated with inequality is a major contributor to the poor health in unequal societies.

- Economic inequality appears to have negative impacts on the natural environment, as those who are relatively powerful and wealthy typically gain disproportionate benefits from the economic activities that degrade the environment, while those who are relatively powerless and poor typically bear disproportionate costs.

- Widespread poverty and inequality tend to undermine democracy, as those with high incomes are able to wield a disproportionate impact on political affairs—and, through political affairs, economic affairs.

- In societies with high degrees of inequality and poverty economic opportunity tends to be undermined, as those at the bottom are without the means to improve their positions and are so far removed from the economic norm.

- The direct effect of poverty and inequality on overall economic growth is often negative, due to many factors—for example, poor education, limited demand for mass produced goods, and political instability.

Many of these general impacts of economic inequality and poverty are readily evident in Puerto Rico. Their existence underscores the widespread implications of the island's general economic conditions as well as the broad importance of improving those conditions. In this regard, perhaps the last point noted above—the potential role of "political instability" in affecting economic conditions—deserves special note. Puerto Rico should not be seen as immune from the sorts of political uprisings that have occurred in many countries in the early 21st century. Lack of economic growth (or absolute decline) combined with extensive poverty and severe economic inequality is a formula for political turmoil.

IV. ECONOMIC CONDITIONS IN PUERTO RICO: THE LONG TERM

A. Continuing Stagnation—Worse and Worse Since the Mid-1970s

Although relatively rapid economic growth took place in Puerto Rico during the period following World War II, since the mid-1970s growth of the island's economy has continually lagged behind that of the United States. Figure 1 above on page 6 and Table 5 below show the decade by decade growth of real GNP in Puerto Rico and the United States from 1950 to 2010. As these data demonstrate, in the early post-World War II period, there was a significant convergence of the income level in Puerto Rico towards that of the United States. However, since 1980—actually since the mid-1970s—things have moved strongly in the other direction: economic expansion on the island was significantly slower than in the states in the 1980s, a little better—though still slower than in the states—in the 1990s, and then, again, much slower than in the states during the most recent decade. (These points are based on official data.[33] The official data for Puerto Rico, however, have serious problems. See Box 1 and the discussion in Section V of experience in recent years.)

Table 5
Real GNP Growth in Puerto Rico and the United States, 1950 to 2010,
Percent Change in the Decade

	Puerto Rico	United States
1950s	67.7	39.6
1960s	96.9	50.8
1970s	40.5	37.5
1980s	20.9	36.7
1990s	31.6	39.4
2000s	- 3.6	19.1

Sources: For Puerto Rico - 1950-1980: James L. Dietz, *Economic History of Puerto Rico.* Princeton: Princeton University Press, 1986, Table 5.1; 1990-2000: Planning Board of Puerto Rico (2002). *Economic Report to the Governor 2001*. San Juan; 2010 and 2001: Planning Board of Puerto Rico, http://www.jp.gobierno.pr/, Apéndice Estadístico. For the United States – 1950-1960, Economic Report of the President 1965; 1960-2010, U.S. Department of Commerce, Bureau of Economic Analysis, https://www.bea.gov/scb/pdf/2011/06%20June/D%20pages/0611dpg_c.pdf

[33] The terms "official statistics" or "official data" refer to data from the Junta de Planificación de Puerto Rico, available at http://www.jp.gobierno.pr/; click on Apéndice Estadístico or Indicadores Económicos. When no source is cited, data are from this source. These data, compiled by the Junta de Planificación, also appear on the web site of the Government Development Bank at http://www.gdb-pur.com/economy/statistical-appendix.html.

Even with the very rapid economic expansion of the 1950s and 1960s, Puerto Rico's level of GNP in 2010 was not a great deal closer to that of the United States than it was in 1950: while Puerto Rico's GNP (in real, inflation adjusted terms) expanded 7.1 times in this sixty year period, the U.S. GNP expanded 6.6 times. GNP per capita in Puerto Rico rose from about 18% of GNP per capita in the United States in 1950 to about 29% in 1980. By 2010, however, the per capita GNP ratio had fallen to 21.5%.[34]

[34] Calculated for Puerto Rico for 1950 and 1980 from James L. Dietz, *Economic History of Puerto Rico.* Princeton: Princeton University Press, 1986, Tabled 5.1 and 5.16, and for 2010 from Junta de Planificación de Puerto Rico, http://www.jp.gobierno.pr/, Apéndice Estadístico; for the United States, from U.S. Department of Commerce, Bureau of Economic Analysis http://www.bea.gov/national/nipaweb/TableView.asp?SelectedTable=264&FirstYear=2002&LastYear=2004&Freq=Qtr. These ratios were calculated in "real" terms, which required putting Puerto Rican and U.S. data in the same "real" terms. Given the problems with the Puerto Rican data (see Box 1), these must be viewed as rough figures. The problem with simply taking the ratios based on current dollar figures is demonstrated by the fact that the ratio would rise during the 2001 to 2010 years, a period when Puerto Rican GNP was falling and U.S. GNP was rising. It has been noted above, p. 16, that per capita personal income in Puerto Rico in 2010 was 37% of U.S. personal income, which seems to contradict these figures. That figure, however, is based simply on current dollar data and would not be useful for comparisons over time.

Box 1
The Data Problem

Any discussion of the performance of the Puerto Rican economy is seriously hampered by the poor quality of the official data. Indeed, in some respects the official data are virtually useless. The poor quality of the data not only calls into question any statements about what has been happening to the economy; bad data also weaken economic performance. Furthermore, it has become increasingly clear that the government views economic data as a political tool, to be withheld or released—and perhaps distorted—according to its needs.

Perhaps the most obvious and most serious problem with the data is that 1954 prices are ostensibly* used to calculate real (inflation adjusted) aggregates. Over a fifty to sixty year period, goods and services change dramatically, the "market basket" of goods that is consumed becomes very different, completely new products are introduced, and many old products no longer exist. Thus "real" calculations for today based on 1954 prices are not real at all.

As an example of the problematic consequences of using the 1954 prices to determine "real" aggregate figures, consider: In 2010, according to the official data, real consumption expenditures were one-and-a-half times as large as real GNP, and the real excess of imports over exports was virtually equal to GNP. In current prices, however, consumption was 90% of GNP and the excess of imports over exports was 22% of GNP. While these strange "real" results may reflect an accurate mathematical application of 1954 prices to 2010 conditions, they provide nothing useful about the real condition of the 2010 economy.

A related problem is revealed by the very large change in the Puerto Rican Consumer Price Index (CPI) that became available in 2010. The new CPI presented a radically reduced and more plausible rate of inflation, as compared with the old CPI. Although the new CPI represents a positive step, the sharp change of these figures, which underlie judgments about what has been happening to the island's economy, increases general concern about the official data. Furthermore, although the CPI was revised, it appears that none of the figures for the last many years based on adjustments for inflation have been altered.

Beyond these problems with the available data, the Puerto Rican government has attempted to prevent the availability of data. In 2010 the government attempted to prevent the release of the new CPI. When the Director of the Instituto de Estadísticas ignored the government's efforts and made the new CPI public, the government tried (unsuccessfully) to have him dismissed. As another example of the government's efforts to suppress economic data, in April 2012 the following statement appeared on the home page of the Government Development Bank (GDB):

> "In compliance with Act 78-2011 (Puerto Rico Electoral Code for the Twenty-First Century), during an election year and until the following day of the election event, the Government Development Bank for Puerto Rico may not publish certain information through the media, including its website, for the benefit of the general public. In order to keep our public informed and maintain our commitment of transparency with the investor community, we may provide updated information, per request. If you wish to receive updated economic information, please send us an email to investorresources@gdb.pr.gov."

The problem, of course, lies in the establishment of Act 78-2011. Yet the application of the law by the GDB, a major source of economic information on the Puerto Rican economy, underscores its implications. (Shortly after it was generally noticed, the statement disappeared from the GDB web site.)

(Box 1 cont'd)

The problems with the data themselves—especially with price adjustments and calculations of "real" values—make it difficult to give much credence to data coming from official government sources, the Junta de Planificación in particular. Adding the apparent view of the government that economic information released by official agencies is a political instrument, an observer must have little confidence in the veracity of these data.

The issue, however, is not simply that one must have little confidence in the picture of the Puerto Rican economy that can be obtained from the official data—though of course this hampers efforts to develop accurate analyses. In addition, it undermines the government's ability to formulate effective economic policy, the ability of rating agencies to know what is going on in Puerto Rico, and the confidence that private investors (internal or external) have in Puerto Rican conditions.

The President of the New York Federal Reserve Bank, William C. Dudley, speaking in Puerto Rico in 2010, both commented on the importance of good economic data and noted the existence of Puerto Rico's shortcomings:

> "The private and public sectors both need accurate, timely and comprehensive economic statistics to perform effectively. It is impossible to make good decisions without a solid factual basis for those decisions. For example, the government needs good economic information to develop effective fiscal, economic development and regulatory policy. Likewise, to make the best production, investment and pricing decisions, businesses need accurate and timely information on things such as wages, income and prices. Poor quality information increases uncertainly and this uncertainty inhibits well-considered risk-taking and investment decisions."
>
> "Although Puerto Rico's statistical system was once a model for other countries, now there are major opportunities for improvement in comparison with the mainland and other countries."**

The poor quality of government economic data in Puerto Rico has created business for private consulting firms, as they sometimes generate estimates of data series to meet the needs of business clients. The work of Estudios Técnicos in building a consumer price index for Puerto Rico is a good example.

In spite of the serious problems with the official data, there is no option but to use them in this report, except in a few place otherwise noted. But the reader has been cautioned.

* "Ostensibly" because it is alleged by people who have worked with the data that, in fact, other methods are used to determine real aggregates. Even if correct, this is hardly reassuring, as it suggests that no one outside of the Junta de Planificación knows how the computations are actually accomplished—which, in itself, makes the data virtually useless.

** William C. Dudley, "The Challenges Ahead," Remarks at the Center for the New Economy 2010 Conference, San Juan, Puerto Rico, February 19, 2010,
http://www.newyorkfed.org/newsevents/speeches/2010/dud100219.html.

The poor economic performance of the Puerto Rican economy as measured by GNP data can also be seen in other indicators—most clearly in the high unemployment rate and the low labor force participation rate; see Figures 3 and 4. Since 1950, the unemployment rate has not dropped below 10% of the labor force; the lowest figure was 10.1% in 2000. (Data are not available for years before 1950.) Unemployment rose sharply in the late 1970s and ran above 20% for several years in the early 1980s. In more recent decades the unemployment rate came down, but then again rose sharply in 2009 and 2010. The high unemployment rate has been accompanied by an extremely low labor force participation rate. The participation rate dropped off after the 1950s and has, with some minor fluctuation, remained low since. In 2010, the participation rate stood at 41.9%, lower than for any year on record except 1982, when the participation rate was

41.8%. In no year since the early 1950s has the participation rate risen to 50%. In spite of these continuing signs of an economy in trouble, signs that were certainly clear by 1980 if not earlier, there remained an illusion of success regarding the Puerto Rican economy. (These data on unemployment and the labor force participation rate should be viewed as quite rough because of the large size of the "underground economy" in Puerto Rico. Estimates vary, but this activity probably accounts for 25% of economic activity, and surely a significant amount of the employment in this "off the books" activity is not counted in the official data. Nonetheless, there is little doubt that unemployment is relatively high and labor force participation is relatively low in Puerto Rico, and that the direction of change since 2006 is a clear indication of the worsening economic conditions.)

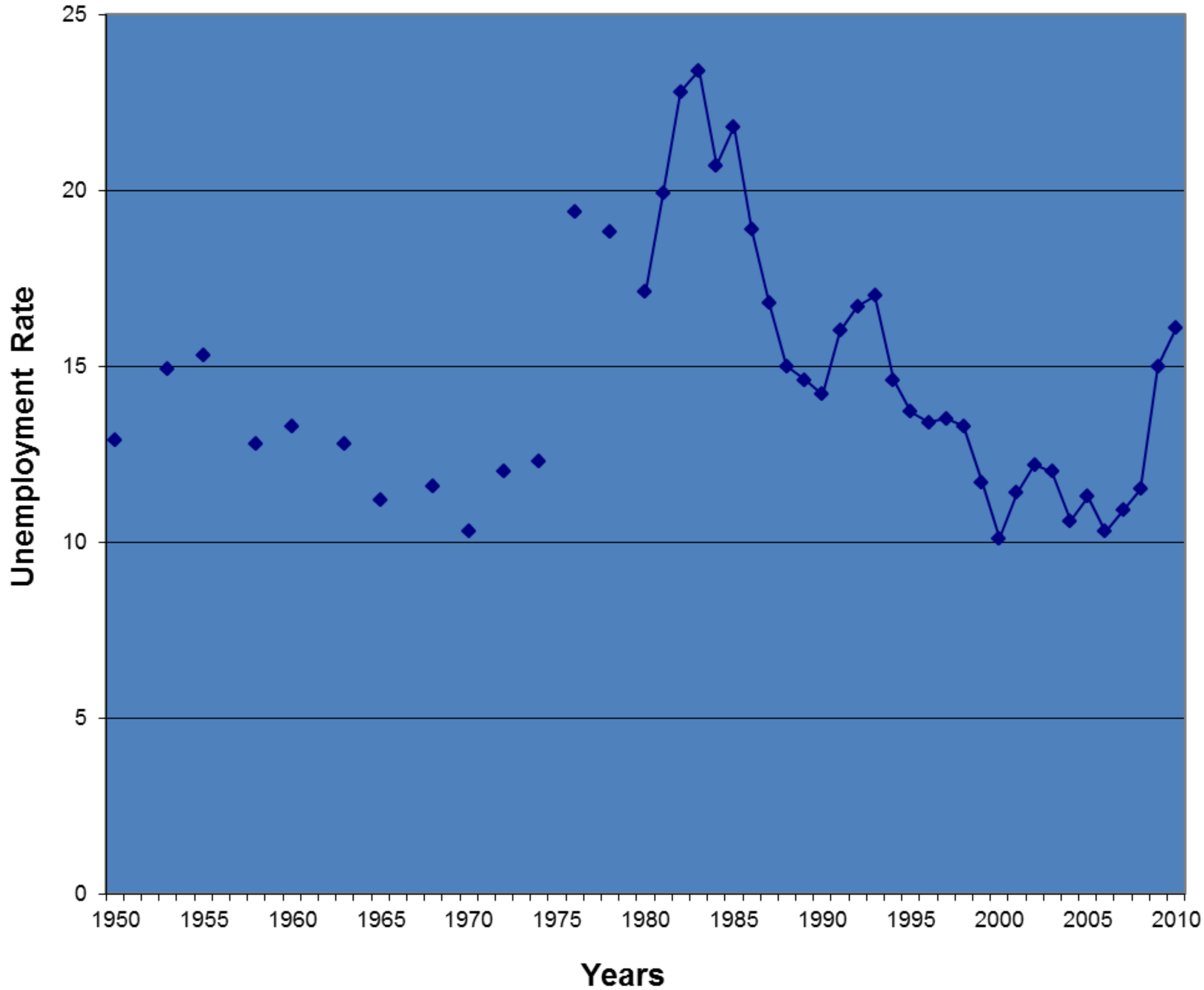
B. The Illusion and Myth of Success

Puerto Rico's rapid economic growth of the 1950s and, especially, the 1960s led many commentators to view the island as rapidly moving from its situation of 'Latin American underdevelopment' to a situation where it would be economically close to, if not part of, the United States. Looking at the experience of those early years, even from the perspective of the 1990s, two well-known and highly capable economists, William Baumol and Edward Wolff, suggested that Puerto Rico might be viewed as in the same category as the so-called "Asian Tigers."[35] In retrospect, however, it is apparent that the island's economic success, insofar as it was real, was due to special circumstances of the period—namely that the relatively low wages combined with unfettered access to the U.S. market made Puerto Rico an attractive site for U.S. firms to locate their labor-intensive production of goods destined for U.S. consumers. This expansion of manufacturing activity led the development of the economy from 1950 up through the early 1970s. Furthermore, under the rubric Operation Bootstrap (*Operación Manos a la Obra*), this expansion was also fueled by special tax treatment from both the federal and Puerto Rican governments. But neither of the special circumstances at the base of this period's economic success—low wages and preferred access to the U.S. market—would last. (Unfortunately, the belief that manufacturing could be the foundation of economic growth in Puerto Rico has lasted,

[35] William J. Baumol and Edward N. Wolff, "Catching Up in the Postwar Period: Puerto Rico as the Fifth 'Tiger'?" *World Development*, Vol. 24, No. 5. 1996.

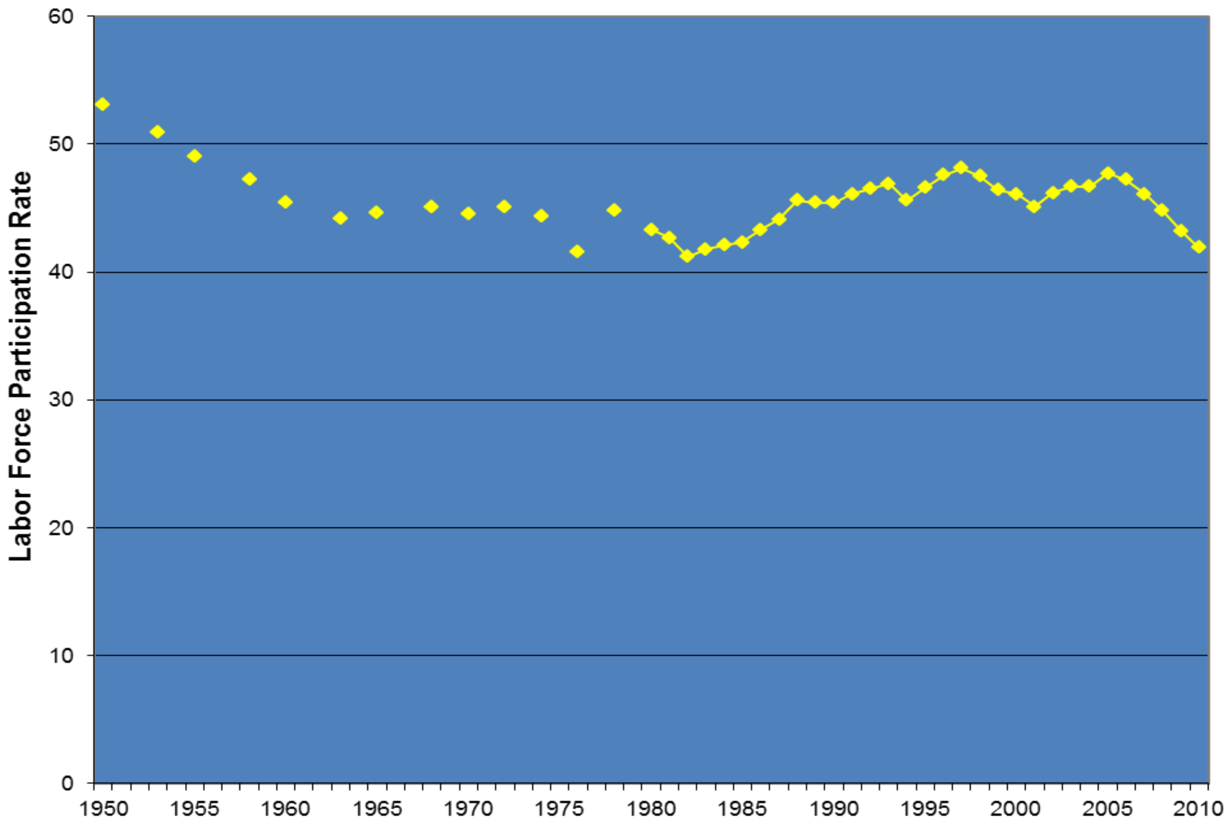
and has generated a perverse distortion of both economic policy and the economy—about which more below on pages 44 and 45.)

Figure 3: Unemployment Rate in Puerto Rico, Selected Years 1950-1980 and 1980-2010



Note: Based on a labor force of non-institutionalized persons 14 years of age and over until 1976 and 16 and over after 1976.
Source: For 1950-1980, James L. Dietz, *Economic History of Puerto Rico*. Princeton: Princeton University Press, 1986, Table 5.13 (not all years are available); for 1980-2010, Puerto Rican Departmento de Trabajo y Recursos Humanos, Tabla 7 at http://www.dtrh.gobierno.pr/pdf/serie_mensual_1980.pdf.

Figure 4: Labor Force Participation Rate in Puerto Rico, Selected Years 1950-1980 and 1980-2010



Note: See Figure 3.
Source: See Figure 3.

The error of Baumol and Wolff, and of many others who saw the Puerto Rican economy as highly successful through the 1990s, was, in part, that they focused on gross domestic product (GDP) rather than on gross national product (GNP). The former includes the large profits of foreign (most often U.S.) firms operating on the island, while the latter does not. Yet this income of foreign firms is generally not available to Puerto Ricans, either for consumption or investment, and is not a good measure of Puerto Ricans' economic well-being. Furthermore, a large portion of these profits do not even represent economic activity in Puerto Rico, as firms have used transfer pricing mechanisms to locate their profits in Puerto Rico due to the tax advantages that this has provided; also, and in addition to transfer pricing in the usual sense, firms, especially pharmaceutical firms, located the income from their patents in Puerto Rico. When the Puerto Rican economy began to slow significantly in the mid-1970s, as measured by GNP growth, GDP growth continued apace. Whereas in 1970, GDP was 7% larger than GNP, by the 1990s the former was 50% greater than the latter. (For more on this GDP-GNP gap, its origin, and its significance, see Box 2.)

The error of placing Puerto Rico in the same category as the "Asian Tigers," however, was not simply a result of focusing on the wrong variable. The error also arose from a failure to recognize the economic implications of Puerto Rico's status as a territory of the United States. The countries of East Asia that experienced such great economic success in the latter half of the 20th century—Taiwan and South Korea being the best examples—were able to shift from an 'easy' early stage of development based on import substitution to a more advanced and more difficult stage of economic progress based on technological advances in which locally-based business and increasingly skilled workers played the leading role. This shift was based on extensive government support, involving restrictions on foreign investment and regulation of foreign commerce, as well as direct support for locally-based business and skill development. For Puerto Rico, under the control of the U.S. government, this sort of support for local business—which necessarily would mean discrimination against foreign-based (U.S.) business—was not an option. As James Dietz has usefully summed up the situation: "…Puerto Rico's strategy of development lacked a focus on the systematic support or fostering of local entrepreneurs and local sources of finance." As a consequence "the central role of domestic entrepreneurs, skilled workers and technological progress that underlies sustained economic progress" has been weaker in Puerto Rico than in sovereign nations where sustained economic progress has proceeded more rapidly.[36]

As its economy slowed after the mid-1970s, Puerto Rico remained highly dependent on foreign (mainly U.S.) firms as the engine of economic progress. This dependence is reflected in the GDP-GNP gap, as GDP has remained about 50% above GNP for the last 20 years. Government development strategy continues to be heavily directed towards attracting investment by U.S. based firms (and other firms based abroad), and limited support is provided for firms based in Puerto

[36] James L. Dietz, *Puerto Rico: Negotiating Development and Change*, Lynne Rienner Publishers, Boulder and London, 2003, pp. 78 and 79.

Rico. (Furthermore, the high level of regulation of business by the Puerto Rican government, while size-neutral in form, weighs more heavily on smaller firms, which tend to be local.) Also, although the Puerto Rican population is extensively educated, as measured by the share of the population that has attained higher levels of schooling, the public school system—and hence the quality of education—is widely seen as seriously deficient. There is also limited progress in establishing the technological foundation for a more advanced economy. (See Section X below for more on the schools and the "high tech" issue.)

Puerto Rico's status, then, has been a major factor inhibiting the establishment of effective broad, economic development strategies. Moreover, territorial status has led to the adoption of poor—indeed, detrimental—economic policies by the governments of both major political parties. There is a sense in which Puerto Rican policy-makers are stuck in the economic 'glory years' of Operation Bootstrap. The same old policies—waiting for tax breaks from Washington to attract external investment and to provide special treatment for manufacturing—are relied upon as though policy makers are thinking, "They worked then, so they should work now."

Box 2
The GDP-GNP Gap in Puerto Rico

The usual measures of economic activity don't work so well for Puerto Rico. The standard gauge of economic activity, Gross Domestic Product yields a very misleading picture of the economic well-being of the Puerto Rican people or how their conditions are changing over time. And measurement is just the beginning of the story. Behind the numbers lie some serious, long term problems in the way Puerto Rican economic development has been organized.

The measurement matter itself is relatively straight forward. In order to gauge the level of development of a country (or region) and to determine how economic activity is progressing, the usual focus is Gross Domestic Product (GDP). GDP measures all the production of goods and services that takes place in a country (or region) in a given period. The problem is that in Puerto Rico a great deal—a very great deal—of the income from that production does not go to either Puerto Rican companies or Puerto Rican workers. It goes as the profits of companies that are based outside of the island, mostly in the United States. Equally important, the share of Puerto Rican GDP that is attributable to off-shore firms grew substantially over the last several decades of the 20th century.

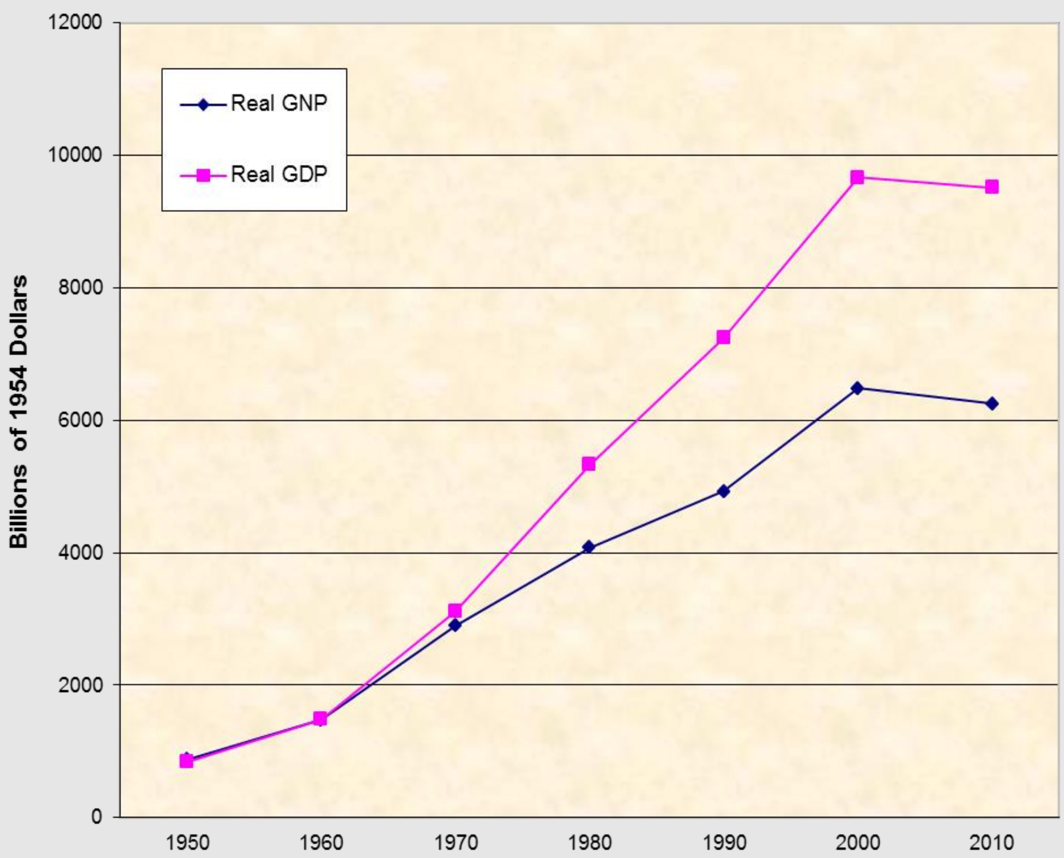
The problem can be understood in terms of the gap between GDP and GNP. While GDP is the amount of production that takes place within a country (or region), GNP—Gross National Product—is the amount of production that is attributable to the nationals of a country (or region). GDP will be larger than GNP insofar as foreign workers or businesses are obtaining income within the country (i.e., insofar as output in the country is attributable to foreign labor and capital); GDP will be smaller than GNP insofar as national labor and capital are obtaining income abroad.*

As is well known, Puerto Rican economic development for several decades has been organized around firms from the mainland U.S. operating on the island. The profits of these firms, while counting as part of Puerto Rican GDP, do not count as part of Puerto Rican GNP. In some cases—936 companies—the income of firms operating in Puerto Rico has been much larger than would normally be associated with the amount of activity they undertake on the island because, through such devices as locating the ownership of a lucrative patent with their Puerto Rican subsidiaries, they are able to locate a large amount of their profits on the island and thus take advantage of tax laws to increase their total after tax profits.

In 1950, before the major influx of U.S.-based firms, GNP actually exceeded GDP by about 4%, the difference accounted for by the incomes earned by Puerto Ricans working in the U.S. which were part of GNP but not part of GDP. In the next two decades, as rapid growth took place with a large role of U.S.-based firms, GNP fell off to 93% of GDP. Then, over the following three decades, as the performance of the economy slowed but as the U.S.-based firms were still central to the economy, GNP fell to 76% of GDP in 1980, 68% in 1990, 67% in 2000, and 66% in 2010. (See Figure B2.1.)

Box 2 (cont'd)

Figure B2.1: The Puerto Rican GDP-GNP Gap



Source: 1950-1980, James L. Dietz, *Economic History of Puerto Rico. Princeton*: Princeton University Press, 1986, Table 5.1; 1990 and 2000, Planning Board of Puerto Rico, Economic Report to the Governor 2001, San Juan, 2002; 2010, Junta de Planificación de Puerto Rico, www.jp.gobierno.pr, Apéndice Estadístico. Real GDP has been calculated on the assumption that the deflator is the same as that for GNP.

To put these figures in some perspective, in 2004, out of 188 countries or territories for which data are available, for only 15 was GNP less than 90% of GDP, and for only 2 was GNP-GDP ratio less than 70%—Puerto Rico at 67% in that year, and Equatorial Guinea at 30%.**

What are the implications of this GDP-GNP gap?

First, and most important, the GDP-GNP gap is a measure of the de-territorialization of the Puerto Rican economy (what we would call de-nationalization were Puerto Rico a nation). This de-territorialization is a measure of the degree to which the economy of the island is dependent on outside sources of capital and outside decision-making. While 'outside' forces are not necessarily 'bad,' firms based outside of Puerto Rico are likely, in general, to operate in a different manner than firms based within Puerto Rico. The former face different sets of information and different sets of economic, political, and social connections than do the latter. While both the outside and

Box 2 (cont'd)

inside firms may have the same set of goals (profits), they have, as sociologists might say, different sets of "boundaries"; as a consequence, they are likely to behave differently. The long run economic growth and development of a region is enhanced when there is a substantial group of firms and individual investors who have a strong identity with and an interest in the local/national/territorial economy. The large GDP-GNP gap in Puerto Rico suggests that this group is significantly lacking.

Second, the substantial GDP-GNP gap indicates that a large share of the profits generated in Puerto Rico is likely to be unavailable for investment in Puerto Rico. This is not to say that all of the profits accruing to firms based off the island are taken out; some undoubtedly remain in Puerto Rican financial institutions and some may even be reinvested locally. However, all of these profits are owned elsewhere and can be taken out. It is, further, likely that in the case of funds that have been kept in Puerto Rico to take advantage of tax benefits, they may be effectively used elsewhere—e.g., as collateral for activities undertaken elsewhere.

Third, the existence of the large GDP-GNP divergence means that GDP per capita is an even less meaningful measure of economic well-being in Puerto Rico than elsewhere. While it tells us about the output (or income) generated in Puerto Rico, it does not tell us about the output (or income) that is in the hands of Puerto Rican firms and individuals and available for their use—GNP gives us this latter form of information. Moreover, during the second half of the 20th century, GDP and GNP were growing at significantly different rates.

While the large GDP-GNP gap for Puerto Rico has these troubling implications, there is another part to the story. The gap, after all, reflects the large amount of outside capital that has come to the island. At least at times, this outside capital has generated jobs and income growth. Nonetheless, the problems associated with the GDP-GNP gap are significant. Moreover, whatever favorable outcomes were generated by the inflow of funds to Puerto Rico in the past, it seems that things have changed substantially in recent decades. If Puerto Rico is to re-establish a more positive economic dynamic, it worthwhile to examine the GDP-GNP gap and what it represents.

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* Both GDP and GNP include only production that is sold for final use—i.e., intermediate goods and services, sales of inputs from one firm to another, are not included.

** Alan Heston, Robert Summers and Bettina Aten, Penn World Tables 6.2, http://datacentre2.chass.utoronto.ca/pwt62/alphacountries.html.

These policy problems will be addressed shortly. However, it is first necessary to examine the extremely poor economic performance in the first decade of the 21st century.

V. THE SEVERE AND LASTING RECESSION

From 2006 onward, Puerto Rico has experienced a long and severe recession. According to official statistics (again, see Box 1), in 2010 real GNP was 3.8% below its 2009 level. Real GNP had fallen every year since 2006, the peak year, and in 2010 was 11.3% below that peak level. Also, in 2010 real GNP was 5.0% below the 2001 level.[37] The situation with personal income, however, is not as bad because of transfer payments from the federal government. As noted above (p. 20), between 2006 and 2010, per capita personal income rose from 89.6% of per capita GNP to 95.4%.

The official data on real GNP, however, are not reliable (perhaps not even close to meaningful, as explained in Box 1). Nonetheless, there are other indicators that also show that the Puerto Rican economy did poorly in the first decade of the 21st century and extremely poorly after 2006. Unemployment, always high by U.S. standards rose to 13.4% of the labor force in 2009 and 16.0% in 2010, far from the 10.1% low in 2000 and from the still relatively low 10.3% in 2006. (Government layoffs of several thousand workers were a major contributor to this sharp upswing in the unemployment rate; more on this below, p. 58.) Moreover, this rise in the unemployment rate was accompanied by a sharp decline in the labor force participation rate, which fell from its peak rate of 47.7% in 2005 to 41.9% in 2010, as (on net) 109 thousand people departed the labor force in this four year period, a 7.7% decline. (See Figures 3 and 4 above.) The situation with investment has been at least as bad as that with employment. Gross domestic fixed investment fell off from 20.9% of GNP in 2006 to only 13.9% in 2010. And this fall in the second half of the decade had been preceded by a decline from 26.5% in 2001. The rising unemployment rate and the falling investment rate are shown in Figure 2 in the Introduction; as noted there, when the

[37] It is somewhat unclear what happened to per capita income over this period because the official Puerto Rican data show a 3.6% growth of population over the decade while the U.S. Census reports a 2.5% decline. Apparently the difficulties with Puerto Rican data exist for demographic as well as economic data. The Puerto Rican data are from the "official statistics" of the Junta de Planificación as cited above in footnote 25, and the Census data are reported at http://www.census.gov/popest/data/intercensal/puerto_rico/pr2010.html.

investment rate and unemployment rate cross and the former goes below the latter, an economy is in severe trouble.[38]

These data on the rising unemployment rate and the falling rates of labor force participation and investment not only demonstrate the severity of the Puerto Rican recession, but they also do not bode well for recovery. The investment figures indicate a two-fold problem: that the capital foundation for future growth is not being put in place and that investors tend not to believe that the outlook for future growth is favorable. The unemployment and labor force participation rates indicate that it will, at best, take a long time before the Puerto Rican economy can return even to the pre-2006 situation. Furthermore, as will be noted in Section X, problems with the schools and training programs also do not bode well for the island's future economic condition, and, insofar as a highly skilled labor force does exist, a "brain drain" is also working against future economic prospects (see Box 3).

[38] The investment decline over the decade was concentrated in construction, with real private construction spending falling by two-thirds and public construction (government and public enterprises) falling by about 45%. Real spending on machinery and equipment fell by less than one percent over the decade. As with other "real" data, these are official figures computed on the basis of 1954 prices. As many investment goods used today did not exist in 1954 (e.g., computers and other IT equipment), one can only wonder about the meaning of these figures.

Box 3
The Brain Drain:
Consequence and Cause of Poor Performance

One of the consequences of Puerto Rico's poor economic performance appears to be a "brain drain" problem. Available data indicate a significant departure from the island of relatively highly educated people. This brain drain should probably be seen as a result, rather than a cause, of the current poor economic situation in Puerto Rico. That is, relatively highly educated people are probably leaving because of the lack of jobs for them on the island. However, as these people leave, their departure is an ominous sign for future economic prospects.

A recent study from the Instituto de Estadísticas de Puerto Rico* reports, first, that in the 2005 to 2009 period, Puerto Rico experienced a net out migration of some 144 thousand people, roughly 4% of the population. This net out migration largely balanced the "natural" growth of population; total population between 2005 and 2009 increased by only 55 thousand, or only 0.35% per year.** Moreover, the out migration has contributed to the aging of the Puerto Rican population.

Within this context, the study also reports that those leaving the island tend to be more highly educated than those returning. In particular, a larger number of people with some higher education are leaving than are coming in. The numbers are not huge, but they are fairly consistent over the years of the study. In 2009, for example, 38,465 people over 25 left the island. Of these, 9,313, 24.2%, had a bachelors degree or further higher education. Of the 18,619 people over 25 coming into the island, 2,936, 15.8%, fell in this educational category. On net, then, migration is reducing the share of the population that is relatively highly educated.

The net out migration is easy to understand. While jobs have been scarce in the states, with the unemployment rate in 2010 at 9.6%, it was much higher in Puerto Rico, at 16%. Moreover, the U.S. unemployment rate for people with a college degree was about 4.5% in 2010. (Similar data are not readily available for Puerto Rico.) The attraction for highly educated Puerto Ricans would appear to be substantial.

Some analysts have downplayed the role of a Puerto Rican brain drain. Based on data from earlier years, they have pointed out that the percentage of emigrants with high levels of education is no greater than the percentage of the population with high levels of education. These more recent data tend to undermine this argument. Moreover, the argument seems to miss the point. The re-establishment of Puerto Rican economic growth, if it is to be sustained, will depend (among other things) on the availability of a well-educated labor force. With the out migration of people with high levels of education, even when accompanied by a proportional out migration of people with low levels of education, re-establishment of sustained growth is less likely. In this sense, the brain drain has long been a significant issue for Puerto Rico.

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* Idania Rodríguez Ayuso, Nahir Rodríguez Hernández, and Mario Marazzi Santiago, Perfil del Migrante, 2000-2009, Instituto de Estadísticas de Puerto Rico, 28 de febrero de 2011.

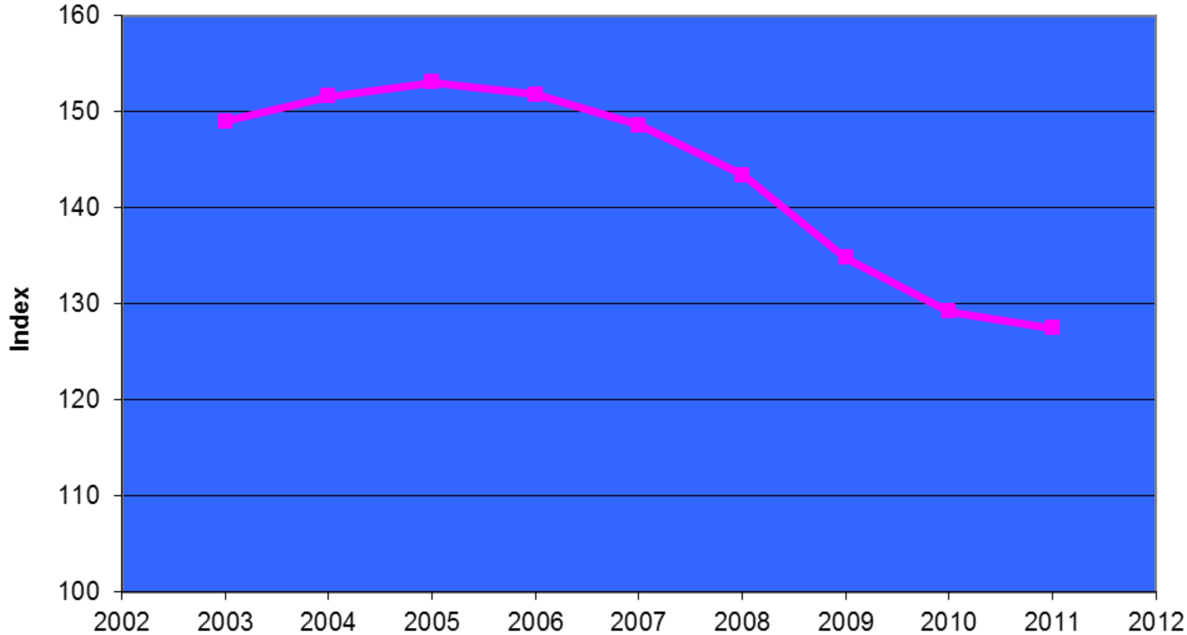
** This population growth figure is from the Junta de Planificación's oficial Puerto Rican data. U.S. Census Bureau data, however, suggest lesser growth—or a decline—of the Puerto Rican population in the early 2000s, as noted in footnote 5 of the text.

The severity of the economic downturn that emerged in 2006 is further demonstrated by the "Economic Activity Index," compiled monthly by the Government Development Bank of Puerto Rico. This index of current economic activity is a composite based on four variables—payroll employment, electric power consumption, cement sales, and gas consumption; the index is based on 1980 =100. As shown in Figure 5, the index peaked at 153.1 in 2005, and then in 2006, as the economy started to decline in the second half of the year, fell to 151.8. From there, the decline was precipitous, with the index dropping each year to 127.5 in 2011.[39]

Even if one discounts the reliability of the Puerto Rican GNP data, all of these other indicators—the unemployment rate, the investment rate, the labor force participation rate, and the Economic Activity Index—tell the same story of an economy in serious decline. (And then there are the perceptions of people in Puerto Rico, based on their own experiences and observations.) Of course the fate of the island's economy is connected to the condition of the U.S. economy, which was not doing well in the first decade of the new millennium. Yet, while the Puerto Rican economy was in serious decline, the U.S. economy grew by over 16% in the 2001 to 2010 decade. Far from "catching up" or "converging," Puerto Rico has been moving further and further from economic conditions in the states.

[39] For the index, go to http://www.gdb-pur.com/economy/pr-monthly-economic-indicators-time-series.html and click on "Economic Activity Index" and the bottom of the page. It should be noted that the index showed some slight upward movement, beginning in late 2011. However, it had risen only to 128.7 by February 2012.

Figure 5: Economic Activity Index for Puerto Rico, 2003 to 2011 (1980 = 100)



Source: Government Development Bank of Puerto Rico, http://www.bgfpr.com/economy/documents/13.EAI-2012-04-24.xls

VI. THE COSTS OF NOT BEING A STATE

The causes of Puerto Rico's poor economic performance in recent decades and, especially, in recent years can be traced to many sources. In terms of the important comparison with the states and in the context of the problems associated with Puerto Rico's status, it is useful to examine the question: How might economic conditions be different were Puerto Rico a state? In other words: What are the costs of the territorial status? What are the costs of the lack of statehood status?

A. The Convergence among the States and Puerto Rico's Lack of Convergence

A 1997 study by Fernando Lefort established two points rather clearly:[40]

[40] Fernando Lefort, "Is Puerto Rico Converging to the United States?" Working Paper 1003, International Tax Program, Harvard University, October 1997.

> One: Among the states of the United States, during the 1940 to 1990 period, there was a substantial and significant convergence of per capita income levels. States with lower per capita income in 1940 tended to experience significantly more rapid economic growth over this fifty year period than did states with higher per capita income in 1940.
>
> Two: Puerto Rico did not experience this convergence. Based on the statistical relationship between income level and economic growth for the states, it is possible to estimate what the economic growth rate of Puerto Rico would have been under the hypothetical assumption that it was a state. Its growth rate would have been much higher.[41] (Some states also performed more poorly than what would have been expected on the basis of the overall experience of all the states—and some performed better. None, however, deviated from statistically expected performance nearly as much as did Puerto Rico.)

Of course, the data presented above (Figure 1 and Table 5, in particular) demonstrate the lack of convergence between per capita income levels in Puerto Rico and the states. The value of Lefort's study, however, is that it demonstrates convergence among the states. Moreover, when Lefort exams the period from 1880 to 1940 and considers the experience of U.S. territories that became states during this period, he finds that territorial status has a significant negative impact on economic growth as compared to statehood status. That is, his data suggest that convergence is connected to statehood.

Since the period covered by Lefort's study (up to 1990), the Puerto Rican economy has diverged sharply from the economy of the states in terms of per capita income (as shown in Figure 1 and Table 5). Thus there is no doubt that the statistical results of his 1997 study would hold as well for subsequent years.

Yet statistical correlation—the association between Puerto Rico's territorial status and the island's lack of convergence with the states—does not necessarily mean causation. Lefort's work certainly

[41] Lefort (p. 17), using conservative assumptions, reports that had Puerto Rico been converging as a state up to 1994, in that year the average Puerto Rican would have had an annual income $6,000 higher than she/he actually had. That's over $9,000 in 2012 prices.

suggests causation. Yet, without establishing reasons for the lack of convergence, there is no assurance that the relationship is causal. It is especially useful, therefore, to examine specific ways in which Puerto Rico's status, its lack of statehood, has inhibited its economic progress.

An important and perhaps the most obvious specific way in which Puerto Rico's status has limited its economic advance has been discussed earlier—namely that with regard to the states Puerto Rico is on an unlevel playing field. The island is placed in a disadvantageous position, treated poorly relative to the states by the federal government in terms of both the availability of tax credits (the EITC and the CTC) and the distribution of federal expenditures. There is no need to repeat what has been said earlier (Section II), but those aspects of the unlevel playing field do deserve emphasis.

B. Investment

Investment is a central driver of economic growth. As pointed out above in Sections I and V, in the last decade, investment in Puerto Rico has fallen off substantially. This fall off, of course, is both cause and effect of the generally dismal condition of the island's economy in recent years. Yet, as serious as has been the condition of investment in the last decade, there are very substantial long-term factors that have had negative impacts on the level of investment in Puerto Rico. These factors include: the political status of Puerto Rico; the excessive, inefficient regulatory regime and the consequent difficulty in starting and operating a business; the high cost of energy; and the limited public provision of infrastructure. Moreover, while political status is an issue in itself, status also has impacts on the other factors inhibiting and misshaping investment in Puerto Rico. Nonetheless, the governments in both San Juan and Washington have encouraged and facilitated a large amount of investment that has come to the island from external sources—mainly from the states. This "foreign" investment, however, has not provided an effective foundation for economic growth.

Impediments to Investment

Direct Effects of Political Status

The political status of Puerto Rico is an impediment to investment, first, because potential investors based in the United States view Puerto Rico as "foreign." Indeed, there is a certain sense in which, for the investor from the states, Puerto Rico *is* "foreign," in spite of having the U.S. dollar as its currency and having ultimate legal authority residing in the U.S. constitution and U.S. courts. The Puerto Rican economy is, to a large extent, governed by a different set of rules and regulation than those familiar to U.S. firms. For large firms, operating internationally, a different set of rules in itself should not be a problem—though Puerto Rico's rules and regulations (about which more shortly) present problems for even the largest firms. But, especially important, Puerto Rico's rules and regulations serve to inhibit the start up of companies, and it is new companies that, in the states and elsewhere, play an important role in both job creation and the introduction of new activities—high-tech and bio-tech activities, for example. New activities, which would employ and build upon Puerto Rico's relatively highly educated labor force,[42] are widely seen as what the island needs for effective economic growth.

Territorial status creates a second impediment to investment in that it is necessarily an uncertain status. Territorial status is always subject to change. The history of U.S. territories has been characterized either by their absorption as states or, in the unique case of the Philippines, independence. Investors, aware of this history and not knowing what is likely in Puerto Rico, are faced with considerable uncertainty—which is of course an inhibition to investment. The problem, moreover, is as much a concern that the island could become a state as that the much more unlikely outcome of independence could take place. Special tax advantages for U.S.-based firms that come with territorial status are reviewed annually by Congress and would no longer exist were Puerto Rico to become a state (though transitional arrangements could readily be put in place). It is of some significance that the rating agencies—Standard and Poor's and the others—place a good deal of emphasis on the uncertainty of Puerto Rico's situation.

[42] See below, Section X, for qualification of the presumption that Puerto Rico has a relatively highly educated labor force.

The Regulatory Regime

Regardless of the difficulties directly connected to status, the rules and regulations governing investment in Puerto Rico are especially problematic, as also are the ways that the rules and regulations are administered. And, at least in a comparative sense, the situation is getting worse. Each year the World Bank and the International Finance Corporation prepare a report ranking countries, including Puerto Rico, on "the ease of doing business." For 2011, of the 183 countries ranked, Puerto Rico was 47th. While far from the group at the bottom of the list (the position occupied by Guinea, Eritrea, Burundi, the Central African Republic and, at the very bottom, Chad), Puerto Rico is also well below the U.S. (5), outside the group of relatively wealthy countries, and also below, for example, Mexico (35), Peru (36), Columbia (39), and the Kyrgyz Republic (44).[43]

The problem here is not simply where Puerto Rico stands in the rankings for 2011, but also that Puerto Rico has been falling in the rankings—from position number 18 and 19 in 2006 and 2007, respectively. These earlier rankings appear somewhat surprising, as the problems with Puerto Rico's rules and regulations certainly existed in those earlier years. Indeed, according to the report for 2011, in recent years Puerto Rico has undertaken some reforms that improve "the ease of doing business." However, such reforms have been widespread among countries, and Puerto Rico's reforms have been relatively less than in many other countries, and thus its drop in the rankings.

These rankings are made up of several particular factors, and while Puerto Rico does fairly well on some, it ranks quite poorly on others. In particular, Puerto Rico ranks fairly well in terms of starting a business (16), protecting investors (16), getting credit (32), and closing a business (25). But it ranks quite poorly in terms of dealing with construction permits (150), paying taxes (108), trading across borders (107), and enforcing contracts (99). Moreover, the relatively favorable

[43] *Doing Business 2011: Making a Difference for Entrepreneurs*, A Publication of the World Bank and the International Finance Corporation, Washington, DC, 2010. The rankings data here and in subsequent paragraphs and the figures (rankings and time involved) on particular aspects of doing business are from this source or the same publication for earlier years.

ranking of Puerto Rico in terms of “starting a business” is misleading, for it is based on only the formal, legal arrangements for starting a business and ignores the problems associated with, for example, construction and registering property (see just below).

Of course, there are often good, socially desirable reasons for placing restrictions on doing business. Environmental regulations and health and safety regulations, for example, can be socially desirable even while they reduce the ease of doing business. Thus a high ranking in terms of “the ease of doing business” is not necessarily an unequivocally good thing. (One suspects that some countries that have risen dramatically in the rankings in recent years have accomplished this feat at considerable cost to society. For example, Georgia ranked 100 for 2006 but moved to 13 for 2011.) Yet in Puerto Rico it is clear that some of the serious problems are not—or not simply—the rules themselves but the time it takes to fulfill the obligations imposed by the rules. For example, dealing with construction permits requires 209 days, registering property takes 194 days, and enforcing contracts takes 620 days.

Furthermore, there are aspects of the Puerto Rican rules and regulations that are not readily quantified for rankings, but which are often cited by businesses as impediments to their operations. In particular, to establish or expand a business, multiple permits are often required from multiple agencies. Each permit at each agency can generate a delay. Furthermore, there are frequent complaints regarding the “bureaucratic ineptitude” that a business confronts in the permitting process. While such subjective appraisals may be no more severe in Puerto Rico than in many other countries, the problems in Puerto Rico are certainly substantial, especially when seen in relation to the states.

It seems fairly clear that were Puerto Rico a state, these conditions would be dramatically altered. There are, to be sure, differences among the states in rules and regulations affecting businesses operations. Yet, were the island a state, many of the factors that present problems for business in Puerto Rico would be submerged under federal authority. Equally important, as a state, Puerto Rico would be under severe pressure to bring its rules and regulations into line with other states.

Additional factors inhibiting investment in Puerto Rico, as noted above (p. 38), include the high cost of energy and the inadequate public support for infrastructure—both the physical foundations (transport and communications facilities) and the social foundations (schools in particular) of economic activity. These issues will be taken up in Section X, but an important part of the explanation for the infrastructure inadequacies will be discussed shortly.

Encouraging of Investment, But…

In spite of the factors inhibiting investment in Puerto Rico, over the decades there has been a great deal of external-source investment on the island. During the period of rapid economic growth in the post-World War II years, Operation Bootstrap (*Operación Manos a la Obra*)—based on low-wage labor, unrestricted access to the U.S. market, and favorable tax treatment (by both the U.S. and Puerto Rican governments)—brought many U.S. firms to the island. In later years, U.S. firms have been provided with special incentives through the U.S. tax code to invest on the island—continuation of Section 931 from the earlier era, then Section 936, and then the Controlled Foreign Corporations (CFC) status. Moreover, these incentives emanating from Washington have been complemented by efforts of the Puerto Rican Commonwealth government to attract U.S. firms to the island. (Although it is generally recognized that a large share of investment in Puerto Rico has come from foreign sources and the role of foreign investment is evident in the large GDP-GNP gap, for the past 30 years the government has not published a breakdown of the data that would show the extent of external-source investment—the data problem again.)

While these various actions have resulted in substantial investment, they have shaped investment in a way that has not provided an effective foundation for economic growth in Puerto Rico. Although in the early era (through the 1960s) much of the activity of foreign/U.S. firms involved labor intensive production, this activity and the employment it generated waned as wages rose and as production in other, lower-wage countries gained access to the U.S. market. In later years, the era of Section 936, foreign/U.S. firms engaged in activity that generated relatively little employment—e.g., pharmaceuticals especially. According to a U.S. Treasury Department report, in 1987 it cost the U.S. government on average at least $1.51 in lost tax revenue for each $1.00 in wages paid in Puerto Rico by firms operating under the provisions of Section 936. Or, put another way, on average it cost at least $26,725 each year to maintain a job that was paying an annual salary of $17,725. For the pharmaceutical industry, the figures were $3.08 per $1.00 in wages, or $81,483 to maintain a job paying $26,471.[44] Another study, using 1992 data, indicated that 936 firms were less integrated with the island's economy than were non-936 firms—the former having a total multiplier effect of 1.7 as compared to 2.6 for the latter.[45]

Not only was 936 a poor job-creating mechanism. It also was costly for the U.S. Treasury. In the late 1980s and early 1990s, when the program was at the center of economic policy in Puerto Rico, annual costs were running between $2 billion and $2.5 billion. In terms of 2011 dollars, this would amount to between $3.4 billion and $4.2 billion. This figure far exceeds the costs to the Treasury of alternative proposals put forth in Section VIII below.[46]

Although the employment and output impacts of the investment induced by the tax benefits of Section 936 have been limited, this activity—again, especially the activity of the pharmaceutical firms—is often viewed as valuable for the Puerto Rican economy because it is relatively "high tech." This designation, however, is based on a confusion between the initial creation of a product, involving (as in the case of pharmaceuticals) extensive research and development, and the regular manufacture of a product, involving largely routine, not highly skilled activity. It is the latter that characterizes much of the production that has taken place in 936 and later CFC firms in Puerto Rico. Moreover, the value added in Puerto Rico that is attributed to these "foreign" firms is surely overstated, as it is clear that through transfer pricing and the allocation of patent payments much

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[44] U.S. Department of the Treasury, "U.S. Possessions Corporations Returns, 1987," Tables 1 and 2, as cited by J. Tomas Hexner et al., *Puerto Rican Statehood: A Precondition to Sound Economic Growth*, Second Edition, Hex, Inc. Cambridge, 1993, p. 27. The ratios of cost to wage benefits are excessively conservative as they are based on the assumption that the persons employed in the 936 industries would otherwise be unemployed.

[45] Angel L. Ruíz and Edwin Meléndez, "The Economic Impact of Repealing Section 936 on Puerto Rico's Economy, " in *Economic Impacts of the Political Options for Puerto Rico*, edited by Edwin Meléndez and Angel L. Ruíz, Universidad Interamericana de Puerto Rico, San Germán, Puerto Rico, 1998, p. 135. The 1.7 multiplier for 936 firms means that a $1 increase in final demand for 936 firms generated $1.70 in increased output.

[46] Estimates of the costs of 936 to the U.S. Treasury are from Ruiz and Melendez, as cited in the previous note, p. 126; P. Morrison, "Testimony before the Committee on Finance, United States Senate," April 26, 1990, p. 2, as cited by J. Tomas Hexner and Glenn P. Jenkins, "Puerto Rico and Section 936: A Costly Dependence," *Tax Notes International*, January 16, 1995, p. 236; and United States Department of the Treasury, "U.S. Possessions Corporations Returns, 1987," Tables 1 and 2, as cited by J. Tomas Hexner et al., "Puerto Rican Statehood: A Precondition to Sound Economic Growth," Hex, Inc., Cambridge, MA, 1993, pp. 25-26. Also, for a full discussion of the costliness of 936, see the 1995 *Tax Notes International* article by Hexner and Jenkins.

of the profits of the firms has nothing to do with production on the island. This phenomenon—and other factors—is illustrated by the high share of proprietors' income (profits, interest, etc.) in value added of 936 firms in the early 1990s; for example: 94% in pharmaceuticals, 93% in bottled and canned soft drinks, 85% in non-electrical machinery, and 80% in professional instruments.[47]

Investment from external sources has gone hand to hand with a heavy reliance on manufacturing as the supposed central pillar of the Puerto Rican economy. Manufacturing was, indeed, important in the economic surge of the 1950s and 1960s, and by some measures manufacturing appears to continue to be extremely important to the Puerto Rican economy. Yet the role of manufacturing is not what it appears. Through the latter part of the twentieth century and into the twenty-first century, manufacturing has accounted for over 40%—in some years over 45%—of Gross Domestic Product (GDP). Yet the great majority of the income that appears through the manufacturing sector is the profits of externally based firms, and the employment and local income generated by manufacturing in Puerto Rico is relatively small. In 2010, for example, 90% of the value added in manufacturing was "proprietors' income," and employment in manufacturing accounted for only 13.7% of total employment.[48]

Thus it is clear that the apparent large role of manufacturing in the Puerto Rican economy, as seen in the share of GDP generated by manufacturing, greatly overstates the contribution of manufacturing to actual economic activity—employment in particular—in Puerto Rico. A huge share of that GDP is simply the profits of firms based elsewhere (and often is not even derived from economic activity in Puerto Rico—as explained in Box 2). Yet, policy makers continue to cling to the idea that manufacturing is "the key." Perhaps this idea had some validity in the 1950s and 1960s, but today it is more an illusion than an idea.

The illusion that manufacturing continues to be the key to Puerto Rico's development has deep roots. However practically important manufacturing was for Puerto Rico in the post-World War II era, it was also a central element in a global ideology of economic development in that era, an

[47] Ruíz and Melendez as previously, p. 135. The authors point out that the relatively small labor share in value added of 936 firms "is particularly relevant when considering that the wage component is the most important contribution of Section 936 investment to the economic welfare of the island."

[48] Junta de Planificación de Puerto Rico, http://www.jp.gobierno.pr/, Apéndice Estadístico.

ideology thoroughly adopted in Puerto Rico. Both in war-devastated Europe and in the world's low-income countries, manufacturing was seen as the foundation of economic progress. Certainly manufacturing is an important component of economic development in most settings, transforming the workforce and generating widespread productivity gains. In Puerto Rico, under the special circumstances that existed in the 1950s through the early 1970s, labor-intensive manufacturing, producing for the U.S. market, gave a major push to expansion. Manufacturing also dramatically shifted the locus of employment. Whereas in 1950, 36% of the labor force was working in agriculture and 11% in manufacturing, by 1980, only 5.3% or workers were in agriculture and 19% were in manufacturing.[49]

Yet this transformation was not based on Puerto Rico's "natural" advantages—especially as wages rose and other low income areas gained access to the U.S. market. Instead it was, as already emphasized, based on special tax treatments and other incentives from both the federal and Commonwealth governments. The result of giving special, privileged treatment to manufacturing has been to create a bias against other sectors of the economy that could have played a substantial, positive role. The virtual wiping out of agriculture (leaving Puerto Rico in a position where it still imports a great deal of its food) and the neglect of tourism (see Section VI.C below) are important examples. Instead of taking advantages of the island's comparative advantages, officials in Puerto Rico have been, and continue to be, driven by a manufacturing-is-key ideology.

The manufacturing illusion is closely tied not just to ideology but also to the heavy reliance on external sources of investment. Yet, while this reliance on external sources of investment has distorted the economy's sectoral structure, perhaps the most serious problem arising from Puerto Rico's heavy reliance on "foreign" investment is its effect of displacing Puerto Rican based business in leading the island's development. The difficulties begin, as the quote from James Dietz cited above (p. 30) indicates, with the failure of the Puerto Rican authorities to provide systematic support for local entrepreneurs and local sources of finance.[50] The difficulties,

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[49] Dietz, *Economic History of Puerto Rico*, Table 5.7, as previously cited. As pointed out above, p. 39, after 1980, manufacturing's share of total employment would drop to its 2010 level of less than 14%.

[50] Elsewhere, Dietz explicitly ties the situation to the strategy pursued by the Puerto Rican authorities. Dealing with the 1960s and 1970s, he writes: "Fomento's strategy of industrialization…enlarged the role of external ownership in the manufacturing sector. External investment has not been a complement to local ownership and control, but a

however, run deeper. Without a strong set of local capitalists, there is limited support for the sorts of policies that focus on the foundations for long-run economic development. For example, there is limited effective support for the formation of a solid infrastructure, both the social infrastructure that is generated by a strong school system and the physical infrastructure of energy, high-tech, transport, and communications (see Section X). Foreign-based investors—that is, investors that have been dominant in Puerto Rico's economy—simply do not have the same interest in supporting the creation of these foundations for long-run development as do local investors.

The rationale—in Puerto Rico, but also elsewhere in low-income countries—for relying on external sources of investment has been two-fold. First, low-income countries are seen as suffering in their development from a shortage of capital, and thus there is seen to be a need for external investment. This rationale is seriously undermined when external investment is replacing, instead of adding to, domestic-source investment. Available data do not allow a determination of the extent to which this replacement phenomenon has characterized the Puerto Rican experience, but it is clear that Puerto Rico has not achieved a high level of investment by bringing in external funds.

Second, and emphasized during the years when Puerto Rico's development strategy was being formed in the post-World War II years, external investment supposedly brings in technology and organizational changes (both in the labor force and in management) that will spread to and bring about improvements in local industry. Of course, simply the engagement with the U.S. economy and society—through far more than U.S. investment on the island—Puerto Ricans have assimilated many of the practices of U.S. firms. Investment from the United States (and from other external sources), however, has (as pointed out) often undermined the emergence of a strong local set of capitalists/entrepreneurs who would lead the transformation of the local economy. Where experience with external capital has been quite different—in countries of East Asia, in particular—governments have played a very different role than in Puerto Rico, accepting foreign

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substitute for it, despite the fact that one goal of Operation Bootstrap was to create an environment propitious for the emergence of local capital linked to firms promoted by Fomento. The Puerto Rican capitalist class has assumed an auxiliary or even subordinate relationship to U.S. capital as small businessmen in banking, trade, insurance, and real estate." James L. Dietz, *Economic History of Puerto Rico*, as previously cited, p. 265.

investment but also regulating and guiding it so as to enhance, rather than distort, the local economy.[51]

[51] See, for example, the comparison of Puerto Rico with East Asian countries in James L. Dietz, *Puerto Rico: Negotiating Development and Change*, Lynn Rienner Publishers, Inc., Boulder, Co., 2003. Also, see studies of South Korea and Taiwan: Alice Amsden, *Asia's Next Giant: South Korea and Late Industrialization*, Oxford University Press, Oxford, 1989, and Robert Wade, *Governing the Market: Economic Theory and the Role of the Government in East Asian Industrialization,* Princeton University Press, Princeton, 1990.

Banking and Finance: Further Distortion

A further distortion in the economy arising from the particular way reliance on external-source investment was established is in the structure of the financial sector in Puerto Rico. The operation of federal government tax incentives, particularly the Section 936 incentive, allowed U.S. firms to pay no federal taxes on their Puerto Rican profits as long as those profits were not returned to the states. These profits, as discussed, have been substantial (including earnings from intangible property that involved no actual economic activity in Puerto Rico), and have been held in Puerto Rican banks. Sitting in the island's banking system, these funds could be used by the firms in various ways—e.g., as collateral for loan-financed activity elsewhere in the world or simply to finance that activity, as long as it was outside of the states.

These funds were certainly a boon for the banks and, not incidentally, gave the banks a strong reason to support continuation of territorial status for the island, which would preserve this important aspect of their operations. But the importance of these funds led the banks to build themselves more on trading in securities as a means of handling the "foreign" deposits and less on the basis of financing the island's development. Thus the structure of the tax incentives not only encouraged a reliance on external-source investment, but also weakened the basis for the development of internally based business. In a chapter in the volume published by the Center for the New Economy and the Brookings Institution, this situation is summed up by Rita Maldonado-Bear and Ingo Walter:[52]

> "Commercial banks appear to have failed to allocate funds to economic development through commercial and industrial loans as much as would seem desirable in an economy such as Puerto Rico's. Moreover, they have not generated sufficient asset gathering in the form of savings and checking deposits from the household sector to underwrite the capital formation needed to create… self-sustained economic development…"
>
> "…all the banks on the island…need to invest less in securities and instead to lend for commercial and industrial purposes at longer maturities, because doing so is more conducive to economic development…"

[52] Rita Maldonaldo-Bear and Ingo Walter, "Financing Economic Development," in S. Collins, B. Bosworth and M.A Soto-Class as previously cited, p. 454.

Furthermore, as the financial sector developed in Puerto Rico in the middle of the 20th century, it was heavily dominated by U.S.-based banks. Examining this period, Dietz notes:[53]

> "Of fifteen mortgage companies in the late 1960s, fourteen were U.S. branch operations. Of the 225 insurance companies, 196 or 87.1 percent were externally owned (182 of them U.S. owned), and they controlled 99.97 percent of all insurance assets at the end of 1966. In commercial banking, the two U.S. banks in operation in 1967—First National City (now Citibank) and Chase Manhattan—controlled 33.4 percent of total banking assets. By 1977, the share of assets held by these two banks had increased to 40.6%... [B]ecause they are international banks, they can move funds and assets in and out of Puerto Rico quite easily. More than 81% of the deposits of international corporations in financial institutions in Puerto Rico were deposited in the branches of these two banks…"

Though full data are not available, it appears that in subsequent years Puerto Rican-based banks have come to play a larger role. Maldonaldo-Bear and Walter classify the fourteen banks operating in Puerto Rico in 2004 as domestic, national, or international: Banco Popular and Citibank fall under their national classification, Nova Scotia Bank is international, and the remaining eleven are domestic. The "domestic" banks are ones for which more than 50 percent of the shares are owned by local residents. However, among the eleven domestic banks several are clearly affiliates of non-Puerto Rican banks—for example, Banco Santander Puerto Rico, Banco Bilbao Viscaya Argenta, and Scotia Bank of Puerto Rico. It seems, then, that in spite of the changes in recent decades, Puerto Rican banking continues to be dominated by non-Puerto Rican firms—and by their priorities. This situation is integrally bound up with the island's territorial status and its consequent reliance on external sources of capital. It is unlikely to be an effective foundation for economic development.

Furthermore, the structure of Puerto Rican banking made it vulnerable to the financial crisis that emerged in the United States in 2007 and 2008. Heavily engaged in securities and less in building a customer deposit foundation for their activities, in 2010, according to *The New York Times*, "An enormous deposit shortfall…developed among the banks. Of the $60 billion of loans outstanding, nearly 60 percent, or $35 billion, have been financed with customer deposits…On the mainland, by contrast, deposits typically finance about 80 percent of lending."[54] In addition, some Puerto

[53] James L. Dietz, *Economic History of Puerto Rico*," as previously cited, pp. 265-266.
[54] Eric Dash, "Puerto Rican Lenders Face Their Own Crisis," *The New York Times*, April 29, 2010.

Rican banks had attempted to extend their operations into the states and were directly caught up in the financial crisis there. All this was on top of the weak and deteriorating condition of the Puerto Rican economy in 2010, which in itself would have been sufficient to cause difficulties for the banks. At the end of April of that year, the Federal Deposit Insurance Corporation "sold off three Puerto Rican banks to head off a potentially ruinous series of failures across the Commonwealth."[55] Of course these developments exacerbated the already severe recession in Puerto Rico, as loans became even more difficult to obtain, hampering production and employment, and feeding back to weaken the banks in a vicious circle.[56]

The problems of the Puerto Rican banking industry are exhibited by the data in Table 6. The elimination of three banks in 2010 is reflected in the drop from 10 to 7 in the first row of the table; the number of institutions had peaked at 16 in 1994. The decline in total assets by 27% between 2007 and 2011 was largely accounted for by the fall off of investment securities and net loans and leases. The 18% reduction of total domestic deposits was accounted for by the severe fall off, 44%, of time deposits (and was partially attenuated by an increase of savings and demand deposits). Already providing a weak foundation for economic development in Puerto Rico, the island's banking sector appears to be in an especially poor position to support economic growth after the difficulties of recent years.

[55] The three banks were Westernbank, R-G Premier Bank, and Eurobank. Dealbook, *The New York Times*, April 30, 2010.

[56] Ironically, the banks' lack of orientation toward the domestic economy may have contributed to the fact that Puerto Rico did not experience the same sort of housing bubble as did the states during the 1997 to 2007 period. In those years, while U.S. housing prices were rapidly rising, housing prices in Puerto Rico were almost stable—with several years of actual price declines. While various forces were involved, it appears that, unlike U.S. financial firms, these firms in Puerto Rico were not pushing the expansion of mortgages. The housing price data are available at http://www.freddiemac.com/corporate/about/pdf/Puerto_Rico.pdf.

Table 6
Selected Data on FDIC-Insured Commercial Banks in Puerto Rico, 2005-2011, year end
(dollar amounts in billions)

	2005	2006	2007	2008	2009	2010	2011
# of institutions	10	10	10	10	10	7	7
Total Assets	104.1	99.1	100.7	99.2	92.6	77.8	73.3
Investment Securities	39.1	33.0	30.0	28.1	23.1	14.8	10.6
Net Loans and Leases	56.4	57.9	61.0	61.1	59.7	51.2	50.5
Total Domestic Office Deposits	54.5	55.6	60.8	63.6	59.8	49.6	49.9
Domestic Time Deposits	34.1	35.5	40.0	42.9	36.4	26.2	22.4

Source: Federal Deposit Insurance Corporations, Historical Statistics on Banking, Tables CB09 and CB15, http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=10&Header=1

Public-Private Partnerships and External Investors: Their Value?

In an effort to pump up the volume of investment and stimulate further investment (and, not surprisingly, to enhance its political image), the government of Puerto Rico touted two large projects in 2011, a public-private partnership project that turns over major toll highways to external investors in return for seemingly large investment and the construction of a natural gas pipeline that would run across the island, again undertaken by external firms. These projects, however, are unlikely to have the positive impacts that the government claims and, indeed, may be significantly damaging to the Puerto Rican economy. (Not surprisingly in the context of the lengthy, severe recession, in recent years there have been no major investment projects underway independent of the government.)

Public-private partnerships can be a useful part of an economic development program. They can, however, also be an ineffective and costly component of economic development, involving a short-run injection of funds to the government in return for high payments to the private partners over the long-run. Especially when a government is facing severe fiscal imbalances, as has been the case with the Puerto Rican government for many years, a good arrangement for the immediate political needs of the government can be a poor investment for the society. The authorities present the supposed efficiency of private firms as a justification for turning over public sector operations to private operators. Yet, when the activity in question is a public good—for example, a highway, water delivery, or a public utility—the private firm is likely to be in a monopoly position but absent meaningful regulation. In any such partnership, the particulars of the arrangement—the prices, payments, and the regulations—will determine its social value.

With the toll highways project, the particulars are not fully clear, but the overall picture is not encouraging. A news release of the governor's office on June 20, 2011, presents the highway project as bringing $1.436 billion of investment to Puerto Rico.[57] With total 2010 investment at $9.135 billion—down from the peak of $12.249 billion in 2005—this would seem a major boon for the economy. However, although the project involves "an upfront payment of $1.090 billion,"

[57] http://www.p3.gov.pr/wp-content/uploads/2011/06/News-Release-ENG.pdf. The two highways are PR-22, which runs from San Juan 51 miles west along the coast, and PR-5, which now connects Cataño and Bayamón and is to be extended under the new arrangements.

the news release also reports: "The private investment will allow the PRHTA [Puerto Rico Highway and Transport Authority] to retire a significant portion of its outstanding debt." Debt retirement in general, but especially retirement of bonds that are held outside of Puerto Rico, greatly reduces the net impact of investment. The remainder of the $1.436 billion is to be spread over the 40 year life of the contract. Moreover, the governor's news release does not specify the payments that will be made to the foreign investors, information that would be necessary to determine even the reduced net impact. There is no reason to believe that this public-private partnership will have an overall impact of great magnitude, and, depending on the particular terms of the agreement (the payments that will be obtained by the investors), may be a poor project for Puerto Rico.

The gas pipeline project has been presented by the governor as an important foundation for reducing the extremely high energy costs in Puerto Rico, by allowing a major shift away from costly oil-based energy generation to natural gas. (The pipeline would run 92 miles from Peñuelas on the south, across the mountains to electrical generating stations in Cataño, Arecibo, and San Juan on the north coast.) Yet, as described in an article in *The New York Times*,[58] the project has generated extensive opposition, a large portion of which is based on the expected environmental damage that would result from running the pipeline across the island. Furthermore, without discounting the negative environmental impact of the pipeline, several other factors lead to questions about the validity of the project:

- The high cost of energy in Puerto Rico is not simply a result of oil-reliance, but to a large extent is a result of dependence on aging, inefficient generation plants.
- The contract to construct the pipeline, according to the *Times* article, has been given to a company headed by an "old friend of [Governor] Fortuño's. The company had no experience in pipeline construction and immediately subcontracted the work to a firm in Texas."

[58] The Pipeline story is recounted by *The New York Times* of October 21, 2011: "Puerto Rico's Plan for Gas Pipeline Has Many Critics," by Lizette Alvarez. The details and quotations presented here are from that article: http://www.nytimes.com/2011/10/22/us/puerto-ricos-plan-for-gas-pipeline-has-many-critics.html?pagewanted=all.

- The *Times* further reports: “In 2008, [Governor Fortuño] campaigned against the natural gas pipeline that his [predecessor and opponent] was putting in place, and called it the wrong approach. But soon after Mr. Fortuño won the election, he proposed his own, larger pipeline.”
- As Puerto Rico’s natural gas is imported, one cannot help but wonder why it is desirable to build a pipeline that transports the gas from one coastal site across the island to another coastal site.

If the pipeline is constructed, while it will create some jobs and provide some stimulus to the economy, it is likely to have an overall negative impact on Puerto Rico.

Even accepting the claims that each of these projects will have considerable positive short-term impacts on the Puerto Rican economy and discounting their limited or damaging impacts, there remains the fact that both perpetuate the reliance on firms from outside the island. This reliance, as explained above in Section VI.B and elsewhere, has been a poor foundation on which to develop the Puerto Rican economy. These projects, as with industry based on the special provisions of Section 936 or CFC status, will contribute to the weak foundation of economic development on the island.

C. Attractiveness to Tourists

At the beginning of July, 2011, the Young Republicans held their national convention in Puerto Rico. On the website for the convention, a brightly colored announcement informed potential participants: “Guess What? No U.S. Passport Required.”[59] In assuming that their members were ignorant of Puerto Rico’s status, that they were likely to view it as a foreign place, the organizers of the conference were simply recognizing the widely held perception—or misperception—about Puerto Rico among people in the states. The impact of this misperception is not trivial.

[59] http://www.yrnfpuertorico2011.com/

Puerto Rico's climate, geography (beaches in particular), and proximity to the eastern population centers of the United States would seem to make it a highly attractive tourist destination. Puerto Rico does of course have a significant tourist industry. That tourist industry, however, is not the dynamic part of the island's economy that one might expect.

Faced with severe debt obligations (as noted in the Introduction and below, page 58) the Puerto Rican government has viewed income from tourism as a means to meet those obligations. Yet, for many years, the tourist industry has not been the dynamic part of the island's economy that one might expect.

Table 7 presents some data on Puerto Rican tourism in comparison with similar data for the Dominican Republic for the period 1990 to 2010. These data demonstrate what can only be viewed as poor performance for tourism in Puerto Rico. While in terms of the various measures, Puerto Rico was well ahead of the Dominican Republic in 1990, the Dominican Republic was well ahead of Puerto Rico by 2010. Even in terms of the multiplier effect (the ratio of total contribution to GDP to direct contribution to GDP), in 2010 the Dominican Republic (3.22) was doing better than Puerto Rico (2.82); that is, a dollar of tourism expenditure was generating more secondary activity in the Dominican Republic than a dollar of tourism expenditure in Puerto Rico.

Why, given its seeming natural advantages, which would seem to offer the island a comparative advantage in tourism, has the Puerto Rican tourism industry done poorly? Why has this sector, which might be a leading sector of the economy, lagged behind? Part of the answer to these questions lies in the limited government support for tourism in Puerto Rico. While government spending to support tourism in Puerto Rico was twice that in the Dominican Republic in 1990, by 2010, this ratio had almost reversed, as shown in Table 7 (another problem with Puerto Rican economic policy). The much larger issue, however, is surely the cost disadvantage that Puerto Rico suffers in comparison with the Dominican Republic—as well as with many other sites in the Caribbean. Wages in the tourism industry are probably twice as high in Puerto Rico as in the Dominican Republic.[60]

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[60] Another factor negatively affecting the development of tourism in Puerto Rico is that policy on the industry has been set in San Juan, without engagement by local authorities. Consequently, opportunities for specialized (niche)

Table 7
Measures of Tourism in Puerto Rico and the Dominican Republic, 1990-2010
(millions of current dollars)

	Direct Contribution to GDP		Total Contribution to GDP		Visitor Spending		Gov Support Spending	
	PR	DR	PR	DR	PR	DR	PR	DR
1990	812	426	2,229	1,270	1,387	890	20	10
1995	829	804	2,261	2,485	1,894	1,612	30	30
2000	1,283	1,292	3,690	3,914	2,499	2,932	40	50
2005	1,915	1,922	5,463	5,999	3,405	3,617	50	60
2010	2,131	2,750	6,010	8,847	3,467	4,985	60	105

Source: World Travel & Tourism Council, Economic Data Search, http://www.wttc.org/

With the obvious cost disadvantage for Puerto Rico as compared to the Dominican Republic and many other sites in the Caribbean, Puerto Rico might nonetheless be able to keep pace were it a state, instead of being viewed as a foreign site (as implied by the Young Republicans' convention ad cited above, p. 51). Viewed by people in the states as part of the states, its attractiveness would almost surely increase considerably. Numerous states and cities in the states developed prosperous tourist industries in the latter half of the 20th century, ranging from Vermont to Florida from Atlantic City to, of course, Las Vegas. But perhaps the most appropriate comparison is with Hawaii. Hawaii, which is a third-again as far by plane from the closest U.S. population centers than is Puerto Rico, receives tourist expenditures three times as great as those of Puerto Rico.[61] Not only further from population centers, Hawaii is also more expensive to reach than Puerto Rico and more expensive once there. Perhaps the beaches and other aspects of Hawaii's geography are

tourism and small scale enterprises are being ignored, in favor of grand schemes. This example of policy centralization is one example of the bureaucratic approach that characterizes government operations in Puerto Rico—an approach, as pointed out elsewhere, that is connected to the island's status.

[61] http://hawaii.gov/dbedt/info/visitor-stats/visitor-research/

more attractive than those of Puerto Rico. Yet it is hard to believe that these factors, if real, explain the large difference in economic gains from tourism.

Surely the fact that Hawaii is a state and Puerto Rico is a territory, perceived by many as a foreign site, is a significant factor in explaining the difference. In addition, however, the difference is explained by the failure of the Puerto Rican government to escape from the development ideas that guided its era of success in the 1950s and 1960s, from the idea that manufacturing was the *sine qua non* of economic progress. In Puerto Rico, tourism was viewed as an inappropriate sector on which to focus and thus did not receive the kind of government support and promotion that it would have needed to play an important role in the island's advance. An opportunity was missed and a full realization of the island's tourism potential has never been realized.[62]

VII. DYSFUNCTIONAL POLICY AND ITS STRUCTURAL CONSEQUENCES

The approach to tourism, the way investment has been both undermined by poorly structured and poorly implemented regulations, and the particular examples of the recent highway and pipeline projects, all illustrate the dysfunctional policies that have characterized Puerto Rican governments'—governments of both major parties—approaches to economic expansion for the past several decades. Several more dysfunctional policies can and will be cited. Behind the particular policies have been several failures of several governments. For example:

- *A failure to recognize the significance of the changing global economy*. Several changes in the world economy undercut the advantages that Puerto Rico had had in terms of access to the U.S. market—in particular, the implementation of the North American Free Trade Agreement (NAFTA) in 1994 and in 2005 the establishment of the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA), the enactment of various other U.S.

[62] In 2012, faced with severe debt problems (as noted in the Introduction and the following section), the Puerto Rican government has touted tourism as a means to provide the income to meet those obligations. See Michael Connor "Puerto Rico bets on American tourists to repay debt," Reuters, May 29, 2012, http://uk.reuters.com/article/2012/05/29/uk-puertorico-debt-idUKLNE84S00T20120529. It would require, however, a major shift in the government's approach to the tourist industry, let alone a change in the island's status, to make a significant dent in the debt obligations.

bi-lateral trade agreements, and the effective opening of the U.S. market to China. Puerto Rico is no longer able to compete as a low-cost manufacturing site.

- *A failure to build up the public educational system*. While often touting Puerto Rico as an advantageous site for "high tech" activity, governments have done little to improve the island's schools. The public school system remains very poor by U.S. standards and is mired in an island-wide bureaucratic structure. (See Section X below.)

- *A failure to deal with lack of reliable economic data and a failure to recognize the importance of good data*. Data are of poor quality and are not readily available. Efforts to improve the data have been blocked by governments that apparently see the control of data as a political tool. As result, neither potential investors nor analysts are able to readily obtain a clear picture of the Puerto Rican economic situation. (See Box 1 for more on the data issue.)

- *A failure to revise the general approach to economic development policy*. Instead of adjusting to the new era of globalization (i.e., the loss of Puerto Rico's special position with regard to the U.S. market), policy makers continue efforts to promote economic development through special business incentives and favors from Washington, policies that had some success in period up to the 1970s. While the world has changed, Puerto Rican governments appear to be ideologically stuck in the middle of the 20th century.

What is important for the argument here, however, is not simply that the economic policies built on these broader failures and pursued by Puerto Rican governments are inappropriate, but also that these inappropriate policies are in large part a consequence of the island's political status. It would not be credible to claim that statehood would somehow assure that the government of the island would pursue effective policies. Many state governments adopt poor economic policies, and no one would claim that statehood per se is a cure for poor policies. Similarly, many state governments seem to go to great lengths to prove that statehood would not automatically eliminate the corruption that is bound up with economic policy in Puerto Rico.

Nonetheless, while statehood would not be a *sufficient* condition for establishing an effective economic policy framework in Puerto Rico, it is a *necessary* condition for moving in this direction. Yet the policy-status connection is widely ignored. The influential 2006 book produced by the Center for the New Economy in San Juan and the Brookings Institution in Washington, for example, portrays policy and status as unconnected: "…our economic analyses and proposed growth strategy are status neutral and will be relevant regardless of political regime."[63] Many of the articles in this volume are useful, and several of the book's policy proposals (though not all) are good in the abstract. Yet, the failure to consider the reasons why these policies are not adopted, the failure to consider the connection between economic policy choices and political status, leaves these proposals as abstractions, unconnected to the Puerto Rican reality. Thus, by ignoring the policy-status connection, this "status neutral" approach becomes an impediment to progress.

There is no great problem in listing good policies for Puerto Rico, policies that would build upon the island's comparative advantages and prepare the economy for long term development. For example, it is generally recognized that a well-educated labor force could play an important role in exploiting Puerto Rico's geographic advantages[64]—the potential for enhanced tourism and the possibility for Puerto Rico to supplement centers such as Miami and Houston as a "bridge" between the states and Latin America.[65] Accordingly, the government programs should be directed toward promoting these particular sorts of activities and toward improving the schools at all levels. Yet, rhetoric notwithstanding, Puerto Rican governments have failed to provide the supports that would be needed. As a result, tourism, as previously noted, has not kept pace with

[63] Susan Collins, Barry P. Bosworth, and Miguel A. Soto-Class, editors, *The Economy of Puerto Rico: Restoring Growth, Center for the New Economy*, San Juan, and Brookings Institution, Washington, 2006, p. 2.

[64] See, for example, the discussion in Robert Lawrence and Juan Lara, "Trade Performance and Industrial Policy," in Collins et al., as cited in the previous footnote.

[65] The possible advantages of rebuilding Puerto Rican much-neglected agriculture are, however, less widely acknowledged. An exception is the brief discussion by James Dietz, *Economic History of Puerto Rico: Institutional Change and Capitalist Development*, Princeton: Princeton University Press, 1986, pp. 295-297. While Dietz notes that the authorities took some steps towards supporting agriculture in the 1970s and early 1980s, he also states (p. 297): "The increased awareness by those in power that agriculture cannot be neglected without further imperiling the economic structure has not resulted in any noticeable increase in the total amount of cultivated land." He also notes: "The multiplier effect from local agricultural production on income and employment is greater than for any other sector of the economy, because of the predominance of local ownership—compelling evidence of the importance of the agricultural sector and, by inference, of the need for expanded local ownership in other sectors as well."

advancements in other parts of the region, and the schools, as will be discussed in Section X, continue in poor condition.

The list of “good policies” could be readily extended. Examples in other realms could be (and often are) provided—on tax policy, government regulation, energy, and physical infrastructure—where there is wide agreement on what should be done. The difficulty is not in figuring out what would be good policies for Puerto Rico, but in figuring out why good policies are not formulated and not implemented.[66]

A central element of the Puerto Rican reality, having major impacts on the formation and implementation of economic policy, is the island’s territorial status. The role of territorial status in affecting economic policy can perhaps be best understood when it is recognized that “territory” is a euphemism for “colony.” The term “colony,” perhaps, conjures up images of overt oppression and military control that do not characterize Puerto Rico (at least not generally), and the fact that Puerto Ricans are U.S. citizens seems to run counter to the popular image of colonial status. (Still, it should not be ignored that during its early decades as a U.S. colony Puerto Rico was under military control, and certainly by some standards was subject to various forms of oppression, including the suppression of the Spanish language.) Of course, because of the term’s negative connotations it is avoided both by the U.S. government and many in Puerto Rico. Yet as a geographic area having its own political integrity but under the rule of another nation, Puerto Rico can reasonably be viewed as a colony.

In terms of economic policy, colonial status has important implications. On the one hand, Puerto Rico does not benefit from full incorporation into the United States and is excluded from benefits of statehood, as has been explained earlier. Not able to vote in national elections and without voting representatives in the Congress, Puerto Ricans do not get a full share in federal programs. On the other hand, Puerto Rico has limits on the control of its own economy. Subject to U.S. laws and U.S. control of its international trade and foreign investment policies, the island’s colonial

[66] There are areas in which dispute exists over the appropriate policies. For example, disputes exist regarding the appropriate way federal government transfers and regulations (e.g., minimum wage laws) should be applied in Puerto Rico. Also, the role of privatization of public services is an issue of controversy. Yet there are, as pointed out, important areas of consensus regarding policies that would be useful foundation for long-run economic development.

status narrows its “policy space.” For example, and of considerable importance, Puerto Rico is not able to choose policies regarding its relations with the rest of the world that would promote its internal economic development. Such policies have been employed in virtually all countries that have attained a high level of economic development, including, for example, not only South Korea and Taiwan, but also Japan, Germany, the United States itself, and, at an early stage, Great Britain.

The failure of Puerto Rican governments to promote internal economic development—that is, development based to a significant extent on Puerto Rican capital and Puerto Rican organization (dependent on local entrepreneurs and highly trained workers)—is not, however, simply a result of the formal constraints of colonial status. From the initial efforts to formulate development plans for Puerto Rico in the post-World War II era, Puerto Rican governments have consistently looked outward in their efforts to drive economic expansion. Starting in that early period with Operation Bootstrap (*Operación* Manos *a la* Obra), followed by the Section 936 program, the Controlled Foreign Corporations provisions, and various particular incentive programs adopted by Puerto Rican governments, foreign firms have been viewed as the key to the island’s economic development. Puerto Rican capital, in particular, and broader Puerto Rican based programs of development, in general, have been placed in a subordinate position. The approach has been a “colonial approach” and stands in sharp contrast to, for example, the approaches of South Korea, Taiwan, and several other countries that have used foreign investment but have done so in the context of building a domestic-based economic program. (Of course, the Puerto Rican government has had ample pressure from the U.S. firms that benefit from the incentive programs; also the role of the U.S. government has been important, as several of the programs just noted have been based on provisions of the U.S. tax code or other U.S. regulations.)

Foreign capital can certainly contribute to a region’s or a country’s economic development. Yet, without being part of a program that also includes central roles for firms based within the region or country, its contribution is at best limited. The remarks of James Dietz, quoted above (p. 30), are worth repeating: “…Puerto Rico’s strategy of development lacked a focus on the systematic support or fostering of local entrepreneurs and local sources of finance.” As a consequence “the central role of domestic entrepreneurs, skilled workers and technological progress that underlies sustained economic progress" has been weaker in Puerto Rico than in sovereign nations where sustained economic progress has proceeded more rapidly.

Without the advance of *Puerto Rican* foundations for development, many policies push in the wrong direction—towards increasing the reliance on outside capital (as starkly illustrated in the highway and gas line projects noted above, pp. 49-51). Further, lacking Puerto Rican foundations, government policy goes awry in numerous particular ways. Perhaps no set of policies illustrates the problem more thoroughly than Puerto Rican governments' handling of finances. The virtually disastrous fiscal policies followed by each of Puerto Rico's two major parties when in power illustrate the dysfunctionality:

- During the early part of the 2000s, the Puerto Rican government—controlled by the *Partido Popular Democrático*, the pro-current status party—ran large fiscal deficits. The large deficits generated a severe debt burden. By 2006, the Puerto Rican public debt was 70% as large as GNP. In 2005, tax supported debt, at $5,758 per capita, was about 59 percent more than that of Connecticut, the state with the highest tax-supported per capita debt, and almost five times that of Hawaii, the state with the greatest debt in relation to personal income. Under this debt pressure, in 2006 the Puerto Rican government laid off without pay 100,000 workers, giving an impetus to the economic downturn that emerged that year.

- When the pro-statehood *Partido Nuevo Progresista* came into power in 2009, it imposed austerity budgets. Arguing that a sharp reduction in government spending was necessary to avoid Puerto Rican government bonds being rated as "junk," the government enacted Law 7 and laid off some 30,000 employees. The result of this pro-cyclical "shock treatment" was to raise the unemployment rate substantially, exacerbate the recession (as noted above, p. 34), and make the debt problem even worse. Puerto Rican public debt increased from $56.5 billion at the end of 2008 to $63.9 billion at the end of 2010—from 92% of GNP to 101% of GNP.[67] (These austerity actions did obtain the government's

[67] http://www.gdb-pur.com/investors_resources/documents/2010-12-DeudaPublica-Engtrs-Final.pdf. For information on COFINA: http://www.gdb-pur.com/investors_resources/cofina.html.

immediate objective of gaining the approval of the rating agencies and thus—in the short-run—avoided excessive costs of further borrowing. However, had the government followed a policy of employment reduction by attrition instead of by "shock treatment," it is likely that the rating agencies could have been satisfied without such a negative impact on the economy.)

Because of its severe debt problem, Puerto Rico is sometimes likened to Greece, which has been at the center of European economic difficulties. While the Greek and Puerto Rican situations have their differences, and that of Greece may be worse, the two situations have common aspects:

- Neither the Greek government nor the Puerto Rico government has effectively collected taxes, and thus neither has had a sufficient base on which to raise revenue (and avoid budget deficits). Tax evasion is rampant in both.

- Both Greece and Puerto Rico have formulated their own fiscal policies, but both use currencies that they do not control. Devaluation is then not an option for overcoming weak economic growth or decline.

Greece, however, is an independent country, in spite of the extensive controls that other European powers exercise over its economic policies. Its people have options, at least formally, that do not exist for Puerto Ricans.

States too have had fiscal difficulties, especially since the emergence of the financial crisis in 2007 and 2008, and few state governments can be held up as paragons of fiscal responsibility. However, none approaches Puerto Rico's debt condition. The difference between the states and Puerto Rico cannot be explained by constitutional or statutory provisions requiring balanced

The government, however, claimed that there was a reduction in "central government" debt between 2008 and 2010. Yet this "reduction" was due to a shift in the manner by which government debt is issued, from being directly issued by the central government to being issued by COFINA, the Government Development Bank agency that issues debt backed by the sales tax.

budgets. The difference between Puerto Rico and the states (and also the variation among the states) is primarily explained by a matter of the policies selected.[68]

The extremely poor fiscal conditions of the Puerto Rican government, however, are the result of more than poor policy. They have structural roots. Without economic progress, the government becomes the employer of last resort and the result is a bloated government bureaucracy—not uncommon in colonial or post-colonial societies. In Puerto Rico, this approach to economic policy was firmly established—in both practice and ideology—during the third quarter of the 20th century. Moreover, the bureaucracy was enhanced in this period by the establishment of several state enterprises, which, whatever positive functions they may have had in that earlier era, have become centers of independent power and patronage—and which do not deliver their services in an efficient and effective manner. PREPA, the electric energy company, and PRHTA, the highway and transportation authority, are good examples.

Part of the employment role of government in Puerto Rico is that patronage positions—ostensibly policy positions—go deeper into the bureaucracy that is generally the case in the states. As a result, the bureaucracy is exceptionally dysfunctional. The government bureaucracy has become an impediment to economic progress, and a cycle of stagnation has been created. Under these circumstances, the sort of "shock treatment" employed by the government in 2009 and 2010 with its huge layoffs of government employees is not a solution to the problem. Not only are essential government functions undermined and the recession made worse, but, in addition, the fundamental reasons for the large government bureaucracy and its contribution to the fiscal problems remain in place.

It is not, however, only the practical and direct impacts of this condition of colonial structure that have negative impacts on Puerto Rico's economic policies.[69] The "second class citizenship" of

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[68] See National Council of State Legislatures, *NCSL Fiscal Brief: State Balanced Budget Provisions*, October 2010, which includes consideration of Puerto Rico, http://www.ncsl.org/documents/fiscal/StateBalancedBudgetProvisions2010.pdf.

[69] However, in the realm of practical matters, it is worth once again mentioning the data problems that exist in Puerto Rico. For the states, with much of the data handled at the federal level, the poor condition of Puerto Rican economic data (and related data on, for example, the schools) could not exist.

Puerto Ricans combined with the continuing instability and fundamentally temporary nature of "territorial" status tends to inhibit commitments, both of private sector actors and the government. Economic actions are viewed as short-run, and there is limited commitment to laying the foundations for the long-run development. For example, while there is a great deal of talk about the need for a better school system and the importance of improving the "high tech" capabilities of Puerto Rico, there is little more than talk. Under colonial conditions, the social foundations for action are not there.

The situation with the schools, lagging support for "high tech," the continuing policy bias in favor of foreign (largely U.S. firms), the virtually disastrous fiscal policies and austerity programs—all are aspects of dysfunctional policy, and all can be connected to Puerto Rico's status. These are problems manifested in the short-run orientation of policy, the lack of "policy space," and the lack of a firm internal social foundation for development.

VIII. FIRST STEPS: SIMULATING STATEHOOD BY CREATING A LEVEL PLAYING FIELD

Although statehood would carry substantial economic advantages for Puerto Rico, there is no reason to think that statehood will come in the near future. The results of opinion polls vary, but most polls do not show that a majority of Puerto Rican's favor statehood.[70] Equally important, there seems to be no impetus in the U.S. Congress towards bringing Puerto Rico in as the 51st state. It is hard to imagine the inertia of inaction in the Congress shifting without much stronger support for statehood among the Puerto Rican population. There are, furthermore, powerful interests—for instance, the large pharmaceutical companies and other firms—that gain considerable advantages as long as the current non-statehood status is maintained.

[70] An early 2012 poll indicated the 51% of Puerto Ricans want to maintain the island's current relationship with the United States; "Poll: Majority Backs Current Status," *Caribbean Business*, May 9, 2012, http://www.caribbeanbusinesspr.com/news03.php?nt_id=71465&ct_id=1&ct_name=1. Another poll conducted by *El Nuevo Día* in March 2011 found 43% of respondents favoring statehood, 39% for the Associated Free State (current status enhanced), 7% for independence, and 11% undecided or did not respond; as reported by the Daily Kos, http://www.dailykos.com/story/2011/07/14/994703/-Puerto-Rico:-new-political-status-poll-(to-be-or-not-to-be!). Virtually all polls on the issue are involved disputes over how the questions are framed. Moreover, the report of the early 2012 poll in *Caribbean Business* notes: "The pollsters found that 45 percent of Puerto Ricans do not understand what the different options really mean."

Fortunately, however, the options are not simply “statehood or nothing.” There are actions that can and should be taken that would have both positive economic impacts for Puerto Rico and could be first steps towards statehood. These actions fall under the rubric of “simulating statehood” because they would increasingly lead to Puerto Ricans being treated by the federal government in the same manner as other U.S. citizens. The basic principle of these steps is that, insofar as possible, in federal legislation, executive orders, and programs, Puerto Rico and Puerto Ricans should be treated in the same manner as the states and citizens living in the states. The result would be, in effect, a level playing field.

In creating a level playing field and thus improving economic conditions and prospects in Puerto Rico, the island would be receiving no special treatment. No special programs focused on Puerto Rico would be needed. However, the treatment of private firms would not be altered.

A. Make Puerto Ricans Fully Eligible for EITC and CTC

The first step in the set of first steps would be to make Puerto Ricans fully eligible for the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC). Full extension of these programs to Puerto Rico would immediately and directly improve the economic well-being of tens of thousands of families, significantly reducing poverty on the island. Also, these programs would provide a very substantial and continuing fiscal stimulus to Puerto Rico’s whole economy. In addition to fiscal stimulus, the EITC and CTC would further spur economic expansion by drawing many more people into the paid, formal workforce. At present, Puerto Ricans are not eligible at all for the EITC (unless they have earned income from activity in the states); the CTC is available to Puerto Ricans only if they have three or more children.

The compelling reason for extending these two programs fully to Puerto Rico is fairness. As pointed out in Section II, the existing situation with these tax credits is dramatically unfair. Identical families with identical earnings in Puerto Rico and the states end up after federal taxes and credits in very different positions, with the family in the states several thousand dollars better off.

While providing very substantial benefits to Puerto Ricans and providing a boost to the Puerto Rican economy—increasing output by as much as 3%—the cost to the U.S. Treasury of extending the EITC and CTC to Puerto Rico would be very small. With the programs fully implemented, the annual cost would be about $1.25 billion, or 33 one-thousandths of the fiscal year 2012 federal budget. Thus these programs would cost about one-fourth of the tax expenditures that have been implemented in the past through Section 936 and continue in the provisions for Controlled Foreign Corporations. (See above pp. 41-43 for these figures.) Yet the resulting job creation and increase in tax payments (Social Security and Medicare) to the federal government would be greater than what has been achieved by these tax expenditure programs.

There is simply no good reason to continue the exclusion of Puerto Ricans from the EITC and CTC programs. Furthermore, extending these programs would be an important step in "simulating statehood," providing the same benefits to Puerto Ricans as are provided to their fellow citizens in the states.

B. Make All Federal Programs Include Puerto Rico Along With the States

As with the EITC and CTC, all federal programs for the states and for U.S. citizens living in the states should be provided for Puerto Rico and for U.S. citizens in Puerto Rico. The generally unequal treatment of Puerto Rico in terms of federal funds has been described in Section II above. There is no reason, other than political (voting) power that Puerto Rico should not be included in all federal programs along with, and in the same manner as, the states.

There are several examples of programs where this level playing field could be implemented:

- *Medicare* payments to Puerto Rico have been "capped," resulting before 2010 in far lower payments for services covered by Medicare than in the states. However, the "cap" was raised substantially in the health care reform enacted in 2010, providing what appear to be sufficient funds for Puerto Rican payments to be on a level similar to those in the states. Yet the procedure of imposing a "cap" on Puerto Rican payments is still in place, and, as health care costs rise, it is likely that the funds for Puerto Rico will be insufficient. To put Puerto Rico on a level playing field, the "cap" should be eliminated and Puerto Ricans should be treated as are other U.S. citizens. This step in creating a level playing field with regard to Medicare would tend to raise payment to Puerto Rico, though perhaps not immediately.

- *Grants* from the federal government to Puerto Rico are, in several cases, substantial in relation to the states because various categories of federal grants are distributed by formula and at least partially based on need. For example, from the Department of Education and the Housing and Urban Development, Puerto Rico appears to get a fair share of federal funds. However, there are several categories of grants where Puerto Rico is clearly treated differently, which is to say poorly. In funds coming from the Department of Health and Human Services, the Department of Energy, and the Department of Transportation, Puerto Rico receives an especially small share. The limited amount of funds coming from the Department of Energy is especially troubling, given the high costs of energy in Puerto Rico and thus the obvious need for support for change in this category. With regard to the Department of Transportation funds, it is well known that federal expenditures in this area are often dictated by political considerations (e.g., the infamous "bridge to nowhere"), and thus Puerto Rico's small share once again illustrates the island's lack of effective representation in Washington.

- *Federal procurement and federal salaries and wages*, as is evident from Tables 1 and 2, are categories of federal funds in which Puerto Rico receives especially short shrift. As indicated in Table 1, in these two categories on a per capita basis, Puerto Rico receives, respectively, only 15.7% and 19.3% of the national average. As noted in the discussion of the data in Table 1, these categories of expenditure, while payments for real needs of the federal government for supplies and services, are also distributed to generate employment in depressed areas and in response to political influence in Washington. Although it is possible that Puerto Rico could not readily meet some of the real needs for services and supplies, there is no reason, aside from lack of political influence, that more of these funds could not go to the island. The impact of relatively small increases would not be trivial.

For example, if each of these two categories Puerto Rico's per capita share of funds in 2010 had been just 27% of the national average, this would have entailed a $1 billion increase of federal expenditures on the island.

These examples illustrate the possibilities for readily moving towards a level playing field for Puerto Rico with regard to the distribution of federal funds. Changes along these lines could considerably improve economic conditions on the island.

C. Adopt Federal Guidelines/Methods on All Statistical Reporting

As has been noted earlier in the discussion of the condition of the Puerto Rican economy, official economic statistics for Puerto Rico are extremely problematic. Data on some of the aggregates (e.g., real GDP, real GNP, and their components) are of dubious value, to say the least. (See Box 1.) The only way to assure that accurate economic statistics are developed and maintained for Puerto Rico is to adopt federal guidelines and methods for all statistical reporting. In the short run at least, doing so will require that Puerto Rico's data gathering and reporting processes be supervised by federal authorities.

Indeed, in some realms, the gathering and reporting of Puerto Rican data should become the responsibility of federal agencies. For example, the U.S. Bureau of Labor Statistics (BLS) currently provides price indexes for various regions of the United States. In the same manner, the BLS could and should provide price indexes for Puerto Rico. Although Puerto Rican agencies made available a new consumer price index (CPI) in late 2010, which corrected substantial errors in the previous existing CPI, those agencies are not prepared (i.e., do not have sufficient resources or procedures) to continue to update and re-calculate the CPI in the manner that would be necessary. Moreover, in 2010, the government attempted to suppress the publication of the new CPI, adding to the public perception that Puerto Rican governments, insofar as they consider economic statistics as important, attempt to shape those statistics (or at least their availability) according to political needs.[71]

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[71] Indeed, since 2010, the government's effort to suppress economic information has been enacted into law. The following statement appeared on the web site of the Government Development Bank in April 2012 (though it was

The sorts of data that can be provided only through the direction and oversight of federal authorities are essential as the foundation for accurate economic policy decisions in Puerto Rico and as accurate guides to private investors considering action on the island. Beyond these important accomplishments, this shift in handling of Puerto Rican economic data would be one more step in "simulating statehood."

IX. THE FEDERAL INCOME TAX ARGUMENT AGAINST STATEHOOD?

Opponents of statehood for Puerto Rico often attempt to support their position by pointing out that, if Puerto Rico were to become a state, Puerto Ricans would fall under the provisions of the federal income tax. They declare—or at least imply—that Puerto Ricans would have to pay the federal income tax and would therefore have an additional tax burden. Yet for the great majority of Puerto Ricans, the truth is the opposite of this claim. Because their incomes are too low, they would not be required to pay federal income taxes. Indeed, most Puerto Ricans would have their tax burden *reduced* because they would receive federal tax credits, the EITC and CTC in particular (assuming those credits had not already been provided to Puerto Ricans, as advocated above in Section VIII.A).

In 2011, the median household income in Puerto Rico was $18,862. Yet in that year, for a household consisting of a married couple with two children, there would have been no tax liability (after credits) as long as the family's income was below $45,800—2.4 times the median. Clearly, the great majority of households in Puerto Rico are below this income level. Furthermore, if the

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removed after it became widely notice: "In compliance with Act 78-2011 (Puerto Rico Electoral Code for the Twenty-First Century), during an election year and until the following day of the election event, the Government Development Bank for Puerto Rico may not publish certain information through the media, including its website, for the benefit of the general public. In order to keep our public informed and maintain our commitment of transparency with the investor community, we may provide updated information, per request. If you wish to receive updated economic information, please send us an email to investorresources@gdp.pr.gov." See further discussion in Box 1.

family's income was $45,000, it would have received a small net federal refund of $90; at $40,000, the net refund would have been $1,904; and at $30,000 the net refund would have been $5,010.[72]

One comprehensive 2005 study of taxation in Puerto Rico concluded:

> "The overall effect of fully incorporating Puerto Rico into the US Federal tax system would be to provide additional benefits in the form of refundable credits to the vast majority of Puerto Rican residents."
>
> "Based on [this study's] estimates, approximately 92.5 percent of all returns of Puerto Rican residents would either receive a tax refund or have no Federal income tax liability if Puerto Rico were fully incorporated into the US Federal tax system. The proportion of single and head of household returns that would either receive a refund or have no income tax liability is approximately 96.1 percent. Likewise, the proportion of married returns filing jointly that would either receive a refund or have no income tax liability is approximately 87.9 percent."[73]

Thus statehood and the incorporation of Puerto Ricans into the federal income tax system would reduce the tax burden for most Puerto Ricans, even while they continued to pay Puerto Rican taxes at the same level. A relatively small number of high income tax payers, however, would experience an increase in tax liability—again, assuming that Puerto Rican taxes were unaltered by the statehood status.

It is possible—indeed, likely—that Puerto Rican taxes would not remain as high as in the pre-statehood era. Although there may not be large functions of the Puerto Rican government that would move into the realm of federal responsibility were the island to become a state, it is likely that in some areas statehood would establish a policy discipline that would reduce the extent of bureaucracy and waste that exists in Puerto Rican government operations. A small but telling example is the collection of economic data; another is the collection of Puerto Rican state taxes, a

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[72] The median income figure is from Amanda Noss, as cited in footnote 21 above. The figure at which there would be no tax liability (after credits) and the amount of refunds at lower levels were computed using TurboTax 2011. It is likely that households with incomes significantly higher than $45,800 would have no federal tax liability because of the deductions they could take, including a deduction for Puerto Rican taxes. The calculations here are based on the standard deduction.

[73] Mary Schmitt and Judy Xanthopoulos, "Puerto Rico and the US Federal Tax System – Lessons from the Past and a Proposal for Economic Growth through Reduced Tax Burdens, A report by Optimal Benefit Strategies, LLC, Washington, November 11, 2005, p. 47.

process that would surely be enhanced (i.e., more revenue per unit of expenditures) were Puerto Ricans subject to the federal income tax; and still another is in the Government Development Bank and in the Puerto Rican Industrial Development Corporation, where the combination of statehood and links to federal policy would enhance their operations or, possibly, eliminate the need for their existence. The consequent reduction in the need for revenue for local (state) functions could lead to reductions in local (state) taxation.

In any case, regardless of the impact of statehood on the tax burden of Puerto Ricans, the immediate steps set out in the previous section—leveling the playing field—would not raise the issue of federal income tax liabilities. These steps that would "simulate statehood" can be undertaken without an alteration of tax policies.

X. CASES: VARIOUS AREAS WHERE STATEHOOD COULD MAKE A POSITIVE DIFFERENCE

A. Schools

Puerto Rico is widely viewed as having a relatively highly educated labor force. That is, given the level of income on the island, one might not expect the Puerto Rican population to be as highly educated as it appears to be. A figure often presented to demonstrate the situation is that 21.7% of the population 25 years old or older has a bachelor's degree or more. The same figure for the states is 28.2%, and half a dozen states have a lower level of educational attainment than Puerto Rico by this measure.[74]

However, this is not the whole picture. In Puerto Rico, the share of the population 25 and older without a high school degree is 31.6% as compared to 14.4% for the states; for only one state is this figure above 20%—Mississippi at 21.1%. It appears, then, that in terms of years of schooling, Puerto Rico has a labor force with a bi-modal structure—i.e., a substantial share of the population is relatively highly educated, but also a substantial share, a larger share, has relatively little schooling.[75]

The view of Puerto Rico as having a highly educated labor force requires further qualification because years of schooling (or degrees held) is a questionable indicator of the educational level of

[74] The figures are averages for 2006-2008 and are from the U.S. Census Bureau. The Puerto Rican figure is available at http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_10_3YR_DP02PR&prodType=table and the figure for the states is available at http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_10_1YR_DP02&prodType=table. For the individual states, the data are from the National Center for Educational Statistics http://nces.ed.gov/programs/digest/d10/tables/dt10_012.asp. West Virginia is as the bottom of the list at 16.9%. It should also be noted that, according to UNESCO data, no country in Latin America has as high a figure as Puerto Rico's for share of the population with a bachelor's degree or higher http://stats.uis.unesco.org/unesco/ReportFolders/ReportFolders.aspx.

[75] Of course, part of the explanation of the low level of high school completion in Puerto Rico is that schooling has expanded more recently than in the states, and thus it is largely among the elderly that the rate of high school completion is low. Nonetheless, these data need to be considered as part of the whole story of the labor force's level of education. See the previous footnote for sources of the data.

the labor force. There is also the quality of the schooling. It is widely believed in Puerto Rico that the quality of the public schools is very low. Perhaps the clearest indication of this view is the very high share of students who attend private schools, a share that has risen greatly over the past few decades. It seems that people have been voting with their feet (or their children's feet).

Table 8 shows the total K-12 student population in Puerto Rican public and private schools and the number and percentage of the total in public schools. The decline in pubic school enrollment is quite dramatic. In the 1980s, the share of students in public schools was similar to the figure for the states, but by the beginning of the new millennium the percentage in public schools in Puerto Rico was far lower than in any state.[76]

Table 8
Enrollment in K-12 Schools in Puerto Rico, 1980-2010

	Total Enrollment	In Public Schools	
	(in thousands)	(in thousands)	(percentage of total)
1980	811.3	716.1	88.3
1985	795.6	692.9	87.1
1990	797.0	651.2	81.7
1995	767.3	621.4	81.0
2000	796.0	612.3	76.9
2005	750.7	575.6	76.7
2010	703.0	493.3	70.2

Source: *Statistical Abstract of the United States 2012*, Table 1321

The decline in public school enrollment (as opposed to the decline in the public school share of enrollment) is not fully accounted for by students shifting to private schools. There are demographic changes, and there are also the students who drop out of school entirely. Although poor data leave a degree of ambiguity, in Puerto Rico the dropout rate is clearly high, and the dropout problem appears to be especially severe for young students, those at the 7th and 8th grade levels. Whereas high school dropout rates appear to be no higher for Puerto Rico than for the

[76] There are problems with these data. In some years (not shown in the table) the data show large swings in private school enrollment that are not plausible. However, the large decline in public school enrollment is probably relatively reliable, even if the percentage figures in the final column of Table 4 are not fully accurate—i.e., even if the number of students in private schools is overstated.

average of the 50 states (and thus significantly better than for many individual states), the dropout rate in Puerto Rico for pre-high school students appears to be higher than in almost all states. Overall, then, from the 6th grade to high school graduation, Puerto Rico is below all or virtually all of the states in its ability to engage and retain students.[77]

The limited test data available that compare Puerto Rican public school students with students in the states also indicate problems with quality of school outcomes on the island. Whether the test data indicate poor quality of the schools or poor quality of other factors—economic and social conditions are important determinants of test scores—they do suggest that the educational quality of the work force is not as high as years of schooling and degrees might suggest. Although the National Assessment of Educational Progress (NAEP) is not used in Puerto Rico (partly because the reading segment of the test is in English), there have been some trials of the NAEP tests in Puerto Rico using the mathematics portion of the NAEP (translated into Spanish). The results for Puerto Rico, presented in Table 9 along with results for the states, are not encouraging. Though the data for 2007 are reported differently than for 2003 and 2005 (see note to the table), the persistence of the gap between the average scores of Puerto Rican and U.S. students is large.

[77] See Neil Allison and Arthur MacEwan, "Students Dropping Out of Puerto Rico Public Schools: Measuring the Problem and Examining the Implications," *Ensayos y Monografías*, Número 125, marzo 2005, Unidad de Investigaciones Económicas, Departamento de Economía, Universidad de Puerto Rico, Recinto de Río Piedras, http://economia.uprrp.edu/ensayo%20125.pdf. It would of course be inappropriate to simply blame the schools for this situation, as socio-economic factors play an important role affecting the dropout rate.

Table 9
National Assessment of Educational Progress,
Mathematics,
Results for Puerto Rico and the United States: 2003, 2005, and 2007

	Average Score for Puerto Rico		Average Score for States	
	4th Grade	8th Grade	4th Grade	8th Grade
2003	178	234	234	276
2005	183	218	237	278
2007	0.26	0.25	0.55	0.51

Note: Scores from year to year and between grade levels are not directly comparable. For 2003 and 2005, scores are reported as absolute numbers. For 2007, scores are reported as average score on questions, presented as a decimal.

Sources: For 2003 and 2005 http://nces.ed.gov/nationsreportcard/pubs/studies/2007459.asp. For 2007 http://nces.ed.gov/nationsreportcard/pubs/studies/2009451.asp.

There are, no doubt, some good public schools in Puerto Rico, and there are many highly intelligent, well-educated, and skilled people. Moreover, as noted, social and economic factors—the high degree of poverty and income inequality in particular—have strong negative impacts on education. Nonetheless, when test scores are combined with the exodus from the public schools and also with the widely held perception within Puerto Rico of the public schools, there is every reason to believe that in general the public school system on the island has serious problems. Also, while it is probably reasonable to view the Puerto Rican labor force as "highly skilled" in the Latin American context, in relation to the states (and other high income countries) the data on years of schooling and degrees held surely give an excessively positive picture of the situation.

Why is it that, with all those years of schooling, Puerto Rico is not able to produce an unequivocally highly educated labor force? Why are there, apparently, such serious problems with the public schools? The answer to these questions is not simply that, in comparison with the states, Puerto Rico has a low level of income. Other countries that had low incomes in the middle of the 20th century have developed effective school systems and a relatively highly educated labor force—and economic advances followed. South Korea stands out as a prime example.

Various points set out above help explain the situation of the schools in Puerto Rico and the consequent less-than-it-appears level of education of the labor force. One of these factors is surely the combined impact of poverty and income inequality on the island, which, in Puerto Rico and elsewhere, has two sorts of impacts on the public schools. One impact is direct: conditions of poverty (whether measured in absolute or relative terms) mean that students are impeded in their capacity to learn. Poverty is, for example, associated with low levels of health and nutrition that affect learning capabilities. Also, coming from poverty, many students see themselves as consigned to low-level jobs in their adulthood, and they therefore have limited incentive to learn or even continue in school. The second impact is indirect, but substantial: the more unequal a society is, the less that the more well-off social groups will be willing to pay for or even give full attention to the problems of the public schools. They will instead turn to private schools for their children. This certainly appears to be increasingly the case in Puerto Rico.

The phenomenon of the more-well off social groups giving little attention to and support for improving the public schools can also be tied to the lack of development of a strong business class within Puerto Rico—an issue that has been repeatedly noted above. In many countries (for example, South Korea in the mid-20th century, on the one hand, and the United States in the 19th century, on the other hand) the expansion of the school system has come with strong support of business leaders who view the schools as establishing the social stability and skilled labor force that they need for their own success. Without a relatively strong social group of business leaders in Puerto Rico—people who look to the quality of the island's labor force as the foundation for their own progress—there is limited support by the social elite for the steps necessary to improve the schools.

A prime example of the failure of Puerto Rican authorities to deal with the problems of the public school system is the continuation of handling all the public schools on the island in a single school district. The Puerto Rican school district is the third largest in the United States, exceeded in size only by New York and Los Angeles (measured by the number of pupils). It is well established that large school districts, run by a centralized administration, tend to yield poor student performance. In Puerto Rico, where the one school district includes highly diverse situations—large cities, medium sized towns, small villages, and rural areas, the problems are likely to be especially severe. (In New York and Los Angeles, while there are certainly serious problems, at least the schools all operate in the similar big-city environment.) Yet inertia dominates, and no moves have been taken to establish a more reasonable administrative structure for the school system—not even an effort to "study the problem."[78]

Furthermore, the data on school operations in Puerto Rico suggest that this single school district is a top-heavy bureaucracy. In 2008-09, for public elementary and secondary schools in the states, 60.95% of current expenditures were expenditures on instruction. (The remainder was divided among a variety of support services, including, for example, operation and maintenance, food services, transportation, student support, and administration.) In Puerto Rico, only 49.63% of current expenditures went to instruction. For no state was the figure below Alaska's 56.01%. For Hawaii, the only state with a single school district, the figure was 62.21%.[79]

Of course, the high level of inequality and the lack of support from the more well-off for organizational changes or particular programs that would improve the public schools are two parts of the same phenomenon. Moreover, these are conditions that, as has been discussed at several places above, are products in large part of Puerto Rico's political status. Statehood would certainly not eliminate the problems of the public schools, but it would create a shift that could lead in a direction of progress.

B. High-Tech Development

Because the Puerto Rican population is relatively highly educated (as both explained and qualified in the previous section) and because Puerto Rican firms can no longer compete effectively on the

[78] While the single administrative unit remains in place, there have been some very small efforts to devolve authority to the local level. For example, legislation of 2009 enabled the municipality of San Juan to become a "local education agency" and directly access federal education funds. As part of this devolution of authority, the municipality of San Juan had, in 2009, established a bilingual elementary school and a specialized sports middle school, together serving 410 students. The small size of this initiative would seem to underscore the limits of significant change. See "Governor links law boosting municipal schools," *Caribbean Business Online*, July 20, 2009, http://www.topix.com/forum/world/puerto-rico/TVE841MJ8TTUQSII7.

[79] National Center for Education Statistics, *Digest of Education 2011*, Table 186. Available at http://nces.ed.gov/programs/digest/d11/tables/dt11_186.asp.

basis of low wages and special access to the U.S. market, many commentators have seen Puerto Rican development as depending on expansion of "high-tech" activities, i.e., so-called "new economy" types of production. There is, moreover, an illusion that Puerto Rico is well situated for gains in these advancing economic areas. For example:

- The web page of the Puerto Rico Industrial Development Company (PRIDCO) tells viewers: "Puerto Rico is one of the fastest growing venture destinations for companies in the biosciences, information technology, engineering services, and advanced manufacturing markets in the world," and continues by touting (among other attributes) a "highly skilled and loyal workforce" and a "proven track record of creativity and innovation."[80]

- A June 2011 report from the U.S. Chamber of Commerce and the National Chamber Foundation notes various initiatives proposed by the Puerto Rican government, among which it lists: "Science City, in the heart of San Juan, to move Puerto Rico to the forefront of science, technology and research and development. Science City is leveraging Puerto Rico's significant competitive advantages in the knowledge-based sectors to integrate medical centers, research centers and university campuses. Efforts intended to transition Puerto Rico to a knowledge-based economy are leveraging the Island's highly educated work force and existing industrial base to create new jobs and businesses by creating new industry clusters and consortia with a focus on innovation."[81]

Yet, these statements are illusory. Investors are unlikely to be so naïve as to accept these publicity statements without a more complete consideration of the actual situation. Leaving aside the qualifications that have been noted in the previous section regarding the quality of formal education in Puerto Rico (indicating that the data on years of school completed do not necessarily mean that the workforce is so highly educated), it is hard to sustain the position that Puerto Rico

[80] http://www.pridco.com/

[81] Enterprising States 2011: Recovery and Renewal for the 21st Century, A Project of the U.S. Chamber of Commerce and the National Chamber Foundation, 2011, p. 128, http://www.uschamber.com/sites/default/files/reports/ES2011-full-doc-web.pdf

has a "proven track record of creativity and innovation" and a "significant competitive advantages in the knowledge-based sectors" that could readily be the foundation for economic expansion based on "high-tech" activities.

The National Science Board's report *Science and Engineering Indicators 2010* (SEI) provides data which allow one to appraise the situation.[82] The SEI data for Puerto Rico are, however, hampered by the usual problems. The report states (p. 8-6): "Although data for Puerto Rico are reported whenever available, they frequently were collected by a different source, making it unclear whether the methodology used for data collection and analysis is comparable with that used for the states." Nonetheless, the data in the report are sufficient to begin to obtain a useful picture of the situation in Puerto Rico. Consider, for example:[83]

- In 2005 in Puerto Rico, science and technology graduate students per 1,000 individuals 25 to 34 years old was 6.6, whereas in the states the figure was 11.7. (Four states did have a lower figure, but see the next point.) Moreover, between 2005 and 2007, the total number of these graduate students in Puerto Rico declined by 10%.

- The data do not indicate, moreover, that Puerto Ricans are going to the states to obtain graduate training in science and engineering and then returning to the island to work. In 2008, individuals in science and engineering occupations in Puerto Rico as a share of the work force were 1.68% as compared to 3.75% for the states (and no state had a lower figure than Puerto Rico). Puerto Rico did compare favorably with the states in terms of the number of physical and life scientists as a share of the work force in 2008—0.39% in Puerto Rico and 0.40% in the states. However, the figure for computer scientists was only 0.64% in Puerto Rico as compared to 2.08% in the states, and for engineers the figures were 0.58% for Puerto Rico and 1.06% for the states.

[82] National Science Board. 2010. *Science and Engineering Indicators 2010*. Arlington, VA: National Science Foundation (NSB 10-01). The data reported here are from this report and from the similar reports of earlier years.

[83] While more recent figures than those reported in the following points are not available, there is no reason to believe that the relative figures comparing Puerto Rico with the states have changed in more recent years.

The relatively weak position of Puerto Rico as compared to the states on these types of measures is at least in part explained by the lack of support from the governments in both Washington and San Juan:

- In 2007, federal research and development obligations per civilian worker for Puerto Rico were less than 10% of those for the states, $69 for Puerto Rico, but $764 states.

- Federal funding for small business innovation research for Puerto Rico in the 2003-2005 period per $1 million of GDP was $6 as compared to $161 for the states. These figures mean that Puerto Rico was getting less than 2% per person of what the states were receiving.

- In terms of state (or Puerto Rican) agency research and development expenditures per civilian worker, the 2007 figure for Puerto Rico was $1.87 while that for the states was $8.42.

Following from these figures, as would be expected, scientific output measured in terms of academic articles and patents presents a similar picture.

- In 2008, there were 577 academic articles per 1,000 science and engineering doctorate holders in academia, whereas in the states there were 2,009.[84]

- In 2006 in Puerto Rico, 1 patent was awarded per 1,000 individuals in science and engineering occupations, while the figure was 16.6 for the states.

- Puerto Rico compares similarly in terms of academic patents per 1,000 science and technology doctorate holders in academia—in 2006, 1.6 for Puerto Rico and 11.6 for the states.

[84] While the number of articles is for 2008, the number of doctorate holders is for 2006.

These various bits of data, especially when combined with the discussion of the schools in the previous section, raise serious doubts about the capacity of Puerto Rico to base its economic development—at least for now—on "high-tech" activity of the so-called "new economy" variety. Furthermore, in these data, Puerto Rico is compared to all the states taken together, most of which are, of course, not "high tech" centers. Were the comparison confined to Silicon Valley, Seattle, Boston, and the Golden Triangle in North Carolina, for example, Puerto Rico would not appear to be even a player in the game.[85] Moreover, it is clear from these data that the governments in both Washington and San Juan have not been providing the support that would make development along these lines a real possibility. The groundwork has not been laid. (And see the appraisal of Bosworth and Collins cited shortly below.)

C. The Physical Infrastructure

The development of physical infrastructure is always a long-term project—or, more precisely, many long-term projects. For this reason, the weaknesses in Puerto Rico's physical infrastructure reveal a good deal about the policy deficiencies of Puerto Rican governments. There are positive aspects of Puerto Rico's physical infrastructure. The island has extensive paved roads, various airports, and substantial sea ports. However, overall there are serious problems with the island's infrastructure.

The Brookings editors of the 2006 volume published by the Center for the New Economy and the Brookings Institute, Bosworth and Collins, conclude their discussion of infrastructure with the comment: "…available indicators suggest a physical infrastructure that is falling behind, particularly in dimensions such as information and communications, and that could constrain

[85] The failure to develop the bases for "new economy" operations on the island has far reaching impacts. Not only are "high tech" companies missing, but all those other firms that are attracted by a "high tech" agglomeration are absent as well. Also, those individual Puerto Ricans who have the capacities to advance a "new economy" tend to leave the island. This "brain drain" is suggested by existing data, as discussed in Box 3. And there are numerous anecdotes of highly educated and technically capable Puerto Ricans leaving the island for positions in mainland private firms and government agencies (e.g,, NASA) where they are able to apply their skills.

Puerto Rico's prospects for increased growth."[86] Focusing on transportation, energy, and telecommunications, Bosworth and Collins cite several particulars:

- In spite of the extensive road network on the island, the extent of traffic congestion and the roughness of roads compare poorly with the states.

- Although overall use of energy is relatively high, the energy system is inefficient and energy prices are very high (about which more shortly).

- Phone coverage, both land lines and wireless, is low and has fallen behind as much of the rest of the world has moved rapidly ahead in recent decades.

The data on which Bosworth and Collins make their appraisal is a few years old. However, there is good reason to believe the situation has deteriorated further in the ensuing years, especially the years of severe recession.[87] Indeed, current dollar fixed investment in "roads, schools, and other public works" fell by 45% between 2003 (the peak year) and 2010, and investment in public enterprises fell by 34% over the 2001 to 2010 decade. The government has proposed public-private partnerships to improve infrastructure, but these partnerships have certainly not had a significant impact. Private investment overall in current dollars fell by 22% over the decade, and thus there is no reason to believe that private activity somehow made up for the lack of public investment.[88] Furthermore, the data suggest not only a failure to establish new infrastructure but

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[86] Barry P. Bosworth and Susan M. Collins, "Economic Growth," in Collins, Bosworth, and Soto-Class, as cited earlier in footnote 55.

[87] The recent information provided in *The Global Competitiveness Report 2011-2012* of the World Economic Forum (http://www.weforum.org/reports/global-competitiveness-report-2011-2012) tends to confirm this appraisal. The report ranks 142 countries, including Puerto Rico, by a measure of overall competitiveness made up of several components, one of which is infrastructure. On overall competitiveness, Puerto Rico is ranked 35, but in terms of infrastructure Puerto Rico is ranked 55. The United States is ranked 5, while its infrastructure is ranked 16. However, the report cannot be taken too seriously, as it ranks Puerto Rico's "macroeconomic environment" as 17, while the U.S. is ranked 90.

[88] These investment data are from the Junta de Planificación, as previously cited. Clearly, in real terms the declines are even greater that the current dollar figures indicate. The toll road project discussed above, pp. 49-51, does not appear in these data, as it had not begun in 2010. However, as explained, it is unlikely to make a substantial contribution to overcoming Puerto Rico's problems with roads or overall investment.

also that the existing infrastructure is not being maintained. To use the in vogue euphemism, it would seem that with regard to Puerto Rico's infrastructure there is a great deal of "deferred maintenance."

The difficulties with roads might not be so severe were Puerto Rico to have an extensive system of public transportation. San Juan does have the *Tren Urbano*, which runs 10.7 miles and links the central business district to residential and employment areas with 16 stations. However, overall public transportation is poor. One travel advisory web site comments:[89]

> "The bus system is really cheap in San Juan… A ride is 75c but contrary to…the bus schedules posted at stops, buses do **not** run every 15-20 minutes; the average time between buses is more like an hour, and even on that schedule, the buses in San Juan can be extremely unpredictable. Additionally traffic gets very heavy heading into Old San Juan on the A-5 and C-52 so even catching a bus does not guarantee a quick trip…"
>
> "…there are no convenient buses connecting San Juan to the rest of the island. Apparently, there are some *publicos* which go to various places on the island. You may want to ask around before you use them - it is rumored that they stop everywhere and it takes ages to get anywhere…"
>
> "All the buses stop running at around 8pm, so forget about them in the evenings."

Returning to the energy matters noted by Bosworth and Collins, the problems here are especially important, significantly raising the costs of many businesses and thus a deterrent to new operations. Electrical energy in Puerto Rico is under monopoly control of the state enterprise Puerto Rico Electric Power Authority (PREPA), which fully controls distribution on the island (though two privately held power plants exist and sell their electricity to PREPA for distribution). The high cost of energy in Puerto Rico has been a long-standing issue. In the latter half of 2011, the price of electricity per kilowatt hour averaged 27.1 cents for residential customers, 28.6 cents

[89] http://www.tripadvisor.com/Travel-g147319-s303/Puerto-Rico:Caribbean:Public. Transportation.html .

for commercial customers, and 24.1 cents for industrial customers.[90] Compared to the states overall, these prices are about 2.4 times as high for residential customers, 2.75 times as high for commercial customers, and 3.6 times as high for industrial customers. Hawaii has somewhat higher prices than does Puerto Rico in all categories, but no other state comes even close to the Puerto Rican prices.[91]

Part of the high cost of electricity in Puerto Rico is due to the heavy reliance on oil-fired plants, and thus the appeal of shifting to lower-cost natural gas. (This has been the basis for the government's attempt to have a cross-island gas pipeline constructed, as discussed above, pp. 49-51) In the past decade, PREPA's reliance on oil has been reduced from 80% to 65%, but the change has been accounted for more by coal than natural gas, as reliance on the former rose from 8% to 15% while reliance on the latter rose from 10% to 15%.[92] Also, the decline in oil-reliance is not explained so much by new non-oil capacity as by the decline in total demand (a consequence of the recession) allowing some of the high-cost oil capacity to be used less extensively. (Whether oil, gas, or coal, all these fuels must be imported.)

In any case, PREPA's problems run deeper than reliance on high-cost fuel. The generation plants are old and relatively inefficient. Eighty-four percent of PREPA's generating capacity was constructed prior to 1977, and the average age of its generating facilities (weighted by capacity) is 34 years.[93] In addition, there is substantial loss in transmission, both from inefficiency and theft.

If public utility monopolies are to deliver electricity at reasonable cost, they must be effectively regulated. The failure of PREPA is, accordingly, one more example of dysfunctional government policy—which, it should once again be emphasized, has been characteristic of government of both parties. It is, then, not unreasonable to see Puerto Rico's electricity problem as reflecting the

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[90] http://www.prepa.com/spanish.asp?url=http://www.aeepr.com/AVISOS.ASP.

[91] The prices for the states are averages of the prices for February 2011 and February 2012 from U.S. Energy Information Administration, Electric Power Monthly, April 2012, 0http://www.eia.gov/electricity/monthly/pdf/epm.pdf.

[92] Current figures are from PREPA, http://www.prepa.com/AEEES2_ENG.ASP. Earlier figures are from a report by Richard D. Tabors and Ram Sekar, *Electric Power in Puerto Rico: An overview and policy analysis*, Tabors Caramanis & Associates, November 2004

[93] Data from. PREPA, http://www.prepa.com/AEEES2_ENG.ASP.

failure of governments to develop a long-run perspective, to develop policies that would provide a firm foundation for the economy's development. As has been explained earlier, this approach is closely connected to the island's territorial status.

And what is true of Puerto Rico's electricity problem is true more broadly of its entire infrastructure problem. To the examples of roads, public transportation, and high tech support that have been cited here, one could add both water and the general disregard of the natural environment, which is, of course, the ultimate infrastructure for economic activity. Continuation of Puerto Rico's territorial status virtually guarantees that there will continue to be no effective approach to creating a firm infrastructure, as the current status generates poor policy and a failure to build the foundation for long-term economic development. Statehood would not guarantee a more effective approach to this complex set of problems, but would at least create the likelihood of moving in a new, more effective direction.

2. Puerto Rico's Economic Debacle: Correctly Blame Washington

By
J. Tomas Hexner and Arthur MacEwan

ABSTRACT

The dire economic situation has been widely recognized. As it has become apparent that the Puerto Rican government will not—indeed, cannot—meet its debt obligations, the situation has received considerable attention in the U.S. Congress and media. Most of the discussion explains the crisis as the result of irresponsible actions by the Puerto Rican government. While such irresponsible actions have certainly played an important role, ultimate responsibility for Puerto Rico's economic decline lies in Washington. This federal government responsibility is formally stated in the U.S. Constitution, where territories are declared to be "property" of the United States and Congress has the authority to "make all needful Rules and Regulations" concerning territories. Moreover, the policies toward Puerto Rico established by the federal government have generated a dependence that has been at the root of the island's economic debacle. While many people, politicians and economists in the states, believe that Puerto Rico has been treated "generously" by federal programs, this view is belied by the data.

Keywords: Puerto Rico bankruptcy, debt obligations, level playing field

When the United States invaded Iraq and brought about "regime change," Colin Powell famously stated, "When you break it, you own it." He meant of course, that the United States had become responsible for the situation in Iraq, problems and all. Ownership means responsibility. With Puerto Rico, U.S. ownership is not simply figurative. As a territory of the United States, Puerto Rico is literally owned by the U.S. government. According to the U.S. Constitution, "The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States."[94] With that ownership comes responsibility.

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[94] *The Constitution of the United States*, Article IV, Section 3, Paragraph 2.

With the Puerto Rican economy in a ten-year recession, the government burdened with $72 billion debt that it cannot pay, and tens of thousands of Puerto Ricans migrating to the states each year, the question looms over the island: Where does responsibility lie for this economic debacle?

Unquestionably, some of the blame rests with the atrocious mismanagement by the local government. Governments of both major parties have pursued damaging policies, borrowing excessively to finance current account spending, failing to collect sufficient tax revenue, and imposing counterproductive austerity policies as the economy has descended. Large firms based off the island, big pharmaceutical firms in particular, using the island as a tax haven, have distorted the economy for decades and thereby undermined the development of policies that might have generated stable economic growth. Just as Colin Powell, in focusing on the responsibility of the U.S. government for the situation in Iraq after the invasion, did not mean to absolve Iraqis for a good share of responsibility for what was happening in their country, these "bad actors" in Puerto Rico cannot be absolved of a good share of responsibility for the economic calamity on the island.

Yet, the context in which the Puerto Rican government and the large firms have operated, and thus a more fundamental share of responsibility for the economic situation, lies in Washington. The responsibility and the ownership are underscored by the limits of the political rights of Puerto Ricans on the island—U.S. citizens—who have no votes in congressional or presidential elections. On all legal matters, they are ultimately controlled by the federal government.

The Dependence of Puerto Rico

Many commentators have focused attention on the extent to which the Puerto Rican government and people have received economic support from the federal government. The "food stamps" program is often used as an example, with one-third of the island's people receiving this form of assistance, while the figure for the states is 15%.[95] As the current long economic decline was

[95] While the percentage of people receiving "food stamps" – formally Supplemental Nutritional Assistance or SNAP – varies a great deal among the states, in no state does the percentage reach 20%. These data for the states are for 2013, and are from http://www.governing.com/gov-data/food-stamp-snap-benefits-enrollment-participation-totals-map.html.

beginning an article in *The Economist* dubbed Puerto Rico "Welfare Island," and pointed out that "Federal transfer payments…make up more than 20% of the island's personal income."[96] While *The Economist* uses the terms "generous" and "largess" to describe federal funds coming to Puerto Rico, the reality is a good deal more complicated—about which more shortly. Yet, the funds from Washington are certainly one part of the manner in which Washington has shaped the Puerto Rican economy.

Other, and quite significant, parts of the federal shaping of the Puerto Rican economy have been the special programs ostensibly designed to support the island's economic development. Especially important was Operation Bootstrap (*Operación Manos a la Obra*), a program initiated in 1947, which involved tax incentives from the federal government (and also from the Puerto Rican government) for U.S. firms to establish operations in Puerto Rico. The program was a major success in transforming a largely traditional agricultural economy into a relatively modern industrial economy and in generating rapid economic growth through the 1950s and 1960s.[97]

Yet, notwithstanding these successes, Operation Bootstrap generated what would be a long-lasting structural distortion of the Puerto Rican economy, an extremely large reliance on manufacturing and a heavy reliance on externally based firms, especially U.S. based firms. The impact of Operation Bootstrap was continued in more recent years by other federal programs, most notably Section 936 of the U.S. tax code, which again gave special tax treatment to U.S. firms in Puerto Rico. After Section 936 was phased out between 1996 and 2006, the firms could generally continue their tax advantages under the Controlled Foreign Corporation (CFC) provision of the tax code.

In spite of the relatively large SNAP payment received by Puerto Ricans, those payments would be larger were Puerto Rico treated the same as the states in the program.

[96] "Puerto Rico: Trouble on 'Welfare Island'," *The Economist,* May 27, 2006.

[97] The success of Operation Bootstrap was also highly dependent on Puerto Rico's access to the U.S. market and on the free movement of "excess population" to the mainland United States. As economies around the world have since gained access to the U.S. market, this Puerto Rican advantage has long been eliminated. Also, it should be noted that prior to Operation Bootstrap, U.S. control of its Puerto Rican territory had contributed to establishing an agriculture based in large part on U.S. owned plantations, a sugar monoculture.

Section 936, while much touted as a great boon for Puerto Rico, did little to generate either jobs or economic growth. It did, however, provide a substantial boon for the profits of the U.S. firms—large pharmaceutical companies, in particular—taking advantage of the tax provisions. For example, in the early 1990s, when 936 was in full force, for the pharmaceuticals operating in Puerto Rico, proprietors' income (profits, interest, etc.) accounted for 94% of value added.[98] (With the end of 936 and the shift of several firms to CFC status, the employment impact was even smaller.)

These tax advantages for manufacturing firms left the island's economy with manufacturing accounting for over 40% of GDP and net domestic income, but only about 11% of employment.[99] They also left the economy highly dependent on businesses based off the island, which to a significant degree pre-empted the development of a strong business class based within Puerto Rico. For Puerto Rico, Section 936 and the approach to development that it represented was a failure that became a myth

And one further way that the federal government shaped economic activity in Puerto Rico, a policy directly connected to the emergence of the current debt crisis: federal law has made Puerto Rican bonds exempt from federal and state taxes. Along with exemption from Puerto Rican taxes, these bonds have a triply advantageous tax position. This tax advantage was one factor, not the only one of course, that facilitated the buildup of the current debt burden, as it made the costs of debt lower relative to the difficulties of raising revenue through taxation.

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[98] Angel L. Ruíz and Edwin Meléndez, "The Economic Impact of Repealing Section 936 on Puerto Rico's Economy, " in *Economic Impacts of the Political Options for Puerto Rico*, edited by Edwin Meléndez and Angel L. Ruíz, Universidad Interamericana de Puerto Rico, San Germán, Puerto Rico, 1998, p. 135. The authors point out that the relatively small labor share in value added of 936 firms "is particularly relevant when considering that the wage component is the most important contribution of Section 936 investment to the economic welfare of the island."

[99] These data are of 2007, just as the long recession was getting underway, and are *from Informe Econnómic al Gobernador, 2011*.

Is Federal Support for Puerto Rico Really So "Generous"?

There is no question but that funds from the federal government play a major role in the Puerto Rican economy. Federal transfers to individuals in Puerto Rico account for about 25% of personal income. These federal transfers to individuals plus federal grants to the Puerto Rican government, amount to about 27% of GNP.[100] However, there are also important federal programs (about which, more below) providing funds to the state that are either not available to Puerto Rico or in which the funds for Puerto Rico are more restricted than for the states. If Puerto Rico were treated the same as the states, about $2 billion annually would be injected into the island's economy, adding another 3% to GNP.

The term "welfare island" is, however, inaccurate, unless several states are also dubbed "welfare states." It turns out that, when federal support for Puerto Rico is compared with federal support for the states, several states receive more "generous" support.

To begin with, Puerto Ricans are excluded from the federal Earned Income Tax Credit (EITC). The EITC was created to offset the burden of payroll taxes (Social Security and Medicare) on low income families, to reduce poverty, and to encourage participation in the labor force. Yet, Puerto Ricans pay Social Security and Medicare taxes, the poverty rate is much higher in Puerto Rico than in any state, and the labor force participation rate is exceedingly low.

Similarly, Puerto Ricans do not receive the Child Tax Credit (CTC) unless they have three or more children, while families in the states receive the CTC if they have one, two, or more children. There is no apparent rationale for this discrepancy.

Puerto Rican's exclusion from the EITC and the full CTC makes a big difference for families and for the Puerto Rican economy. For example, in 2011, a married couple with two children in Puerto Rico earning $25,000 before taxes would end up with $23,587.50 after paying federal taxes—i.e.,

[100] The data for 2013 show $15.6 billion of federal transfers to individuals. Social Security and Medicare account of $10.6 billion of this. Federal grants to various levels of government (about 60% to the central government) were $3.8 billion, with Department of Education and Department of Health grants by far the largest. Personal income in 2013 was $63.4 billion and GNP was $70.7 billion. Data are from *Informe Económico al Gobernador, 2013.*

Social Security and Medicare taxes. An identical family in the states, after paying all federal taxes, would also receive an EITC of $4,426.00 and a CTC of $2,000.00, and would thus end up with an income after federal taxes and credits of $30,013.50—$6,426.00 more than the Puerto Rican family.[101]

Also, with regard to both Medicare and Medicaid, Puerto Rico is not treated as well as the states. For example, Medicare reimbursement rates are lower in Puerto Rico for doctors and hospitals, and Medicaid payments do not cover some services that are covered in the states. Moreover, total annual federal funds for Medicare in Puerto Rico are "capped" at a lower amount than would be available were residents of the island treated in the same manner as residents in the states. The poor treatment with regard to these programs takes place in spite of the fact that Puerto Ricans pay Medicare taxes at the same rate as do people in the states; also, as previously noted, the poverty rate is especially high on the island and poverty is the target of Medicaid. Correcting the unequal treatment of Puerto Ricans in these two programs would generate an injection of over $100 million a year to the economy.[102]

Exclusion or poor treatment relative to the states in these and other programs affecting the availability of federal funds tends bring skepticism to the widespread belief that Puerto Rico is treated "generously" by the U.S. government. The data overall on funds going to Puerto Rico and the states bears out this skepticism. In terms of federal payments per capita, Puerto Rico receives about half of the average for the states and ranks below all fifty states and Washington, D.C. Also, and especially significant, in terms of *net* federal expenditures per capita—that is, expenditures going to a state or territory minus taxes coming from a state or territory—Puerto Rico ranks below

[101] Similar disparities exist for other family structures, other levels of income, and other years. These figures were obtained using TurboTax 2011.

[102] See, for example, the speech of Representative Pedro Pierluisi to the Puerto Rico Health and Insurance Conference, March 10, 2016, http://pierluisi.house.gov/sites/pierluisi.house.gov/files/3.10.16%20Keynote%20Speech%20at%20the%202016%20Puerto%20Rico%20Health%20and%20Insurance%20Conference.pdf.

several states. For example, in 2010, Puerto ranked lower in terms of net federal expenditures per capita than 18 states and Washington, D.C. Data for other years show a similar ranking.[103]

Insofar as the dispersal of federal funds has a relation to real needs, it might be expected that Puerto Rico with its high poverty rate would do better by these measures. And, indeed, some of the country's lowest per capita income states are higher in the net expenditure per capita ranking—e.g., West Virginia, Mississippi, and Alabama. But the dispersal of federal funds is also affected by political clout in Washington. With no voting members in Congress and no votes in presidential elections, Puerto Rico's clout is virtually non-existent.

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Regardless of Puerto Rico's relatively poor treatment in federal economic programs, the reliance of the island's economy on the U.S. government is large. The economy has been shaped by federal actions over many decades, and the funds coming from Washington, while not what they would be were Puerto Rico treated unequally with the states, have a large impact on the functioning of the economy. Puerto Ricans play no role, except as supplicants, in the determination of these actions and funding decisions. The decisions and therefore the responsibility lies in Washington.

Thus the concept of Puerto Rican "sovereignty" has no real meaning under the current circumstances. To be sure, the local government has thoroughly mismanaged economic affairs. Yet it has been allowed to do so—indeed, in important ways, pushed to do so—by the territory's owner, the U.S. government. The U.S. tax code and other U.S. regulations have been used to favor the interests of powerful U.S. firms, from "Big Pharma" to Wall Street. Today, the "tenants" of this U.S. property, the Puerto Rican people, are paying the price for the mismanagement. Again, it is the owners that bear ultimate responsibility.

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[103] Computed for 2010 from the *Consolidated Federal Funds Report for Fiscal Year 2010, State and County Areas*, U.S. Department of Commerce, Economics and Statistics Administration, U.S. Census Bureau, Issued September 2011; and for personal income for the states *Statistical Abstract of the United States 2012*, and for Puerto Rico Junta de Planificación de Puerto Rico, Apéndice Estadístico, www.jp.gobierno.pr. Tax revenue from *Internal Revenue Service Data Book, 2010*, Department of the Treasury, IRS, http://www.irs.gov/pub/irs-soi/10databk.pdf.

3. Should the U.S. Government Do More? Why Puerto Rico's Economic Conditions Matters to the United States

by
J. Tomas Hexner and Arthur MacEwan

ABSTRACT

In 2016, the federal government established the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) to deal with the Puerto Rican economic crisis. However, PROMESA did not provide substantial and direct support for the island's economy—i.e., no funds. Should the U.S. government do more? Puerto Rico has an economy larger than several states, and it has a substantial level of trade with the states. Thus, the states have an economic interest in the well-being of Puerto Rico. Aside from narrow economic interests, the federal government has a responsibility to protect its people, whether danger comes from crime, disease, severe weather, or economic collapse. Puerto Ricans, as U.S. citizens, deserve the same protection as their fellow citizens in the states. In terms of human rights, the *de facto* colonial status of Puerto Rico is in conflict with avowed principles of the U.S. government and has resulted in relatively poor treatment by the federal government. There are several actions that the U.S. government could take to do more for Puerto Rico; for example, including Puerto Rico in federal programs in the same manner as the states are included and providing U.S. Treasury guarantees for new Puerto Rican bonds, which would supply funds to catalyze a new era of economic growth.

Keywords: Puerto Rico, PROMESA, Puerto Rico bonds, sovereignty

It is well recognized that the Puerto Rican economy is in crisis. GNP has been falling virtually steadily over more than a decade, and is now down 15% since 2006 (inflation adjusted). Perhaps a more accurate measure of the decline, the Government Development Bank's Economic Activity Index is down 20% in this period.[104]

[104] Data used here are available in the *Informe Económico al Gobernador, Puerto Rico, 2015*. However, the Economic Activity Index is available on the web site of the Government Development Bank, http://www.gdb-pur.com/economy/GDB-Economic-Activity-Index.html.

The clearest sign of Puerto Rico's economic distress, is the large population decline. The island's population in 2016 was 11% below its 2005 peak. The decline has been brought about primarily by a mass exodus, as Puerto Ricans have moved to the states. Yet, in addition, the birth rate has declined and the death rate has risen, yielding a decline in the natural annual rate of increase from 0.53% in 2006 to 0.12% in 2015.

As economic activity has dropped, the government has built up a debt of almost $70 billion, roughly the same as GNP, on which annual debt service obligations are in excess of $4 billion. And these debt figures do not include the some $40 billion in underfunded public pensions.

Recognizing the economic crisis in Puerto Rico—and concerned that the debt, much of which is held by funds and individuals in the states, will not be repaid—the U.S. Congress in 2016 established a process for overseeing economic policy in Puerto Rico. The process contained in the Puerto Rico Oversight, Management, and Economic Stability Act (or PROMESA) focuses on improving the Puerto Rican government's economic policy and, perhaps, finding a means to restructure and alleviate the debt burden. It does not provide and does not hold out a promise of providing federal funds.

Should the U.S. government do more?

The Economic Interests

Although Puerto Rico is not a state, it is part of the United States as a "territory." Its economy is larger than several states—fourteen in 2013, see the table below—and is heavily integrated with the U.S. economy. In 2015, Puerto Rico imported $22.3 billion of goods and services from the states and exported $51.4 billion of goods and services to the states. In a national economy of over $17 trillion, these are not large numbers. However, the jobs that are created by sales to Puerto Rico and the activities that are dependent on the imports from Puerto Rico—which include, for example, large amounts of pharmaceuticals, medical devices, and chemicals—are not trivial or irrelevant to the well-being of people in the states.

Gross Domestic Product of Puerto Rico and of States with Smaller GDPs than Puerto Rico, 2013 (billions of dollars)

Vermont	$28,838	Alaska	$57,276
Wyoming	$41,782	Delaware	$60,816
Montana	$43,006	Idaho	$61,117
South Dakota	$44,673	New Hampshire	$68,701
North Dakota	$51,048	West Virginia	$70,595
Rhode Island	$53,300	Hawaii	$75,095
Maine	$54,609	New Mexico	$90,828

Puerto Rico	$102,450
(Puerto Rico GNP)*	$69,945

Source: *Statistical Abstract of the United States 2015* and *Informe Económco al Gobernador, Puerto Rico, 2015.*
* For Puerto Rico, GDP is a problematic measure of economic activity, so GNP is also shown here. By the standard of GNP, the Puerto Rican economy was still larger than the economies of eleven states in 2013 (the latest year for which full data are readily available).

Beyond trade, Puerto Rico has been the site for substantial investment by U.S. firms. Although data are not available on the extent of U.S. investment, U.S. based firms have long had major operations on the island. As a site for U.S. pharmaceutical firms, Puerto Rico has been especially important. According to the Puerto Rico Industrial Development Company (PRIDCO), "With 49 FDA-approved pharmaceutical plants scattered across the island, Puerto Rico is home to top multinational pharmaceutical companies, including [the U.S. based firms] Abbott-Abbvie, Bristol-Meyers Squibb, Merck, Pfizer, Eli Lilly and numerous others."[105]

U.S. service firms and retail firms are conspicuous on the island, including, for example, Microsoft, Walmart, McDonalds, The Gap, Banana Republic, Sears, Citibank, and numerous mortgage companies and insurance firms. The successful operation of all these U.S. firms—the returns they can bring to their investors—are dependent on the conditions of the Puerto Rican economy.

105 http://www.pridco.com/industries/Pages/Pharmaceutical.aspx.

And then there are the investment in Puerto Rican bonds. Puerto Rican government bonds have paid high, tax free returns to U.S. investors, largely through mutual finds. Again, as with direct investment, the success of these portfolio investments depends on conditions of the Puerto Rican economy. At present, and while the crisis continues, with the economy failing to grow, these bond investments are in danger. Not only are the returns to U.S. investors threatened, but in addition the failure of the Puerto Rican bonds could cause systemic damage.

All in all, simply in economic terms, the United States has substantial interest in the improvement of the Puerto Rican economy. Promoting "good" policies is not enough. At best, new policies cannot be implemented quickly and their positive impacts will not follow immediately from their implementation. If Puerto Rico were a sovereign nation, it could turn to the International Monetary Fund and the World Bank for support. It is, however, only a territory of the United States. It has nowhere to turn by to the federal government.

The Political Interests

Perhaps the most fundamental interest the U.S. government has in providing support for the Puerto Rican economy lies, as with any government, in protecting its citizens. Whether the danger to its citizens is crime, disease, or economic collapse, the first responsibility of a government is to provide protection. Clearly, the people of Puerto Rico, U.S. citizens, are now in need of protection from economic collapse. More, because of the worsening economic situation, both disease and crime are also threatening Puerto Ricans. Prior to the emergence of the current economic crisis, the conditions of people on the island were poor relative to their fellow citizen in the states—with per capita GNP about one-third of that in the states and the poverty rate around 50%. Over the last several years, however, the situation has gotten worse—though the worsening has been hidden by some measures.

A seeming paradox exists in that while between 2006 and 2015 real GNP fell by 15%, real personal income was virtually unchanged. Indeed, in 2016, real personal income was slightly higher than in 2006. The paradox disappears, however, when transfers from the federal government are considered. Between 2006 and 2015, real federal transfers to individuals in Puerto Rico rose by about 25%. The $16.7 billion of these transfers to individuals were 24% as large as the $68.5 billion GNP. (Of the $16.7 billion, Social Security benefits, medical benefits, and veteran benefits accounted for 80%.) In other words, personal income in Puerto Rico was maintained in spite of the economic decline only because of the transfers from the federal government.

The transfers, however, did not alter other signs of economic distress—in particular, the severe decline in the labor force participation rate and the rise of the unemployment rate. Between 2006 and 2015, the unemployment rate rose only from 11.0% to 13.0%, but the labor force participation rate plummeted from 48.6% to 39.9%. (Even the 2006 labor force participation rate was very low by international standards and by comparison with the states, where the rate was 66.2% in 2006.) If the decline in the participation rate is considered *de facto* unemployment, the rate of unemployment would be 21.7%.

These data and the data presented earlier (the out migration in particular), underscore the extent of the humanitarian crisis that is part of the economic decline in Puerto Rico. From simply a humanitarian perspective, the federal government would need to respond to the situation in order protect U.S. citizens living in Puerto Rico.

But there is a political issue as well as a humanitarian issue. Internationally, Puerto Rico is widely viewed as a colony of the United States. The U.S. government and many Puerto Rican officials do not accept this colonial designation. Yet, the reality of this widespread international view continues to exist and works to the detriment of the United States in world affairs. To hold areas as colonies is seen as quite negative, involving a denial of basic human rights.

If, however, a colony is prosperous and its people economically thriving, the negative view of the country that holds the colony is significantly attenuated. For example, in the decades following World War II, when the Puerto Rican economy was growing rapidly, the view that it was a colony did not establish a nasty blot on the U.S. record. Observers may have opposed the holding of a colony in principle, but the reality of an advancing economy undermined criticism of the United States.

Today the situation is different. The alleged colony is in distress. It is increasingly becoming a nasty blot on the U.S. record. As the situation continues, as the economy of Puerto Rico continues to decline, U.S. credibility as a paragon of democracy weakens. U.S. effectiveness in world affairs is damaged.

What Can the Federal Government Do?

The economic and political interests of the United States, then, call for the federal government to take action to improve the economic situation in Puerto Rico. Policy improvements are desirable—indeed, essential. Yet, they are not sufficient to put the island's economy on an upward path of development. In particular, while the public debt and debt service obligations remain so high, there is little hope for economic growth.

Puerto Rico cannot declare bankruptcy. Moreover, the Puerto Rican constitution requires that payment on a large share of the debt be given priority over all other categories of government expenditures—education, health, public safety, infrastructure investment, etc. The federal government, however, can nonetheless do a great deal to reduce the Puerto Rican government's debt burden.

A moderate course of action would be for the federal government to establish a procedure for *de facto* bankruptcy on that share of the debt—the majority—that is not covered by the constitutional protection. (A more extreme course, would include the constitutionally protected portion, but a great deal can be accomplished through the moderate course of action.) If, for example, restructuring the portion of the debt that is not constitutionally protected could result in the annual debt servicing be halved, about $1.3 billion could be saved annually—i.e., made available for supporting government activities that would be crucial for economic expansion.

Yet, more funds will still be needed to support meaningful expansion. In part, these additional funds could be obtained on the bond market at a reasonable rate if the federal government would provide guarantees of these new bonds. With the oversight of PROMESA-created Oversight Board and Revitalization Coordinator, there would be substantial assurance that these funds would be used in a productive manner, generating the economic growth for their repayment.

Furthermore, the federal government could and should provide funds to Puerto Rico and the U.S. citizens in Puerto Rico simply by treating them under important federal programs in the same manner as states and citizens in the states are treated. Examples include the Earned Income Tax Credit, the Child Tax Credit, Medicare and Medicaid, Supplemental Nutritional Assistance, and several others. (The programs that do not apply in Puerto Rico as they apply in the states are listed and explained in the report of the PROMESA-created Task Force.)

These are examples of modest proposals, ways that the U.S. government could provide a foundation for a renewal of the Puerto Rican economy. More could be done, but these action would provide a useful beginning.

Still, such proposals are often opposed with a broad argument against providing more federal support for Puerto Rico. According to this argument, the economic crisis has been the result of policies (or lack of policies) adopted by the Puerto Rican people's elected government. Puerto Ricans themselves, according to this argument, have thus created the crisis, and it is not the job of the federal government to bail them out. Indeed, to do so, the federal government would be sending a message to state and local governments that, failing to operate in a financially prudent manner, they needn't worry; Washington will bail them out.

While these concerns are real, it should also be recognized that the economic and political interest of the U.S. government in Puerto Rico's economic condition, as described above, tend to dominate. Furthermore, the situation of Puerto Rico is different than that of the states. States have a degree of sovereignty greater than Puerto Rico, and, what's more, have representation in Washington that is denied to Puerto Rico. The states are more fully responsible for their own economic conditions. Puerto Rico lacks the power to fully manage its economic affairs, and, whether the island is viewed as a “territory” or a “colony,” the U.S. government bears a different responsibility with regard to Puerto Rico than it does with regard to the states.

Indeed, according to the U.S. Constitution (Article IV, Section 3, Paragraph 2), “The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States.” Thus, as a territory, Puerto Rico is *property* of the U.S. government—that is, Puerto Rico is *owned* by the U.S. government. With that ownership comes responsibility.

4. Making Puerto Rico a State: A Win-Win Opportunity Working

by
J. Tomas Hexner and Arthur MacEwan

ABSTRACT

Since Puerto Rico was ceded by Spain to the United States at the end of the Spanish-American War, the status of Puerto Rico has been adjusted at various times and has continually been an issue of controversy. In recent decades, the controversy has focused on whether Puerto Rico should become a state, remain in its current territorial status, or become an independent nation. This paper explains how Puerto Rico's territorial status has created a condition of dependency, doing substantial harm to the island's economic condition. The period of successful economic growth in decades immediately following World War II created some rapid economic growth, but firmly established the era of dependence that has been so economically detrimental. Thus the current status has to be rejected as a basis for long-run economic success in Puerto Rico. Statehood, in particular, holds out the likelihood of gains for both the United States and Puerto Rico, a win-win situation. The Puerto Rican people have increasingly come to favor the statehood option. With a recognition of the opportunity for a win-win outcome, the foundation for a move to statehood would be established.

Keywords: Puerto Rico status, Puerto Rico statehood, PROMESA,

In 1493, Puerto Rico was claimed for Spain by Christopher Columbus and remained a colony of Spain for almost 400 years. Then, in 1898, under the Treaty of Paris at the end of the Spanish-American War, the island was ceded to the United States.

In the many decades under U.S. rule, the status of Puerto Rico and its people has been surrounded by controversy and has undergone several adjustments. In 1917, Puerto Ricans were granted U.S. citizenship. Yet, the governor was still appointed from Washington, and through the mid-1940s, was always a non-Puerto Rican. Puerto Ricans on the island had no voting representatives in the U.S. Congress and no votes for the U.S. President.

In 1947, Puerto Rico was granted partial self-government, and in 1948 the first Puerto Rican governor, Luis Muñoz Marín, was elected. In 1950 President Truman signed the Puerto Rico Commonwealth Bill, paving the way for a 1951 vote on the island regarding commonwealth status, and in 1952 Puerto Rico's constitution was adopted, establishing a commonwealth with autonomy in internal affairs—albeit constrained by the U.S. Constitution and U.S. laws.

Yet, the constitution and commonwealth status did not end disputes over the relation of Puerto Rico to the United States. Whatever euphemism was used—commonwealth, territory, or *estado libre asociado* (free associated state)—the island remained under the rule of the United States. Even with a degree of "autonomy in internal affairs," Puerto Rico was not sovereign. It remained a colony.

One reaction to the status issue was a demand for independence. Shortly after the Commonwealth Bill of 1950 was enacted, Puerto Rican nationalists (i.e., people seeking Puerto Rican independence) attempted to assassinate President Truman, and in 1954 nationalists opened fire in the U.S. House of Representatives, injuring five congressmen. Over subsequent decades, the independence movement, though still present, has greatly weakened. Instead, opposition to the island's colonial status has increasing become a demand for statehood, and the dominant political dispute has been whether Puerto Rico should retain its current status or become a state.

While the Puerto Rican Republican Party had long favored statehood, it was only with the formation in the late 1960s of the New Progressive Party (NPP), formally unaligned with either Democrats or Republicans in the states, that the pro-statehood forces contended effectively for power on the island. The NPP has held the governorship and majorities in the legislature several times, including at present.

Four plebiscites have been held on Puerto Rico's status, in which statehood has increasingly gained favor among the population. In 1967, 39% of those voting chose statehood, while 60.4% opted for the existing commonwealth status. The statehood vote rose to 46.3% in 1993, to 48.6% in 1998, and to 61.2% in 2012. Another plebiscite is scheduled for June 11, 2017.[106]

[106] In the plebiscites, there has often been controversy over the wording of the questions, and, consequently, the legitimacy of the results has been in dispute.

If the June vote shows a continuation of the rising support for statehood on the island, the U.S. Congress will be under considerable pressure to act. Although several U.S. political figures have expressed themselves in favor of supporting the will of the Puerto Rican people, there remains opposition. Much of the opposition is based on the argument that Puerto Rico as a state would be a burden on the U.S. government—which ultimately means U.S. taxpayers.

On the contrary, however, it is the current colonial status of Puerto Rico—or, if one prefers, the current territorial status—that creates a burden for the United States. Indeed, the burden has become acute with the island's decade-long recession and the associated crisis of the public debt. *Statehood, in fact, presents a way out, a win-win opportunity, benefiting both Puerto Ricans and the U.S. government—that is, both the people on the island and the people in the (current) states. The potential benefits are both economic and political (in terms of human rights issues).*[107]

The Economics of Statehood

The most important economic point to recognize about the consequence of Puerto Rico becoming a state is that statehood would provide the necessary foundation for economic growth on the island. Economic expansion over the longer run will both provide a revenue stream to the U.S. Treasury and establish a "growth pole" with positive impacts for economic activity in other states. (In the short-run, halting the island's current recession and dealing with the debt crisis would likely present Washington with some short-run costs, but these costs will be incurred whether Puerto Rico becomes a state or remains a territory.)

To appreciate the economic potential of statehood, it is useful, first, to recognize that the reality of Puerto Rico's poor economic performance predates the severe recession that began in 2006.

[107] It needs to be emphasized that the economic costs to the United States of the current status are acute at the current time, with Puerto Rico's recession and public debt crisis. But it is myth that Puerto Rico is a "welfare island" (as dubbed by a May 27, 2006, *Economist* article), continually dependent on "handouts" from the U.S. government. As a footnote below points out, in relations between the per capita federal expenditures it receives and the per capita federal taxes it pays, Puerto Rico is less dependent on the federal government than are many states.

Decades of Poor Performance

The post-World War II policies of using federal tax breaks to attract U.S firms to then low-wage Puerto Rico and the advantage of special access to the U.S. market brought a period of rapid economic growth to the island, but these policies stopped working long ago. With rising wages, Puerto Rico ceased being a low-cost site for manufacturing. Also, as the world economy changed, many low-wage countries gained access to the U.S. market. Even when the policies of the postwar era appeared to work, bringing rapid growth and transformation of the economy in the 1950s and 1960s, they enmeshed the Puerto Rican government in a deeply dependent approach to economic policy. The consequence has been an era of poor economic performance.

In 1976, writing in her undergraduate thesis at Princeton University, current Supreme Court Justice, Sonia Sotomayor, focused on the impact of the economic program of the 1950s and 1960s, the so-called Operation Bootstrap (*Operación Manos a la Obra*).[108] She argued that the program, promoted by the island's first Puerto Rican governor, Luis Muñoz Marín, had failed because it:

> "…was based on a negation of self-sufficiency and an acceptance of utter dependency on the colonial master, the United States. Manufacturing firms in Puerto Rico were almost completely export oriented to the mainland market….Puerto Rico was also dependent on the United States for its investment capital." (p. 98)

> "Operation Bootstrap allowed Puerto Rico to improve in absolute terms," but Muñoz Marín's program "had failed to bring Puerto Rico to the level of the poorest state, Mississippi, of the Union as he had promised in his campaigns of the forties." (p. 90)

[108] Sonia Maria Sotomayor, *La Historia Cíclica de Puerto Rico: The Impact of the Life of Luis Muñoz Marín on the Political and Economic History of Puerto Rico, 1930-1975,* Princeton University, Senior Thesis, Department of History, April 16, 1976.

"Dependency had a very real economic component which created the failures of Operation Bootstrap. Operation Bootstrap failed because Puerto Rico accepted its own colonial inferiority…Unemployment, absentee ownership, expatriation through migration, federal aid—in a word, dependency was the legacy of Puerto Rico left by Operation Bootstrap." (p. 89)

Since at least the late 1970s, the Puerto Rican economy has been falling further and further behind the U.S. economy. Between 1980 and 2000, while GNP grew by 60% in Puerto Rico, the U.S. economy expanded by 90%. For the short 2000 to 2006 period, the Puerto Rican economy did grow as rapidly as the U.S. economy, but then Puerto Rico's recession emerged. By 2015 the Puerto Rican economy was 2.2% smaller than in 2000, while the U.S. economy, even with the Great Recession, grew by 30% in those fifteen years. (These figures are all inflation adjusted.)[109]

Giving prescience to Justice Sotomayor's 1976 insights, Puerto Rico's dependent status as a territory of the United States has largely defined economic policy for decades. Under the control of the U.S. government, economic policies have been directed outward to obtain special favors from Washington and investment from firms based in the United States. Those "favors" have come in large part in the form of federal tax breaks for U.S. investors (Section 936 of the U.S. Tax Code, in particular), as well as tax breaks provided by the Puerto Rican government. The tax breaks, however, did much more for the profits of the firms than for employment or output expansion.[110] Of greater importance, the tax breaks distorted the economy, and they obstructed the formulation of an economic strategy focused on Puerto Rico's strengths.

[109] Not only did many observers fail to recognize the relatively poor performance of the Puerto Rican economy in the final decades of the 20th century, but many viewed it as strongly growing. Their error was in viewing the growth of GDP as the meaningful indicator of economic progress on the island—an issue discussed below.

[110] For example, when Section 936 was in full-force in the late 1980s and early 1990s, for the pharmaceutical firms, it cost the U.S. government on average more than $3.08 in lost tax revenue for each $1.00 in wages paid in Puerto Rico by the firms. U.S. See, Department of the Treasury, "U.S. Possessions Corporations Returns, 1987," Tables 1 and 2, as cited by J. Tomas Hexner et al., *Puerto Rican Statehood: A Precondition to Sound Economic Growth*, Second Edition, Hex, Inc. Cambridge, 1993, p. 27. The ratios of cost to wage benefits are excessively conservative as they are based on the assumption that the persons employed in the 936 industries would otherwise be unemployed

These policies, first, undercut the emergence of strong *Puerto Rican* foundations for growth, retarding the expansion of Puerto Rican based business and the development of a skilled labor force.[111] (Note, for example, the weakness of the Puerto Rican educational system.) With firms from the United States dominating the island's major industries, there has been little room for the emergence of Puerto Rican entrepreneurs. The large firms have generally not spawned smaller, locally based suppliers. To a large extent locally based business has been pre-empted and, in effect, pushed aside by firms based off the island.

Moreover, the bureaucracy, which can be handled by large firms, greatly limits the attempts by residents to create startup firms. For large firms, the cost of obtaining permits for starting a business and the personnel needed for complying with the numerous regulations affecting operations are relatively small burdens. For small firms, locally based startups in particular, these burdens can be prohibitive. It is much easier for Puerto Ricans with entrepreneurial skills and ambitions to move to the mainland. Second, these policies generated a bloated manufacturing sector in Puerto Rico, with pharmaceuticals in the lead. Yet, Puerto Rico has had no particular advantage in manufacturing, and the buildup of this sector diminished realms of activity in which Puerto Rico could have real advantages—for example, tourism and business services linking the United States to the rest of the Caribbean and Latin America.[112]

The degree of Puerto Rico's dependence on U.S. based investors (and other external investors), as well as on the tax breaks that have brought them to the island, shows up in the large difference between gross national product (GNP) and gross domestic product (GDP). GNP is a measure of the economic activity attributable to nationals of a nation or territory, while GDP is a measure of

[111] In his *Puerto Rico: Negotiating Development and Change* (Lynne Rienner Publishers, Boulder and London, 2003, pp. 78 and 79), James Dietz has usefully summed up the situation: "…Puerto Rico's strategy of development lacked a focus on the systematic support or fostering of local entrepreneurs and local sources of finance." As a consequence "the central role of domestic entrepreneurs, skilled workers and technological progress that underlies sustained economic progress" has been weaker in Puerto Rico than in sovereign nations where sustained economic progress has proceeded more rapidly.

[112] Puerto Rico's situation has been an ironic inversion of the so-called "Dutch disease," whereby a country or region's wealth in a natural resource (oil, natural gas, copper, etc.) has retarded the development of other activities—manufacturing, in particular—to the long-run detriment of the country or region. In Puerto Rico, it has been the expansion of manufacturing that has retarded the development of other activities. However, unlike the situation with natural resources, there is nothing "natural" about the centrality of Puerto Rican manufacturing.

the economic activity within the nation or territory. In 1960 these two measure of Puerto Rico's economic activity were virtually the same. Over the next several decades, GDP, which includes the profits of firms based off the island, grew substantially more than GNP, which does not include those profits. By 2000, GDP was 50% larger than GNP, and the GDP-GNP ratio has stayed roughly stable in subsequent years. The GDP-GNP gap indicates that a great deal of the income generated on the island goes neither to Puerto Rican workers nor Puerto Rican firms. The gap also reveals a distribution of economic power, a dependence on firms based off the island.[113]

Although there have been some gains from U.S. firms' investments in Puerto Rico, all forms of investment have been inhibited by the uncertainty which surrounds the island's political status. The push for and possibility of status change mean that investors are continually uncertain about the nature of economic policies and conditions under which they would operate. This uncertainly leads to both a bias against long-run investments and limited business support for building the foundations of the economy—especially, education and physical infrastructure. Only status change can remove this uncertainty and its detrimental consequences.

The Economic Potential of Statehood

Most broadly, statehood, establishing a permanent status for Puerto Rico, would greatly alter the environment in which economic activity takes place on the island. In particular, statehood for Puerto Rico would immediately remove the economy-limiting uncertainty. Statehood would generate more and longer term investment because statehood is immune to change. In addition, as a state, Puerto Rico would be more attractive as a tourist destination and as a site for retirement and vacation homes for people in the other states. This change in status would open up possibilities for rapid economic growth, full realization of the Puerto Rican people's potentials.

Beyond the uncertainty issue, statehood would bring many aspects of Puerto Rican government activity under greater discipline, effectiveness, and efficiency. Tax collection, in particular, would

[113] An indeterminate but surely substantial amount of the profits, and thus a significant amount of the GDP-GNP gap, does not even flow from actual activity in Puerto Rico. Pharmaceutical firms (and perhaps others) have located the ownership of patents with their Puerto Rican subsidiaries, and thus the returns to those patents show up as profits in Puerto Rico.

be tied more closely to the IRS. And in realms from data collection to regulatory oversight, statehood would bring advances that would strengthen the foundations for private investment, employment, and economic growth. Most important, these particular changes would be part of a whole new political context for the formulation and operation of economic policy in Puerto Rico. As part of the United States instead of only a territory of the United States, the aura of dependency, which has affected policy for decades, would fade and ultimately disappear.

Especially important, Puerto Rico would have a voice in Washington, with its full share of congressional representatives and votes for president. Policies would not be placed *onto* Puerto Rico by Washington, but would be created *along with* Puerto Rico. As to federal programs, full representation in Washington would quickly move Puerto Rico onto a level playing field with the other states. For example, statehood would make Puerto Rico and Puerto Ricans on the island fully eligible for several federal programs, as are their fellow citizen in the states. Prime examples are the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC). The impact is substantial:

- With all eligible Puerto Ricans applying for and receiving the EITC and CTC (which could take a number of years), the direct stimulus could be as much as $1.8 billion per year. When multiplier effects are taken into account, the overall impact of the infusion of these funds would raise income by close to 4%. Together, the infusion of funds and the greater engagement in productive work (encouraged by these programs) would make a major contribution towards transforming the island's economy out of relative stagnation onto a healthy growth path.

- A two-parent, two-child family in Puerto Rico with a gross income of $28,000 would see its net income, after federal taxes and these two federal credits, rise by $6,622. The family in Puerto Rico, U.S. citizens, would then be on the same level as a family in the states with two parents, two children and a $28,000 gross income. Fairness.[114]

[114] The example here is based on tax regulations for 2015.

With Puerto Rico as a state and thus fully eligible for these and other federal programs, there would be a short-run cost to the U.S. Treasury. But the injection of funds to the island would be one factor in building the foundation for economic growth and stability, which would generate longer run benefits to the federal government. (And see the footnote below regarding the net federal expenditures to states and Puerto Rico in recent years.)

The economic value of statehood for a low-income state (which Puerto Rico would be upon becoming a state) is evident in the general process of income convergence among the states over the last several decades. For example, in 1940, Mississippi, the lowest income state, had a per capita income 22% of that in Delaware, then the highest income state. In 2010, per capita income in Mississippi, still the lowest income state, was 50% of that in Connecticut, which had become the highest income state. Many other examples would tell the same story. Several factors account for this convergence, including: representation in Washington; the degree of integration of capital, labor, and product markets; and the common set of laws and regulations. Some of these factors also operate for Puerto Rico, but the connections between Puerto Rico and the states are not as effective as the connections among the states. And the representation in Washington is missing.[115]

All of these factors that would come with statehood—reduction of uncertainty, greater discipline and effectiveness of government policies, full inclusion in federal programs—would generate economic progress in Puerto Rico. This economic progress, short-run costs notwithstanding, would be beneficial for Washington and the U.S. populace.[116]

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[115] See Fernando Lafort, "Is Puerto Rico Converging to the United States?" Working Paper 1003, International Tax Program, Harvard University, October 1997.

[116] However, there really is no basis for holding Puerto Rico, were it to become a state, up to the standard of paying more into the U.S. Treasury than it would receive in federal expenditures. In terms of net federal expenditures per capita (i.e., direct federal expenditures per capita to a state minus federal taxes per capita from a state), *in 2004 and 2010, seventeen states and the District of Columbia received more in net federal expenditures per capita than did Puerto Rico.* That is, in those two years, in more than one-third of all the states, the net amount per capita received from the federal government—federal expenditures minus federal taxes—was greater than the net amount per capita received from the federal government to Puerto Rico. Moreover, in 2010, only six states paid more to the federal government than they received in federal expenditures—i.e., negative net federal expenditures per capita. (Since 2010, data on which these calculations are based are no longer available. But there is no reason to think that 2004 and 2010 were unusual with respect to federal expenditures and taxes.)

Beyond the contributions to the U.S. Treasury that Puerto Rico as a state would make as its economy grew, the island's economy is already heavily integrated with the national economy, a degree of integration that would only grow with statehood. In 2015, Puerto Rico imported $22.3 billion of goods and services from the states and exported $51.4 billion of goods and services to the states. In a national economy of over $17 trillion, these are not large numbers. However, the jobs that are created by sales to Puerto Rico and the activities that are dependent on the imports from Puerto Rico—which include, for example, large amounts of pharmaceuticals, medical devices, and chemicals—are not trivial or irrelevant to the well-being of people in the states.

The importance of economic growth on the island for other states depends on the size of the Puerto Rican economy as well as its extent of trade with the states. On this score, of course, Puerto Rico's economy is not large. It is, however, larger than that of several states. In 2013, Puerto Rico had a GDP larger than fourteen states. By the more meaningful measure of GNP, the Puerto Rican economy was larger than the economies of eleven states in 2013. Economic growth in Puerto Rico, even under the most favorable circumstances, will not drive the U.S. economy, but the "growth pole" it could provide would be of significant value.

Basic Principles of Human Rights

While the economic considerations make a compelling case for Puerto Rican statehood, there is, perhaps, an even stronger case for statehood based on the principles of human rights. Puerto Ricans are U.S. citizen, with citizenship granted to them in 1917. Yet, Puerto Ricans living on the island are second class citizens. They do not have the right to vote for congressional representatives or for the president.[117] They do elect a Puerto Rican legislature and a governor, but both operate subject to the U.S. constitution and the laws and courts of the United States. Puerto Rican laws can be overturned by U.S. courts (as, for example, was the case in 2016 when the U.S. Supreme Court overturned a Puerto Rican bankruptcy law, which, if upheld, would have provided a means to attenuate the government's debt crisis). As a territory, Puerto Rico does not have sovereign power.

[117] Puerto Ricans on the island do elect a single Resident Commissioner, who is, in effect, a non-voting member of the U.S. Congress.

This limited citizenship, whereby Puerto Ricans have no say in the ultimate authority by which they are governed, is in conflict with basic principles of human rights, principles formally subscribed to by the U.S. government and the U.S. people. This fact alone makes the current territorial status of Puerto Rico unacceptable.

Limited citizenship, however, is not only a matter of principle but also has negative practical impacts for Puerto Rico. Especially important and as emphasized above, in many federal programs Puerto Rico is treated more poorly than are states. Without votes for congress and the president, this poor treatment is the consequence.

Beyond principles and practical impacts, the limited status of Puerto Ricans on the island is also a blot on the U.S. human rights record, working to the detriment of the United States in world affairs. In the eyes of official Washington and of many in San Juan, Puerto Rico is a U.S. “territory.” But in much of the world and among many Puerto Ricans, Puerto Rico is viewed as a U.S. “colony.” To hold areas as colonies is widely seen as quite negative, involving a denial of basic human rights.

The issue of human rights makes the current status of Puerto Rico untenable as a matter of principle, and it also damages the United States it its international operations. Statehood would halt the damage. As with the economy, the principles of human rights would make the status change a win-win situation.

The Current Situation and What Can Be Done

In the short-run, however, there is little likelihood of Puerto Rico becoming a state. Although the latest plebiscite, that of 2012, showed that a majority of Puerto Rican voters favored statehood, an even greater push will be needed to sway Congress and U.S. voters in favor of statehood. That push is likely to come via the new plebiscite scheduled for June 2017. When that push is combined with a recognition that statehood presents a win-win opportunity, status change, the move toward statehood, can pick up momentum.

Neither the island's vote for statehood nor the economic decline had received much notice in either the press or Congress until it became clear that Puerto Rico might default on its public debt. The debt crisis, however, combined with an impending humanitarian crisis on the island and the pressure in some states of the large migration from Puerto Rico, brought attention to the Puerto Rican economic debacle. Along with a plethora of stories in the media, Congress took action, enacting the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) on June 30, 2016.

In Puerto Rico, the impetus for status change in Puerto Rico has become increasing strong as the economy has been in virtually continuous decline for over a decade. In 2016, GNP (inflation adjusted) was 8.5% below its 2006 peak, and the Government Development Bank's Economic Activity Index fell by 18% in this decade. What's more, Puerto Rico's population has declined by over 10% since 2006, as hundreds of thousands of people have moved to the states in search of employment and more economically secure lives.

Also, as the economy has declined, the government of Puerto Rico has increasingly taken on debt. By 2016, the public debt was roughly equal to the island's GNP of $70 billion. Indeed, in June 2015, the governor had declared that the debt was unpayable; without effectively destroying essential public services, the government simply did have the funds to pay its creditors. (In addition to the $70 billion debt to bondholders, public pension funds have been severely underfunded, and are owed approximately $40 billion by the government.)

PROMESA, however, was based on the premise that the economic problems in Puerto Rico were due to bad policy choices by the Puerto Rican government. Thus, it established an Oversight Board to in effect control the Puerto Rican government's fiscal policy. It also created a Revitalization Coordinator, appointed by the Governor from a list of nominees provided by the Oversight Board. The Coordinator would have control over the selection and implementation of infrastructure projects, which are seen in PROMESA as an important foundation of economic recovery. PROMESA also created a bipartisan Congressional Task Force to examine ways that federal policies might be changed to positive affect the situation in Puerto Rico. Unlike that

Oversight Board and the Revitalization Coordinator, both of which had real power over Puerto Rican policy, the Task Force was limited to making recommendations.

Beyond funds for these bodies to operate, PROMESA provides no funds or procedures of support for Puerto Rico. As to the debt, the act does establish a period in which litigation by creditors cannot be undertaken while the Puerto Rican government and debtors undertake *voluntary* negotiations to restructure the debt. No procedures are established that would allow Puerto Rico to move in a bankruptcy-type procedure where a court would impose the conditions of debt restructuring. And a principal purpose of PROMESA is to avoid a U.S. government debt bailout.[118]

The Congressional assertion of control over the Puerto Rican economy via the Oversight Board and Revitalization coordinator was widely perceived in Puerto Rico as an assertion of U.S. colonial control over the island and as undermining (if not destroying) the idea that Puerto Rico was a "self-governing territory." The resentment against PROMESA has been exacerbated as the Oversight Board has given principal insistence to the Puerto Rican government establishing a balanced budget as quickly as possible, which means, of course, the continuing implementation of an austerity program that is most likely to worsen economic conditions.[119]

In spite of Congress's assumption that the economic and financial problems in Puerto Rico were the responsibility of the Puerto Rican government and that the those problems could be repaired by action in Puerto Rico, it is relatively clear that the situation on the island is so serious that important *actions are needed in Washington for the decline of the Puerto Rican economy to be halted and a basis for economic growth established*. Examples of these actions include:

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[118] According to the Speaker of the House, Representative Paul Ryan, the PROMESA "addresses the fiscal crisis in Puerto Rico and prevents a bailout for the island…" See the Speaker's website: http://www.speaker.gov/general/what-you-need-know-about-house-s-puerto-rico-bill.

[119] In the wake of the enactment of PROMESA and the rejection by the U.S. Supreme Court of a Puerto Rican law that would have allowed a means for the Puerto Rican government to deal with its debt, the Puerto Rican journalist Rafael Matos wrote in a July 14, *New York Times* op-ed essay, "In vulgar street talk here, Puerto Rico has been stripped naked and put on show to be shamed. This after we'd grown up being told we had a unique privileged relationship with the United States—we were full citizens, free to migrate north, and autonomous to govern our own affairs. A bit like a state, without surrendering our Latin personality. But now it is clear that was a charade."

- **A Level Playing Field.** Furthermore, the federal government could and should provide funds to Puerto Rico and the U.S. citizens in Puerto Rico simply by treating them under important federal programs in the same manner as states and citizens in the states are treated. Examples include the Earned Income Tax Credit, the Child Tax Credit, Medicare and Medicaid, Supplemental Nutritional Assistance, and several others. (The programs that do not apply in Puerto Rico as they apply in the states are listed and explained in the report of the PROMESA-created Task Force.)

- **"Bankruptcy."** The Puerto Rico government cannot declare bankruptcy, as it is excluded from federal bankruptcy legislation. Moreover, the Puerto Rican constitution requires that payment on a large share of the public debt be given priority over all other categories of government expenditures—education, health, public safety, infrastructure investment, etc.

  A moderate course of action would be for the federal government to establish a procedure for *de facto* bankruptcy on that share of the debt—the majority—that is not covered by the constitutional protection. If, for example, restructuring the portion of the debt that is not constitutionally protected could result in the annual debt service being halved, about $1.3 billion could be saved annually—i.e., made available for supporting government basic needs and activities that would be crucial for economic expansion.

- **New Bonds.** Yet, more funds will still be needed to support meaningful expansion. In part, these additional funds could be obtained on the bond market at a reasonable rate if the federal government would provide guarantees of these new bonds. With the oversight of the PROMESA-created Oversight Board and Revitalization Coordinator, there would be substantial assurance that these funds would be used in a productive manner, generating the economic growth for their repayment.

These are examples of modest actions, ways that the U.S. government could provide a foundation for a renewal of the Puerto Rican economy. More could be done, but these action would provide a useful beginning.[120] An example of the way these actions could have a positive impact on the Puerto Rican economy is that they would allow a "big push" through public infrastructure investment. Improving and expanding the island's infrastructure would establish a foundation for a resurgence of private sector investment. However, because of the extent of decline that has occurred over recent years, for such public investment to play a major role in turning around Puerto Rico's economy, it must be very large—a "big push."[121]

The long decline of the Puerto Rican economy has thoroughly undermined the confidence of private sector investors. Between 2006 and 2015, private gross domestic investment fell from 15.5% of GNP to 10.4% of GNP, even as GNP fell by 11%. To affect the views of private investors, to convince them that the economy is turning around, and to reinvigorate private investment will require a "big push" in public infrastructure investment.[122]

Responsibility for Action

When the United States invaded Iraq and brought about "regime change," Colin Powell famously stated, "When you break it, you own it." He meant of course, that the United States had become responsible for the situation in Iraq, problems and all. Ownership means responsibility. With Puerto Rico, U.S. ownership is not simply figurative. As a territory of the United States, Puerto

[120] Of course, such actions, if they are to have significant impact, must be accompanied by policy changes in Puerto Rico. Examples include effective tax collection and greater efficiency in government practices (especially, with business permitting and by the elimination of unnecessary and counter-productive regulations). Policy changes in San Juan, however, will do little to rectify the economic situation without substantial action from Washington.

[121] For an examination of the impact and financing of a $20 billion "big push," see, J. Tomas Hexner and Arthur MacEwan, "Reviving the Puerto Rican Economy Requires: A Big Push of Public Infrastructure Investment," Paper submitted to the PROMESA Task Force, August 23, 2016. This paper estimates that a $20 billion "big push" would expand permanent output expansion by $6.7 billion and create 93 thousand permanent new jobs. Yet, these estimates of the GNP and employment impacts are conservative because (except for the normal multiplier impact of the investment) they do not include the extent and impact of new private investment, which would surely be substantial. Indeed, the surge of public infrastructure investment, while valuable in terms of immediate growth and employment effects, is justified largely because of the impetus it would create for private sector development. In its "Fiscal Plan" issued on February 28, 2017, the Government of Puerto Rico recognized the need for such investment, but proposed an allocation of only $4.5 billion over the coming decade for this purpose. Government of Puerto Rico, Puerto Rican Fiscal Agency and Financial Advisory Authority, *Fiscal Plan,* February 28, 2017, p. 79.

[122] The data here are from the *Informe Económico al Gobernador, Puerto Rico, 2015*. The fall of public sector investment in this period was even greater than that of the private sector, declining from 5.0% of GNP to 2.1%. If the level of public sector investment had been the same percentage of GNP in 2015 as in 2006, it would have provided an additional $2 billion, a good start on a "big push."

Rico is literally owned by the U.S. government. According to the U.S. Constitution (Article IV, Section 3, Paragraph 2), "The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States." With that ownership comes responsibility.

The responsibility of the United States government toward Puerto Rico cannot be fulfilled simply by particular actions aimed at improving the island's economy and resolving the current debt crisis—though even effective action at that level has so far been lacking. The needed action is to recognize the will of the Puerto Rican people, which is likely to be clear through the plebiscite scheduled for June, and establish the legislation to create Puerto Rican statehood.

There will, of course, be opposition. Within Puerto Rico, in addition to those who favor the current status, there are those who favor independence. Independence would resolve the human rights issue that goes with colonial status. Yet, while the demand for independence has long historical roots, it appears to have limited support for in recent years. Moreover, in general the economic experience of small island countries does not provide a basis for optimism regarding the economic conditions in an independent Puerto Rico. In any case, it seems unlikely that the U.S. Congress would grant independence and allow Puerto Ricans, especially coming generations, to maintain U.S. citizenship—which is one of the planks in the platform of the pro-independence party.

Within the United States, there are a variety of bases of opposition to Puerto Rican statehood. The most important means to overcome this opposition will be for the U.S. Congress and people in the United States to recognize the economic and human rights benefits that they would experience, as well as the benefits that would come to Puerto Rico, as a result of statehood. These benefits, the win-win opportunity, have been explained here. Part of recognizing this opportunity is to also recognize that Puerto Rico is in fact a colony, a status that by human rights and economic standards cannot be continued.

Widespread recognition of the win-win opportunity is a key to moving Puerto Rico from colonial status to statehood.

5. Reviving the Puerto Rican Economy Requires A Big Push of Public Infrastructure Investment

by

J. Tomas Hexner and Arthur MacEwan

Without a large infusion of investment the Puerto Rican economy will continue to slide downward and be a problem for United States. To bring about this investment, the Oversight Board and Revitalization Coordinator should support a Big Push of public infrastructure investment. This Big Push would entail $20 billion of investment during the FY2018 to FY2027 decade and would raise GNP by more than 10%, establish close to $7 billion of lasting annual production capacity, and create close to one hundred thousand new jobs. *Most important, this public infrastructure investment would alter the economic environment, laying the foundation for a lasting upsurge of private investment*.

Much of the $20 billion could be raised at reasonable interest rates once the current debt crisis is resolved and appropriate support from the federal government is established. One mechanism to accomplish the funding would be through the creation of a Rehabilitation Trust Fund (RTF). The RTF would be guided by the Oversight Board, and, under the Revitalization Coordinator, could both select and oversee infrastructure projects. Beyond borrowing for the projects, additional contributions to this $20 billion could come from reductions in debt service payments on existing debt, revenue from equal treatment in federal programs, and increased effectiveness of tax collection.

This Big Push proposal should be seen as an extension of Title V of PROMESA and could be promoted by a recommendation from the Task Force.
Keywords: Puerto Rico, control board, investment, infrastructure, PROMESA

Overcoming Puerto Rico's immediate debt crisis is essential. Fixing the severe debt problems, however, will be little more than putting a bandage on a chronically ill patient. The real need is to revive the economy, to begin to generate sustainable growth.

Effective policies and major reforms must be initiated *immediately*. Private investment is essential, but conditions must be altered to attract private investment. *Puerto Rico cannot wait.*

Over the next decade public investment will be indispensable to re-establish economic growth. Not only will public investment increase growth and generate jobs, but, if targeted on much-needed infrastructure investment, it will create conditions that will directly support private activity, which will continue over the long-run.

The purpose here is to show the impact on economic growth and employment expansion of a decade-long, $20 billion Big Push of public investment. In addition, the potential sources of funding this investment will be laid out. The role that a Rehabilitation Trust Fund (RTF) could play in both the funding and implementation of the Big Push will be explained. To a large extent, this Big Push would be the implementation of Title V of PROMESA, "Puerto Rico Infrastructure Revitalization," and an RTF is a mechanism through which the Revitalization Coordinator could operate.

The Big Push for Economic Growth

Puerto Rico needs a game changer. The Big Push of public investment in infrastructure is the game changer that could set the economy on a rehabilitated path of development.

The Big Push would involve an immediate, very large increase of public infrastructure investment, followed by a tapering off towards a lower, but still substantial amount of public investment in subsequent years. In particular, this scenario calls for
$20 billion of new public investment over ten years, with FY2018 as the first year. Twenty billion is an amount that is necessary to generate a substantial upsurge in the Puerto Rican economy, sharply raising output and employment, *and, crucially, providing a catalyst to a resurgence of private investment*. At the same time, when spread over a decade, $20 billion is a feasible amount, an amount that could be raised (as explained below) through borrowing and from other sources and that could be effectively spent.

Over the decade, the Big Push would raise GNP by more than 10% and would yield employment growth of nearly 100,000, roughly 10% above the FY2016 level. Yet, these estimates of the GNP and employment impacts are conservative *because they do not include the extent and impact of new private investment, which would surely be substantial. Indeed, the surge of public infrastructure investment, while valuable in terms of immediate growth and employment effects, is justified largely because of the impetus it will create for private sector development.*

The Big Push calls for $3 billion of new public infrastructure investment in each of the first two years of the decade (FY2018 and FY2019), $2.5 billion in each of the next two years, three years with investment at $2 billion, and the final three years of the decade at $1 billion. The results would be an immediate increase of GNP (as investment is part of GNP) and the creation of over 60,000 jobs connected, directly and indirectly (through the multiplier process), to the investment activity in each of those first two years. The levels of expanded output and of job creation generated by the investment activity itself would taper off in subsequent years as the level of new investment declines. However, by the third year, the investment activity would start giving rise to new production activity, as the new capacity comes on line. This new production would then augment the level of GNP and the level of employment.

By the end of the 10 year period, output and employment would be more than 10% higher than in FY2017, including both output from the new productive capacity created by the investment over the decade and the investment activity itself in that last year. As the new productive capacity from investment in the last two years of the decade comes on line in the subsequent two years, production and employment from new capacity would have risen by almost 7% as compared to FY2017. This would be continuing output and employment (assuming the productive capacity is maintained).

A summary of the investment and outcomes of the Big Push over the decade are shown in Table 1. Year to year investments and outcomes and explanation of the assumptions on which the figures are based are provided in Appendix A.

Table 1: Investment and Outcomes of the Big Push for Boosting the Puerto Rican Economy Over the FY2018 to FY2027 Decade

	The Big Push
Public Infrastructure Investment	$20 billion
New Lasting Output Capacity	$6.67 billion
New Lasting Jobs Created	92.5 thousand
Total Addition to Output During the Decade	$60.5 billion
Job-Years of Employment Created During the Decade	834 thousand

Beyond these gains by the end of the decade, two additional consequences of the Big Push should be emphasized. First, much of the increase comes in the first years of the decade, as the investment level is very high at the outset. By the five-year mark, output and employment would have each increased by over 8%. Second, and *especially important, this surge of new activity, by significantly altering the economic climate in Puerto Rico, would give rise early-on to new private activity, bringing gains well beyond those attributable to the public investment alone. While private activity resulting from the multiplier process generated by the investment spending is included in the impact estimates, the rise in private activity resulting from the improved investment climate is not included. Therefore, the expansion estimates in Table 1 should be viewed as conservative.*

Questions might exist as to whether or not Puerto Rico would be able to absorb the high rate of investment called for in the Big Push. That is, it might not be able to effectively invest funds in new infrastructure at such a high rate. Yet, given the starved condition of the economy, the large amounts of investment seem both necessary and reasonable. The roles of the Revitalization Coordinator, working under the Oversight Board, in exercising oversight of the choice and operation of projects, would reduce the likelihood of ineffective investments. Nonetheless, if the Big Push is rejected as unrealistic, more moderate approaches to rehabilitation of the Puerto

Rican economy could be undertaken. In Appendix B one such more moderate approach is laid out.

The Source of Funds

The Big Push set out above would require $20 billion in new funds over the FY2018 to FY2027 decade, for an average of $2 billion each year. While the actual amount of funds needed would vary from year to year, the source of the funds here is shown for the "average" year—that is, for $2 billion. Clearly, in the early years of the decade, with the very large amounts of investment, a larger amount of funds would be needed, but the larger amounts of these years would be offset by the lesser needs of later years.

The funds would come from four sources:

- Reduction in debt service payments on pre-existing debt;
- Government revenue from equal treatment in federal programs;
- Increased effectiveness of tax collection; and
- New bonds.

Table 2 lists the amount from each source for the "average" year (i.e., for $2 billion). Explanation of each category follow.

Table 2: Sources of $2 Billion Annually for New Public Infrastructure Investment

Reduction of Debt Service Payments (one-third of reduction in debt service of public enterprises and municipalities)	$450 million
Revenue from Equal Treatment in Federal Programs (share that accrues to the government)	$200 million
Increased Effectiveness of Tax Collection (10% increase in collection of individual Income tax and an additional $100 million from all other taxes)	$300 million
New Annual Borrowing (RTF bonds at 5%)	$1,105.3 million
First Year's Interest on New Debt*	-$55.3 million
Total	$2,000 million

* This set of sources of funds does not include funds to pay the interest on the new debt beyond the initial year of that debt. It seems reasonable to assume, however, that, as the economy begins to grow and creates an impetus for private investment, the increased economic activity will generate sufficient government revenue to pay the interest on the new debt in subsequent years.

Reduction of Debt Service Payments. A reasonable resolution of Puerto Rico's debt crisis would result in a halving of the debt service payments of public enterprises and municipalities through some form of restructuring. In FY2016 (i.e., before any restructuring), total debt servicing payments due on Puerto Rico's public debt were about $4.7 billion. However, as much as $2 billion of this is servicing "General Obligation, Guaranteed and Publically Issued Appropriation Debt." The assumption here is that only the remaining debt service—i.e., $2.7 billion—will be halved. Also, it is assumed that, although the savings of $1.35 billion will directly accrue to public enterprises and municipalities, it will be available for general government use. Here it is further assumed that two-thirds of this, $900 million, will go to meet current needs (e.g., schools and other public services, maintenance of existing infrastructure, and the immediate needs of public enterprises). This will leave $450 million that that could be devoted to new public infrastructure investment.

Revenue from Equal Treatment in Federal Programs. Any program for economic growth will depend in significant part on Puerto Rico being treated in the same manner as the states (i.e., U.S. citizens in Puerto Rico being treated in the same manner as U.S. citizens in the states). One aspect of this equal treatment would be to extend the Earned Income Tax Credit and the Child Tax Credit fully to Puerto Rico. Also, equal treatment would affect Medicare and Medicaid programs and other social support programs, "food stamps" in particular. Taken together, equal treatment in this set of programs would inject up to $1 billion annually to the Puerto Rican economy. Most of this injection of funds would go to families and directly to services (e.g., medical services). Some, however, would offset medical services currently funded by the government. Also, this injection of funds would yield some tax income for the government and would induce a higher level of economic activity, which would also raise tax revenue. All in all, it is reasonable to estimate that equal treatment would result in a $200 million increase in government revenue that could be directed towards new infrastructure investment.

Increased Effectiveness of Tax Collection. Any program to alleviate the current debt crisis will require steps by the Puerto Rican government to increase the effectiveness of its economic policies, most importantly its tax collection policies. More effective tax collection policies should raise collection of the individual income tax by 10%, or roughly $200 million. From increased effectiveness in the collection of all other taxes, which accounted for $6.6 billion in revenue in FY2015, an additional $100 million could be raised. (The shift from the sales and use tax to a value added tax is ignored here, as its implementation is too uncertain at this time.)

New Annual Borrowing. While these three sources of funds totaling $950 million would be important, they would not be sufficient to fund the level of infrastructure investment that would generate substantial growth and employment increases. New borrowing will be needed. With the existing debt burden greatly reduced and with the role of the Oversight Board and Revitalization Coordinator well established, bond investors should have a level of confidence that would make new borrowing possible at lower interest rates (as compared to the over 8% interest rate that has been charged recently on Puerto Rico's bonds). Moreover, repairing the Puerto Rican economy would be most effective if the U.S. Treasury would guarantee payment on the new bonds. (The possibility of federal guarantees is suggested in PROMESA, Title V, Sec. 505, Paragraph b.) Assuming the Puerto Rican government could borrow under these circumstances at 5%, it would need to borrow $1,105.3 million each year. After allowing for the $55.3 million for first-year servicing of the 5% payment on this new debt (see note to Table 2), the net addition to funds would be $1,050 million and would bring the total available for new infrastructure investment to $2 billion each year. (If a Rehabilitation Trust Fund were created—see below—one of its major roles would be to manage the issuing of these new bonds, which should create additional confidence in the bond market.)

A Rehabilitation Trust Fund (RTF)

Through PROMESA, Congress has created the Oversight Board for Puerto Rico. This Oversight Board is to play a major role in restructuring the Puerto Rican government's debt and in guiding the government's fiscal and financial actions for some period to come. While there has been controversy regarding the extent of the Oversight Board's authority and duration, as conceived its purview seems to be limited to the two realms of debt restructuring and fiscal and financial oversight. These two realms are not enough.

As the discussion above indicates, a third realm must be added to the Oversight Board's charge: the rehabilitation of the Puerto Rican economy. Recognizing this need for setting the Puerto Rican economy on a path to economic growth, Congress also established in PROMESA the Task Force on Economic Growth in Puerto Rico with the charge of making recommendations, particularly on federal laws and programs, that would advance economic growth in Puerto Rico. Also, PROMESA specifies the establishment of a Revitalization Coordinator, who would have a major role in selecting and supporting major infrastructure investments in Puerto Rico.

A Rehabilitation Trust Fund, which is being proposed here for the Task Force to recommend, could be the instrument by which the Revitalization Coordinator could most effectively advance a growth agenda. Congress should authorize the Oversight Board to create and oversee the operations of the RTF. The RTF, under the direction of the Revitalization Coordinator and working with the Puerto Rican government, would play a determining role in selecting investments, organizing the financing of those investments, and overseeing their implementation. *This combination of roles is critical. The projects cannot proceed without financing, and the roles of the RTF selection and oversight of projects could create the confidence in bond markets that would facilitate raising funds at a moderate cost.*

Because the Oversight Board would be an instrument of the U.S. government and would be made up of people with widely recognized credentials of expertise and integrity, its roles overseeing the RTF would provide a foundation for confidence among potential investors. Those investors—i.e., purchasers of bonds floated by the RTF— would expect that the funds would be used for projects with substantial payoff in terms of economic expansion and catalyzing private investment. Moreover, they would expect that the projects would be run efficiently, eliminating concerns about waste and corruption. The economic growth generated by the RTF investments would yield rising tax revenue that would be the basis for paying off the bonds.

The confidence in RTF bonds by potential investors, based on their confidence in the Oversight Board, would make it feasible for the RTF bonds to pay reasonable interest rates—as opposed to the very high interest rates that have of late been demanded by investors on other Puerto Rican bonds. In the calculations used here to examine the impact and costs of a Big Push program, a rate of 5% on the RTF bonds is used.

Necessary Provisions

Because the payments on RTF bonds would come from the Puerto Rican government's tax revenue, some additional provisions are necessary in order to justify the assumption of a 5% rate of return on those bonds:

- Of primary importance is that the federal government will act to create a mechanism for restructuring a substantial part—half is assumed in the calculations above—of the Puerto Rican government's debt, resulting in a large reduction of the government's debt service obligations. This federal action is a necessary condition for Puerto Rico to re-enter the bond market.

- Furthermore, to ensure reasonable rates, the credibility and the reputation of the Oversight Board must be behind the bonds. In fact, after testing the market the Oversight Board may determine that U.S. Treasury assurance, perhaps a guarantee, is necessary. (Again, the possibility of federal guarantees is suggested in PROMESA.)

- Confidence in the RTF bonds (or any other Puerto Rican bonds) will also depend on the extent to which the government undertakes fiscal reforms. While these reforms should affect significant areas of government spending, *the primary change will need to be an increased effectiveness of tax collection*.

- Substantial improvement in the economy could be accomplished forthwith if the federal government would enact changes that would treat Puerto Rico in the same manner as the states with regard to major social support programs—in particular, the Earned Income Tax Credit, the Child Tax Credit, Medicare, Medicaid, the Supplemental Security Income program, and the Supplemental Nutritional Assistance Program.

Appendix A: Details of the Big Push

The estimates of the impacts of the Big Push are based on three relationships:

- *The amount of output and employment created with $1 billion in public infrastructure investment.* The $1 billion of investment would directly add $1 billion to GNP, and, assuming a multiplier of 1.5, the total increase of GNP would be $1.5 billion. On the basis of past experience in Puerto Rico, $1 billion of new construction investment is associated with 13,700 new jobs. Applying the 1.5 multiplier to this job creation yields a figure of 20,550 for both the direct and indirect jobs created. (The rationale for this figure is explained below.)

- *The amount of new, continuing output capacity created by that $1 billion infrastructure investment*. This figure is referred to as the incremental capital output ratio (ICOR). Evidence from many countries under many circumstances indicates that ICORs vary widely. However, it seems reasonable, as the basis for a rough estimate, to use an ICOR of 3.0 for Puerto Rico. This means that for $1 billion of new investment, the level of economic activity would rise by $333 million and would stay at that level as long as the capital created by this new investment is maintained. It is assumed here that there is a lag of two years between when investment takes place and when the productive capacity created by that investment comes on line.

- *The number of jobs that would be created by the new, continuing production*. This figure is obtained by assuming the ratio of GNP to employment in FY2016 remains unchanged. Thus a 1% increase in output over current output yields a 1% increase in employment over the current employment. The output and employment figures for FY2016 used here are $72 billion and 1 million, respectively. (These are, of course, rough figures because FY2016 data are not yet fully available.)

As to employment, past experience in Puerto Rico indicates that each $1 billion of investment is associated with 13,700 construction jobs in the year in which the investment is taking place, and public investment in infrastructure would be largely in construction. If the multiplier is 1.5, an additional 6,850 jobs would be created elsewhere in the economy in the year of the investment—thus a total of 20,550 jobs associated with the higher level of investment. These construction related jobs, would not be permanent jobs. While important—for the workers and for the growth of the economy— they would only exist as long as the new investment was maintained.

Table A below sets out the year-by-year impact of the Big Push scenario.

Table A: The Big Push to Bolster the Puerto Rican Economy and Its Impact on Output and Employment

Fiscal Year	New public investment in infrastructure, billions of dollars	Direct and indirect increase of GNP, of dollars	Direct and indirect increase of employment	Increase of output due to new investment, billions of dollars	Cumulative increase of out9 put due to the new investment, billions of dollars	Increase of employment due to the production	Cumulative increase of employment due to the production	Total increase of Output, billions of dollars	Total increase of employment
2018	3	4.5	61,650	0	0.00	0	0	4.50	61,650
2019	3	4.5	61,650	0	0.00	0	0	4.50	61,650
2020	2.5	3.75	51,375	1.00	1.00	13,875	13,875	4.75	65,250
2021	2.5	3.75	51,375	1.00	2.00	13,875	27,750	5.75	79,125
2022	2	3	41,100	0.83	2.83	11,563	39,313	5.83	80,413
2023	2	3	41,100	0.83	3.66	11,563	50,875	6.66	91,975
2024	2	3	41,100	0.67	4.33	9,264	60,139	7.33	101,239
2025	1	1.5	20,550	0.67	5.00	9,264	69,403	6.50	89,953
2026	1	1.5	20,550	0.67	5.66	9,264	78,667	7.16	99,217
2027	1	1.5	20,550	0.33	6.00	4,625	83,292	7.50	103,842
2028				0.33	6.33				
2029				0.33	6.66				

Appendix B: A More Moderate Approach

If the Big Push approach is not accepted, because of either political constraints or the belief that the economy cannot effectively absorb the early large amounts of investment, a more moderate approach could be initiated. An example of a more moderate approach presented here would still be based on $20 billion of new infrastructure investment over a decade, but the pattern of investment would be different—with a much smaller amount of investment in the initial years and building to larger amounts in later years.

Because the more moderate approach involves the same total amount of new investment over the decade as does the Big Push, the resulting production from new capacity (once all the capacity has come on line) is thus the same as with the Big Push. In the moderate scenario, however, in the first four years of the decade, the amount of this investment would be $1 billion, $1.5 billion, $2 billion, and $2.5 billion; in years 5 through 9, each year would see investment of $2.5 billion, and in the final year investment would drop back down to $2 billion. (See Appendix Table B.2 for the year-to- year pattern of investment of the moderate path and for the impact of that investment.)

At first, the moderate path might appear as preferable to the Big Push, as the levels of output and employment in year 10 are higher in the former than in the latter. This, however, is only a result of the output and employment from the investment activity itself, which is higher in the final years of the moderate path than in the Big Push. The increase in output from new productive capacity, as noted, is the same once the new capacity has come on line (which would be two years after the end of the decade of expansion). Furthermore, because the Big Push generates earlier expansion, the total amount of output and the total amount of jobs created are greater with the Big Push than with the moderate path. The total new output during the ten years associated with the new investment of the Big Push is $60.5 billion, while the moderate path generates
$51.4 billion; similarly, the total job-years created during the ten years with the Big Push is 834 thousand, while only 708 thousand job-years are created by the moderate path. Table B.1 compares aspects of the Big Push and the more moderate approach.

Because the two approaches involve the same amount of total investment over the decade, both would be based on the same funding sources described earlier. Also, the assumptions on which the Big Push calculations are based, as described in Appendix A, are also used as the basis for the calculations of the more moderate approach.

While the Big Push has clear advantages (Table B.1), it also has a potential important advantage that is not so clear. With the large injection of funds in the early years, it could have a greater impact of "jump starting" private investment. Ultimately, it is this private investment that would place the Puerto Rican economy back on a growth path.

Table B.1: Outcomes of Two Scenarios for Boosting the Puerto Rican Economy Over the FY2018 to Fy2027 Decade*

	The Big Push	The More Moderate Approach
Public Infrastructure Investment	$20 billion	$20 billion
New Lasting Output Capacity	$6.67 billion	$6.67 billion
New Lasting Jobs Created	92.5 thousand	92.5 thousand
Total Addition to Output During the Decade	$60.5 billion	$51.4 billion
Job-Years of Employment Created During the Decade	834 thousand	708 thousand

* Both scenarios have the same overall new investment and therefore the same new lasting output capacity created and the same new lasting jobs created. However, with the Big Push, jobs and output come earlier and therefore, as compared to the more moderate approach, more output is generated and more job-years of employment created during the decade. Moreover, with the earlier generation of output and jobs, the Big Push is likely to elicit an earlier and larger upsurge of private investment, which is not included in the figures here.

Table B.2: The Moderate Path Approach to Bolster the Puerto Rican Economy and Its Impact on Output and Employment

Fiscal Year	New public investment in infrastructure, billions of dollars	Direct and indirect increase of GNP, [illegible] of dollars	Direct and indirect increase of employment	Increase of output due to new investment, billions of dollars	Cumulative increase of out9 put due to the new investment, billions of dollars	Increase of employment due to the new production	Cumulative increase of employment due to the new production	Total increase of output, billions of dollars	Total increase of employment
2018	1	1.50	20,550	0.00	0.00	0	0	1.50	20,550
2019	1.5	2.25	30,825	0.00	0.00	0	0	2.25	30,825
2020	2	3.00	41,100	0.33	0.33	4,625	4,625	3.33	45,725
2021	2.25	3.38	46,238	0.50	0.83	6,938	11,563	4.21	57,800
2022	2.25	3.38	46,238	0.67	1.50	9,250	20,813	4.87	67,050
2023	2.25	3.38	46,238	0.75	2.25	10,406	31,219	5.62	77,456
2024	2.25	3.38	46,238	0.75	3.00	10,406	41,625	6.37	87,863
2025	2.25	3.38	46,238	0.75	3.75	10,406	52,031	7.12	98,269
2026	2.25	3.38	46,238	0.75	4.50	10,406	62,438	7.87	108,675
2027	2	3.00	41,100	0.75	5.24	10,406	72,844	8.24	113,944
2027				0.75	5.99				
2029				0.67	6.66				

[1] An earlier version of this paper appeared as Hexner, J. Tomas, and MacEwan, Arthur, "Reviving the Puerto Rican Economy Requires a Rehabilitation Trust Fund, Center for Global Development and Sustainability, Working Paper Series, 2016-2, Brandeis University, April 2016 (with a forward by R. Godoy), http://heller.brandeis.edu/gds/pdfs/reviving-the-puerto-rican-economy.pdf.

[2] J. Tomas Hexner is an independent consultant based in Cambridge, Massachusetts. Arthur MacEwan is Professor Emeritus of Economics at the University of Massachusetts Boston

6. Puerto Rico: Quantifying Federal Expenditures

By
Arthur MacEwan and J. Tomas Hexner

In 2004 and 2010, seventeen states and the District of Columbia received more in "net federal expenditures per capita" than did Puerto Rico.
That is, in more than one-third of all the states, in these two years, the net amount per capita received from the federal government—federal expenditures minus federal taxes—was greater than the net amount per capita received from the federal government in Puerto Rico. There is no reason to think that 2004 and 2010 were unusual with respect to federal expenditures and taxes.

Keywords: Puerto Rico, federal expenditures, transfer, welfare

How much financial support does Puerto Rico receive from the federal government? The conventional wisdom, expressed in Washington and in the media, is that Puerto Rico is a "welfare island" and receives a large amount from the federal government. This flow of funds is often referred to as "generous" support for Puerto Rico.

Yet, to determine whether or not something is a "large amount," it is necessary to have a basis for comparison. When a relevant comparison is made, it turns out, as is often the case, the conventional wisdom is incorrect.

First of all, to determine the amount of financial support that Puerto Rico receives from the federal government, it would be misleading to look only at the amount of federal spending that goes to Puerto Rico. It is necessary to look also at how much goes from Puerto Rico to the federal government—i.e., taxes. So it is necessary to look at the *net federal expenditures*—expenditures minus taxes—from Washington to Puerto Rico.

Second, the total amount of this net flow has to be adjusted for the size of the population. So the relevant figure is the *net federal expenditures per capita*.

Third, as a basis of comparison, the net federal expenditures per capita from the federal government to Puerto Rico should be examined alongside of the net federal expenditures per capita to each of the states and the District of Columbia.

Data to calculate net federal expenditures per capita for the states, Puerto Rico, and D.C. have been available in the annual *Consolidated Federal Funds Report* from the U.S. Department of Commerce and *Internal Revenue Service Data Book* from the Department of the Treasury. However, and unfortunately, the former of these sources has not been published since 2010, and the data it contained are not available for later years.

Nonetheless, the two tables below, present the "net" figures for 2004 and 2010. *The tables show that in 2004 and 2010, seventeen states and the District of Columbia received more in net federal expenditures per capita than did Puerto Rico.* That is, in more than one-third of all the states, in these two years, the net amount per capita received from the federal government—federal expenditures minus federal taxes—was greater than the net amount per capita received in Puerto Rico from the federal government. The reality demonstrated in the tables, then, belies the conventional wisdom and indicates that, by a reasonable comparative standard, Puerto Rico is not treated "generously" by the federal government.[2]

It would be desirable to have data for years since 2010. The data for these two years, however, suggest a high degree of stability in the financial relation between Puerto Rico and the federal government as compared to the states and D.C. There is no apparent reason to believe that this relation of how Puerto Rico compares to the states and D.C. has changed significantly since 2010.

Puerto Rico's position in the two tables might seem odd. After all, Puerto Ricans do not pay federal income taxes, and U.S. firms operating in Puerto Rico do not pay federal corporate taxes. Puerto Ricans, however, do pay Social Security and Medicare taxes at the same rates as do people in the states. Also, Puerto Rico is excluded from some major federal expenditure programs (e.g., the Earned Income Tax Credit) and is treated less favorably than states in some others (e.g. Medicare). Further, Puerto Rico is virtually excluded from federal procurement and employment expenditures. These various exclusions from federal expenditures appear to more than balance the privilege of not paying personal and corporate taxes.

There is, of course, no good reason that states and Puerto Rico should receive the same net federal expenditure per capita as one another. Federal spending is determined by many factors, but one of these is ostensibly to aid low-income parts of the country. By that criterion Puerto Rico would be right at the top. However, another factor is the political power of a state's representatives in Washington, and Puerto Rico has no such power. If Puerto Rico were to have political power as a state, the sobriquet of "welfare island" would soon be forgotten.

Table 1: Net Federal Expenditures Per Capita (Expenditures Minus Taxes) by State, the District of Columbia and Puerto Rico, FY2004

	Net Federal Expenditures	Rank		Net Federal Expenditures	Rank
District of Columbia	37,457	1	Missouri	1,381	27
Alaska	8,005	2	Kansas	1,282	28
New Mexico	7,348	3	Indiana	1,019	29
Virginia	5,940	4	Oregon	916	30
West Virginia	5,562	5	New Hampshire	689	31
North Dakota	5,157	6	Pennsylvania	658	32
Montana	4,792	7	Washington	525	33
Mississippi	4,700	8	North Carolina	236	34
Alabama	4,629	9	California	-62	35
South Dakota	4,389	10	Nevada	-129	36
Maryland	4,383	11	Rhode Island	-188	37
Maine	4,175	12	Michigan	-225	38
South Carolina	3,586	13	Arkansas	-310	39
Kentucky	3,514	14	Georgia	-350	40
Hawaii	3,093	15	Texas	-380	41
Arizona	2,984	16	Wisconsin	-473	42
Wyoming	2,980	17	Massachusetts	-837	43
Louisiana	2,887	18	Colorado	-906	44
Puerto Rico	**2,823**	**19**	Ohio	-1,181	45
Vermont	2,596	20	New York	-1,370	46
Idaho	1,887	21	Nebraska	-1,385	46
Oklahoma	1,858	22	Illinois	-2,393	48
Utah	1,826	23	Connecticut	-3,223	49
Iowa	1,768	24	New Jersey	-4,025	50
Florida	1,677	25	Minnesota	-5,639	51
Tennessee	1,557	26	Delaware	-7,010	52

Source: See text.

Table 2: Net Federal Expenditures Per Capita (Expenditures Minus Taxes), States, the District of Columbia, and Puerto Rico, FY2010

	Net Federal Expenditures	Rank		Net Federal Expenditures	Rank
District of Columbia	72,292.40	1	Utah	3,618.10	27
Alaska	11,123.10	2	Kansas	3,575.04	28
Hawaii	10,732.90	3	Iowa	3,545.22	29
New Mexico	9,906.86	4	North Carolina	3,481.73	30
Virginia	9,761.25	5	Pennsylvania	3,463.92	31
Maryland	8,417.70	6	Oregon	3,367.20	32
West Virginia	8,364.84	7	Connecticut	3,357.49	33
Kentucky	7,812.20	8	Georgia	3,292.85	34
Alabama	7,657.33	9	Washington	3,271.60	35
Mississippi	7,515.26	10	Wisconsin	2,936.53	36
Montana	6,872.75	11	Nevada	2,555.03	37
Vermont	6,712.04	12	Indiana	2,359.73	38
Maine	6,549.42	13	New Hampshire	2,202.86	39
North Dakota	6,541.87	14	Colorado	2,067.92	40
South Dakota	6,386.79	15	Massachusetts	1,695.27	41
South Carolina	6,313.02	16	California	1,621.30	42
Idaho	5,167.19	17	Texas	1,455.53	43
Arizona	5,115.76	18	Rhode Island	1,235.08	44
Puerto Rico	4,696.73	19	Arkansas	240.06	45
Wyoming	4,258.14	20	New York	108.37	46
Louisiana	4,102.91	21	Ohio	-8.67	47
Missouri	4,057.49	22	Illinois	-77.94	48
Oklahoma	4,025.22	23	Nebraska	-602.30	49
Florida	4,005.04	24	New Jersey	-4,310.79	50
Tennessee	3,829.12	25	Minnesota	-4,449.54	51
Michigan	3,753.68	26	Delaware	-8,018.41	52

Source: See text.

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[1] Arthur MacEwan is Professor Emeritus of Economics at the University of Massachusetts Boston. J. Tomas Hexner is an independent consultant based in Cambridge, Massachusetts.

[2] A reader might wonder how so many more states can receive net positive federal expenditures while relatively few are net negative recipients. However, because in both 2004 and 2010 the federal government ran deficits, the total net positive flows of funds to the states will outweigh the negative flows (though there are some funds that do not go to the states—e.g., foreign expenditures). Furthermore, the tables show per capita figures. If the table figures were weighted by states' populations, the balance would be different—though the existence of the federal deficit would still be evident in the mix of positive and negative figures in the tables.

7. Congressional Task Force on Economic Growth in Puerto Rico Report to the House and Senate

Introduction

On June 30, 2016, the Puerto Rico Oversight, Management, and Economic Stability Act, or "PROMESA," was enacted into law as Public Law 114-187. Section 409 of PROMESA established an eight-member "Congressional Task Force on Economic Growth in Puerto Rico" ("Task Force"). In July 2016, in accordance with Section 409(b), two members of the Task Force were appointed by House Speaker Paul Ryan, two members were appointed by House Minority Leader Nancy Pelosi, two members were appointed by Senate Majority Leader Mitch McConnell, and two members were appointed by Senate Minority Leader Harry Reid.

Keywords: Puerto Rico debt, PROMESA, bankruptcy, level playing field, status, statehood, investment, infrastructure, bonds, sovereignty, control board, federal expenditures, transfer, welfare, U.S. territory, EITC, CTC)

Congressional Task Force on Economic Growth in Puerto Rico, Chairman, Senator Orrin Hatch (R-Utah).

The members appointed are as follows:

- Representative Sean Duffy (R-Wisconsin), appointed by House Speaker Paul Ryan;
- Representative Tom MacArthur (R-New Jersey), appointed by House Speaker Paul Ryan;
- Resident Commissioner Pedro Pierluisi (D-Puerto Rico), appointed by House Minority Leader Nancy Pelosi;
- Representative Nydia Velázquez (D-New York), appointed by House Minority Leader Nancy Pelosi;
- Senator Orrin Hatch (R-Utah), appointed by Senate Majority Leader Mitch McConnell;
- Senator Marco Rubio (R-Florida), appointed by Senate Majority Leader Mitch McConnell;
- Senator Robert Menendez (D-New Jersey), appointed by Senate Minority Leader Harry Reid; and
- Senator Bill Nelson (D-Florida), appointed by Senate Minority Leader Harry Reid.

Pursuant to Section 409(d), Speaker Ryan designated Senator Hatch to serve as chairman of the Task Force.

Section 409(f) required the Task Force to provide a "status update" to the House and Senate between September 1, 2016 and September 15, 2016, containing "information the Task Force has collected" and "a discussion on matters the chairman of the Task Force deems urgent for consideration by Congress." On September 15th, the Task Force published this status update in both English and Spanish.

Section 409(g) requires the Task Force to produce a report, by December 31, 2016, regarding:

> "(1) impediments in current Federal law and programs to economic growth in Puerto Rico including equitable access to Federal health care programs;
>
> (2) recommended changes to Federal law and programs that, if adopted, would serve to spur sustainable long-term economic growth, job creation, reduce child poverty, and attract investment in Puerto Rico;
>
> (3) the economic effect of Administrative Order No. 346 of the Department of Health of the Commonwealth of Puerto Rico (relating to natural products, natural supplements, and dietary supplements) or any successor or substantially similar order, rule, or guidance of the Commonwealth of Puerto Rico; and
>
> (4) additional information the Task Force deems appropriate."

This document is the report mandated by Section 409(g). Having issued this report, the Task Force now terminates, consistent with Section 409(l).

1. Sources of Information

To prepare this report, the Task Force obtained information from various sources.

First, on August 4, 2016, the Task Force issued a press release announcing the creation of an email portal and encouraged stakeholders to submit their recommendations to this portal. The Task Force initially announced a deadline of September 2nd for submissions to the portal. However, on September 6th, the Task Force issued a press release extending the deadline until October 14th in order to ensure that stakeholders had sufficient opportunity to provide input.

The Task Force received approximately 450 submissions via the email portal. **Appendix 1** of this report contains an alphabetized table that lists the individuals and organizations that made written submissions, including hyperlinks to each submission and any attachments. Submissions made after the October 14th deadline are included in the table, but marked as late.

The Task Force is grateful to the individuals and organizations who took time to provide submissions to the email portal, as well as to those who visited Capitol Hill—many of them traveling from Puerto Rico—to expand upon their submission. It is clear that there are many people who care deeply about Puerto Rico, who want the island to prosper, and who have thoughtful suggestions for how it can overcome its challenges and reach its potential. In preparing this report, and crafting its recommendations, the Task Force was guided by its own appreciation for Puerto Rico and desire to see it succeed.

The Task Force does note that many submissions to the email portal offer recommendations that are local rather than federal in nature, and would therefore be more properly addressed to—and by—the government of Puerto Rico than to—and by—Congress or federal executive branch agencies. Accordingly, the Task Force recommends that Puerto Rico's elected and appointed leaders, as well as the members and staff of the Financial Oversight and Management Board ("Oversight Board") established by Section 101 of PROMESA, carefully review the submissions in Appendix 1.

Second, the Task Force organized a series of formal staff-level briefings with federal agencies. Here is a list of those briefings:

- August 12: Federal Reserve Bank of New York
- September 20: U.S. Small Business Administration
- September 30: U.S. Department of Energy
- October 4: Community Development Financial Institutions Fund (U.S. Department of the Treasury)
- October 7: U.S. Department of Health and Human Services
- October 11: U.S. Department of the Treasury
- October 14: U.S. Environmental Protection Agency
- October 21: U.S. Census Bureau (U.S. Department of Commerce), Bureau of Labor Statistics (U.S. Department of Labor), and National Agricultural Statistics Service (U.S. Department of Agriculture)
- October 28: Bureau of Economic Analysis (U.S. Department of Commerce), Economic Development Administration (U.S. Department of Commerce), International Trade Administration (U.S. Department of Commerce), and Minority Business Development Agency (U.S. Department of Commerce)

Third, the Task Force consulted with non-partisan congressional support organizations. Specifically, it consulted with analysts at the Congressional Research Service (CRS) about a wide range of federal policy matters pertaining to Puerto Rico, and with analysts at the Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT) about the budgetary impact of spending and revenue proposals related to Puerto Rico. The Task Force also reviewed reports written by CRS, JCT, and the U.S. Government Accountability Office (GAO) regarding Puerto Rico. Since CRS does not release its reports to the public, the Task Force exercised its right to make the relevant CRS products public, and has linked to these products in this report.

Fourth, Section 409(j) of PROMESA required the Task Force to consult with the Puerto Rico Legislative Assembly, the Puerto Rico Department of Economic Development and Commerce (DDEC, in its Spanish-language acronym), and the private sector of Puerto Rico—and the Task Force has fulfilled that mandate.

Finally, the Task Force staff held a conference call with the Secretary of the Puerto Rico Department of Health, Dr. Ana Rius Armendariz, to discuss Administrative Order 346, issued by the Department on February 9, 2016.

2. Organization of Report

This report is organized as follows. Following this "Introduction" section, there is a "Background" section that includes two subsections. Subsection 1 presents a brief overview of the economic, fiscal and demographic situation in Puerto Rico. Subsection 2 provides information on Puerto Rico's treatment under federal programs. As explained in Subsection 2, in an effort to inform policymakers and the public, the Task Force has prepared a table of approximately 40 federal programs that allocate resources to states and territories according to a formula, where that formula treats Puerto Rico differently than the states. That table appears in **Appendix 2**. The "Background" section is followed by the "Discussion and Recommendations" section, which contains the Task Force's recommendations to Congress, federal agencies, and the government of Puerto Rico. Recommendations are organized by subject matter area or by federal agency. Since Section 409(g) of PROMESA makes clear that the Task Force should focus on federal laws and programs, recommendations to the government of Puerto Rico are purposefully limited in scope, confined to areas where there is a strong federal nexus.

Section 409(h) of PROMESA instructs the Task Force that, "[t]o the greatest extent practicable," the Task Force report "shall reflect the shared views of all eight Members." Consistent with that directive, where the Task Force does make a specific recommendation, that recommendation reflects a consensus among the members. Section 409(h) authorizes a member, or multiple members, to publish dissenting views, but no member has elected to do so.

The Task Force notes that a number of its recommendations also apply to the four other U.S. territories—American Samoa, Guam, the Northern Mariana Islands, and the United States Virgin Islands, which (to varying degrees) face considerable challenges of their own.

3. Statement of Purpose

The 3.4 million U.S. citizens in Puerto Rico confront significant economic, financial, and social challenges. A review of Puerto Rico's history demonstrates that these challenges are enduring, not transitory. In recent years, the challenges have grown more severe, and have attracted more attention from policymakers and the public.

The Task Force is of the view that Puerto Rico's best days lie before it, not behind it. It is a fact that residents of Puerto Rico, who have greatly contributed to this nation in times of both war and peace, are as talented and as hard-working as their fellow citizens living anywhere else in the country.[1] It is also a fact that they have not always been well served by their leaders in San Juan or in Washington, DC. The Task Force believes that the people of Puerto Rico deserve a strong, stable and diversified economy. Judging from the written submissions that the Task Force received through the email portal, there is no shortage of important economic development work being performed or planned in Puerto Rico.[2]

The Task Force hopes this report will contribute to a brighter future in Puerto Rico. At the same time, the Task Force offers a word of caution to those expecting a "federal solution" to each of Puerto Rico's problems. There are certain challenges in Puerto Rico—such as an outdated energy system, a troubled K-12 public education system, and inefficiencies in various other sectors—that must be tackled first and foremost by the government of Puerto Rico and the private sector.

The members of the Task Force have worked across party lines to identify steps that can be taken to help Puerto Rico's economy stabilize and grow. The Task Force hopes that its work will serve as a platform for continued bipartisan efforts to support the American citizens in Puerto Rico.

Background

1. Overview of Economic, Fiscal and Demographic Situation in Puerto Rico

Individual members of the Task Force have a range of views on PROMESA itself, which authorizes public entities in Puerto Rico to restructure their debts pursuant to a process prescribed by law, and establishes a seven-member Oversight Board to temporarily supervise or otherwise be involved in decision-making by the government of Puerto Rico on budgetary, fiscal, and debt restructuring matters.[3] However, the members of the Task Force concur that

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[1] For example, the director of the Minority Business Development Agency within the U.S. Department of Commerce informed the Task Force that an executive from the world's largest aerospace company told her that many of the company's best engineers are recruited from Puerto Rico, which is home to one of the leading engineering schools in the nation (the University of Puerto Rico at Mayagüez). Similarly, representatives of biotechnology firms operating in Puerto Rico regularly cite the productivity and technical proficiency of the locally-educated, locally-trained workforce.

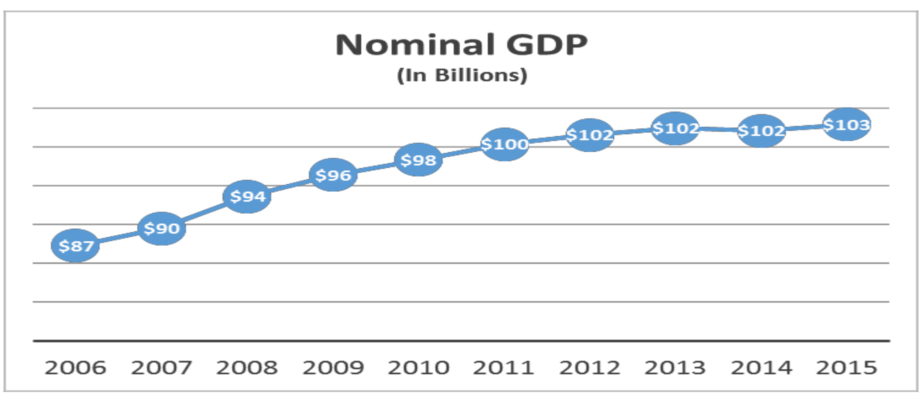
[2] For a sampling of many possible examples, see Appendix 2 for submissions from Parallel18; the Puerto Rico Science, Technology, and Research Trust; the Aeronautical and Aerospace Institute of Puerto Rico; the Puerto Rico Chapter of the Association of Information Technology Professionals; the Foundation for Puerto Rico; Non-Profit Community Service Organizations in Puerto Rico (*Red de Fundaciones de Puerto Rico* and *Una Sola Voz*); the Puerto Rico Community Foundation; the Puerto Rico Information Technology Cluster; and the Youth Development Institute.

[3] For an overview of PROMESA, see D. Andrew Austin et al, The Puerto Rico Oversight, Management, and Economic Stability Act, Congressional Research Service, July 1, 2016.

PROMESA is a product of the grave economic, fiscal and demographic situation in Puerto Rico. The crisis has multiple root causes, and a discussion of those causes is beyond the scope of this report. Nevertheless, it is clear that Puerto Rico faces formidable challenges.

The Task Force will summarize current conditions on the island with a series of bullet points. Because Puerto Rico is a U.S. jurisdiction, the 50 states and the District of Columbia serve as an appropriate point of comparison. As discussed later in the report, many federal statistical programs that collect and publish state-by-state economic data do not collect and publish data for Puerto Rico. Likewise, economic data produced by the government of Puerto Rico are often unreliable or untimely, although efforts are underway to make improvements in this area. Accordingly, the Task Force was not able to obtain as much information about Puerto Rico's economy and government finances as it would have liked. Nevertheless, sufficient information exists to form a reasonably accurate picture of the territory's economy.

- Puerto Rico's economy is typically measured using gross national product (GNP), rather than gross domestic product (GDP). Puerto Rico's GNP is calculated by the Puerto Rico Planning Board (*Junta de Planificación de Puerto Rico*). According to the Statistical Appendix to the Puerto Rico Planning Board's Fiscal Year 2015 Economic Report to the Governor and Legislative Assembly, Puerto Rico's real GNP—measured in constant *1954* dollars—contracted every year between Fiscal Year 2006 ($7.4 billion) and Fiscal Year 2015 ($6.3 billion), except for one year of slight growth between Fiscal Year 2011 ($6.43 billion) and Fiscal Year 2012 ($6.47 billion).[4] In nominal terms, Puerto Rico's GNP increased from $57.9 billion in Fiscal Year 2006 to $68.5 billion in Fiscal Year 2015, and its GDP increased from $87.3 billion in Fiscal Year 2006 to $102.9 billion in Fiscal Year 2015.[5]

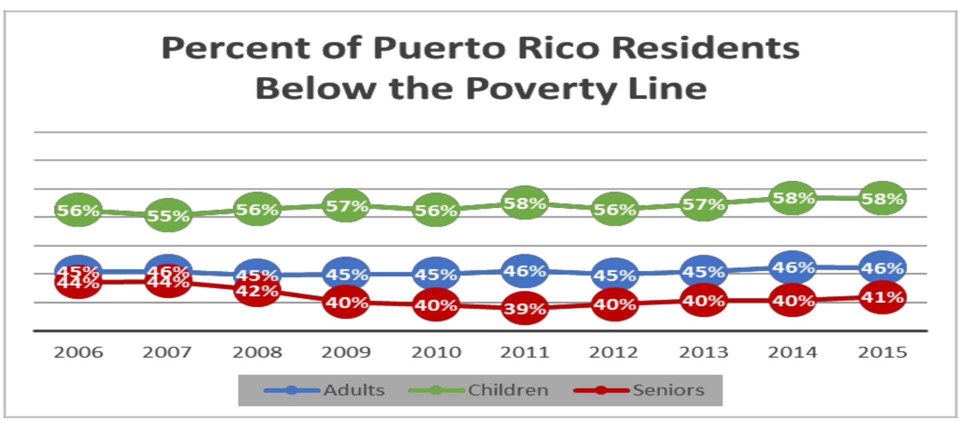


[4] See Statistical Appendix, page A-6.

[5] See Statistical Appendix, page A-1.

- The Puerto Rico Fiscal Agency and Financial Advisory Authority (FAFAA), formerly the Puerto Rico Government Development Bank (GDB), maintains an Economic Activity Index (EAI) that consists of four factors: (1) payroll employment, (2) electric power generation, (3) cement sales, and (4) gasoline consumption. Between August 2005 and August 2016, the EAI fell by approximately 20 percent, from nearly 160.0 to 124.1.

- According to the U.S. Census Bureau's 2015 Puerto Rico Community Survey and the 2015 American Community Survey, 46.1 percent of Puerto Rico residents live below the federal poverty level, compared to a national average of 14.7 percent.[6] Of Puerto Rico residents under age 18, 58.3 percent live below the federal poverty level, compared to a national average of 20.7 percent. Of children in Puerto Rico under age 5, 63.7 percent live below the federal poverty level, compared to a national average of 22.8 percent. Of Puerto Rico seniors age 65 and older, 41 percent live below the federal poverty level, compared to about 9 percent nationally.



[6] To corroborate the Census Bureau data referenced in this report, readers can use the "Advanced Search" function on American FactFinder, available here.

- According to the 2015 Puerto Rico Community Survey, median household income in Puerto Rico is $18,626, with 83.3 percent of island households earning less than $50,000 per year. In the states and the District of Columbia, median household income is $56,515. The state with the lowest median household income is Mississippi, at $40,593. According to May 2015 data from the Bureau of Labor Statistics (BLS) within the U.S. Department of Labor, the median hourly wage for workers in Puerto Rico is $9.61, while the median hourly wage in the states and the District of Columbia is $17.40.

- According to BLS, Puerto Rico's unemployment rate in October 2016 was 12.1 percent, while the national unemployment rate was 4.9 percent and the state with the highest unemployment rate was Alaska at 6.8 percent. According to historical state-by-state BLS unemployment data, which have been published since January 1976, Puerto Rico's unemployment rate has always been several percentage points or more higher than the state with the highest unemployment rate. From January 1976 to December 1989, Puerto Rico's average unemployment rate was about 19 percent. From January 1990 to December 1999, it was about 14 percent. From January 2000 to December 2009, it was about 12 percent. And from January 2010 to October 2016, it was about 14 percent.

- According to BLS, the number of persons employed in Puerto Rico peaked in December 2006 at 1,277,559. In October 2016, that figure was 987,606—a 23 percent reduction.[7] According to the Puerto Rico Planning Board, even when employment was at its peak in Puerto Rico in 2006, the labor force participation rate was 48.6 percent.[8] In 2015, the labor force participation rate was 39.9 percent.[9] According to BLS, the national labor force participation rate is approximately 63 percent.

- Puerto Rico has a large informal or "underground" economy, which refers to activities and income that are partially or fully outside of government regulation (e.g., minimum wage laws and workplace safety laws) and taxation (e.g., income tax and employment tax). Although the size of Puerto Rico's informal economy is, by definition, difficult to measure with precision, estimates about its size generally range from about 15 percent of GNP to about 20 percent of GNP. The existence of a large informal economy has a number of negative effects, chief among them the erosion of Puerto Rico's individual and corporate tax base,

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[7] The employment decline in this period—23 percent—was significantly larger than the population decline—about 8 percent—during the same period.

[8] The labor force participation rate measures the labor force—the sum of employed individuals and unemployed individuals who do not have a job and are looking for work—as a percentage of the non-institutionalized population age 16 and older.

[9] See Statistical Appendix, page A-62.

which deprives the government of revenue needed to finance operations, provide services, and meet debt obligations.

- According to the proposed Fiscal Plan and Appendix presented to the Oversight Board by the government of Puerto Rico on October 14, 2016, Puerto Rico's aggregate public sector debt stock is $68.7 billion, which is roughly equal to Puerto Rico's nominal GNP. Puerto Rico's public sector debt as a percentage of GNP grew steadily starting in Fiscal Year 2001, when it was about 60 percent of GNP. In 2005, it was about 70 percent of GNP. In 2009, it was about 90 percent of GNP. By 2013, it was about 102 percent of GNP.[10] According to a 2014 report published by the Federal Reserve Bank of New York (FRBNY)—which oversees the Second District of the Federal Reserve System, which encompasses Puerto Rico—Puerto Rico's public debt to GNP ratio is "far higher" than the public debt to GDP ratio of any state.[11]

- According to the Independent Auditors Report accompanying the government of Puerto Rico's audited financial statements for Fiscal Year 2013-Fiscal Year 2014, which were not released until July 1, 2016, the main public pension systems in Puerto Rico—the Puerto Rico Teachers Retirement System (TRS), the Puerto Rico Government Employees Retirement System (ERS), and the Puerto Rico Judiciary Retirement System (JRS)—"are at risk of becoming insolvent."

    - As of June 30, 2015, the TRS reported a net pension liability of $15.0 billion with a "funded ratio"—the value of assets as a percentage of total pension liability—of 8.1 percent.

    - As of June 30, 2015, the ERS—which provides retirement benefits to former central government employees, municipal government employees, and employees of all but one public corporation—is in a *negative* funded position, when assets are considered net of pension obligation bond proceeds. ERS reported a net pension liability of $33.2 billion with a funded ratio of -1.8 percent.

[10] See Testimony of Sergio M. Marxuach, Center for a New Economy, Hearing on "Financial and Economic Challenges in Puerto Rico," Senate Committee on Finance, September 29, 2015, at page 25; Carlos A. Colón De Armas, Submission to Congressional Task Force on Economic Growth in Puerto Rico, at page 12; D. Andrew Austin, Puerto Rico's Current Fiscal Challenges: In Brief, Congressional Research Service, June 3, 2016, at page 10.

[11] See Federal Reserve Bank of New York, An Update on the Competitiveness of Puerto Rico's Economy, July 31, 2014, at page 16.

- As of June 30, 2015, the JRS net pension liability was $542.6 million, with a funded ratio of 7.3 percent.

($ thousands)	ERS 2015	TRS 2015	JRS 2015
Total Pension Liability (TPL)	32,669,162	16,307,731	585,312
Actuarial Value of Assets (net)	(578,633)	1,313,148	42,729
Net Pension Liability	33,247,795	14,994,583	542,583
Net Position as % of TPL	-1.8%	8.1%	7.3%

- According to the U.S. Census Bureau, Puerto Rico's population was 3,808,610 in 2000. The island's population peaked in 2004, at 3,826,878 and has decreased every year since then. Puerto Rico's population in 2015 stood at 3,474,182. From the 2004 peak, that is a loss of 352,696 persons, or 9.2 percent. Researchers at the FRBNY have called the population loss in the territory "staggering" and published multiple reports examining its nature and implications.[12] According to the 2015 American Community Survey, there are now 5.4 million individuals of Puerto Rican birth or descent living in the 50 states and the District of Columbia, up from 3.8 million in 2005. Of those 5.4 million, 1.7 million were born in Puerto Rico, up from 1.3 million in 2005.

- According to the FRBNY, the mortgage delinquency rate (the percentage of mortgage balances that are more than 90 days due) in both Puerto Rico and the United States as a whole rose sharply between 2005 and 2009. While the delinquency rate in the United States has since fallen to about 2 percent, the delinquency rate in Puerto Rico—which peaked in 2010 at 8 percent—"has remained stubbornly high, at 7 percent." The FRBNY notes that "[s]erious delinquency rates on other forms of debt in Puerto Rico also remain well above those on the mainland."

- FRBNY researchers have identified a number of challenges facing Puerto Rico—such as the need to improve labor market opportunities, develop human capital, lower the costs of doing business, mobilize financing for business development and growth, and reduce dependence on the "shrinking" pharmaceutical industry—and presented a series of corresponding policy recommendations.[13] While the Task Force does not necessarily endorse all of the policy

[12] See, e.g., Migration in Puerto Rico: Is There a Brain Drain?, Liberty Street Economics, August 9, 2016; Population Lost: Puerto Rico's Troubling Out-Migration, Liberty Street Economics, April 13, 2015; The Causes and Consequences of Puerto Rico's Declining Population, Current Issues in Economics and Finance (Volume 20, Number 4; 2014).

[13] See, e.g., Federal Reserve Bank of New York, A Report on the Competitiveness of Puerto Rico's Economy, June 29, 2012; Federal Reserve Bank of New York, An Update on the Competitiveness of Puerto Rico's Economy, July 31, 2014; William C. Dudley, President and Chief Executive Officer,

recommendations of the FRBNY researchers, it does believe they are worthy of study and debate.

- A decade ago, researchers from across the political spectrum, organized by the Brookings Institution and the Puerto Rico-based Center for the New Economy (CNE), authored a series of academic papers on obstacles to economic growth in Puerto Rico, and policies that could help overcome those obstacles, and these papers were compiled in a 2006 book.[14] Many of the challenges identified at the time remain challenges today, and some have become more severe. Corrective actions that could have been taken at the time were not, in part because of Puerto Rico's excessive reliance on debt financing. While the Task Force does not necessarily endorse all of the policy recommendations contained in the Brookings-CNE book, it does believe that the book remains a useful tool for policymakers thinking about Puerto Rico.

2. Puerto Rico's Treatment Under Federal Programs

The U.S. Supreme Court has held that the Territory Clause of the U.S. Constitution (Article IV, Section 3, Clause 2) authorizes Congress to treat territories differently than states under federal laws and programs as long as there is a "rational basis" for the differential treatment. Congress generally determines whether Puerto Rico and the four other territories are eligible for federal programs on a case-by-case basis, and defines any differential treatment in law. Puerto Rico is treated the same as the states under certain federal programs, and differently than the states under other federal programs.

Federal law provides that a bona fide resident of Puerto Rico is generally not required to pay federal tax on income he or she earns in Puerto Rico (except for income earned by the roughly 9,400 federal government employees on the island), and that a corporation organized in Puerto Rico is generally treated as a foreign corporation for U.S. tax purposes, and therefore is generally not required to pay federal tax on its Puerto Rico-source income.[15]

Federal Reserve Bank of New York, "Opportunities for Economic Growth in Puerto Rico," November 29, 2016.

[14] See The Economy of Puerto Rico: Restoring Growth, edited by Susan M. Collins, Barry P. Bosworth, and Miguel A. Soto-Class (CNE/Brookings 2006).

[15] For information on Puerto Rico's treatment under federal tax law, see Federal Tax Law And Issues Related To The Commonwealth Of Puerto Rico, Joint Committee on Taxation, September 28, 2015 (JCX-132-15); Puerto Rico, Information on How Statehood Would Potentially Affect Selected Federal Programs and Revenue Sources, Government Accountability Office, March 2014 (GAO-14-31); and Sean Lowry, Tax Policy and U.S. Territories: Overview and Issues for Congress, Congressional Research Service, October 7, 2016.

In those instances when Congress does choose to treat Puerto Rico differently than the states under a particular federal assistance program that is funded by appropriations made from the general fund of the United States, Congress often relies, either explicitly or implicitly, on the argument that such differential treatment is warranted because individuals and businesses in Puerto Rico do not contribute federal income taxes into the general fund to the same degree and extent as their counterparts in the states.

The tax treatment of U.S. corporations operating in Puerto Rico is more complex. U.S. corporations are subject to federal income tax on their worldwide earnings. Generally, income earned by the active business operations of U.S. corporations in Puerto Rico is considered foreign-source income. Federal tax on active corporate income earned in Puerto Rico by foreign *subsidiaries* of U.S. corporations—known as controlled foreign corporations (CFCs)—can be deferred until these earnings are "repatriated" to the United States in the form of dividend distributions to the U.S. parent corporation. However, federal tax on the income earned by foreign *branches* of U.S. corporations is not deferrable. A foreign subsidiary is a legal entity separate from its parent company, while a foreign branch is an extension of a domestic company. Most, but not all, U.S. corporations with active business operations in Puerto Rico are organized as CFCs.

Federal law generally requires individuals and businesses in Puerto Rico to pay federal tax on income they earn outside of Puerto Rico, whether in the United States or in a foreign country. Federal law also requires employers and employees in Puerto Rico to pay all federal payroll taxes, which fund the Old Age, Survivors, and Disability Insurance program (Social Security), the Medicare hospital insurance program, and the federal unemployment compensation program. According to the 2015 Internal Revenue Service Data Book, the IRS collected $3.52 billion in federal taxes on individuals and businesses in Puerto Rico in Fiscal Year 2015.[16]

With the assistance of CRS, the Task Force has created a table of approximately 40 federal programs that allocate resources according to a formula, as distinct from programs that allocate resources on a competitive basis, under which Puerto Rico is treated differently than the states and, in certain cases, differently than other territories. The table, which appears in **Appendix 3**, is intended to be thorough but not exhaustive. It provides: (1) the name of the program; (2) the federal executive branch agency that administers the program; (3) the congressional committees in the Senate and the House with jurisdiction over the program; and (4) a description of Puerto Rico's differential treatment under the program. The table also includes certain programs that allocate resources but do not fall within the commonly-understood definition of a formula-based program.

[16] See Internal Revenue Service Data Book, at page 12, Table 5.

This table is intended solely to provide factual information to policymakers and the public. Reference to a program should not be interpreted to signify either support for or opposition to Puerto Rico's differential treatment under the program on the part of the Task Force. Later in the report, the Task Force will make recommendations pertaining to several of these programs.

With respect to federal programs that allocate resources on a competitive basis, rather than pursuant to a formula prescribed in law, the Task Force's informed judgment is that entities in Puerto Rico—whether it be the central government, municipal governments, for-profit firms, or non-profit organizations—tend to fare poorly relative to entities in other jurisdictions, and often do not apply for available funding or apply unsuccessfully. While there is no simple way to reverse this trend, the Task Force believes that steps should be taken by Puerto Rico-based entities to better familiarize themselves with competitive funding opportunities across the federal government, and that the government of Puerto Rico and federal agencies should enhance their respective efforts to provide these entities with information and technical assistance.

In addition, the Task Force is aware of numerous instances in which the government of Puerto Rico has received a formula-based or competitive grant from the federal government, but has not utilized all of that funding within the applicable time frame, thereby requiring the return of unused funding to the federal treasury. Although this problem is not unique to Puerto Rico, it does appear to be more pronounced on the island compared to other jurisdictions, based on information provided to the Task Force. The Task Force urges the government of Puerto Rico as a whole, and each Puerto Rico agency individually, to scrutinize its grant management system so as to reduce such funding reversions to the greatest extent possible. The Task Force further urges the government of Puerto Rico to make appropriate use of available federal support services in this area. Every federal grant dollar returned by the local government is a missed opportunity to assist the people of Puerto Rico.

Discussion and Recommendations

1. Health Care

Section 409(g)(1) of PROMESA requires the Task Force to make recommendations regarding impediments in current federal law and programs to economic growth in Puerto Rico, "including equitable access to federal health care programs."

On October 7th, the Task Force held a staff-level briefing with officials from the U.S. Department of Health and Human Services (HHS). The Task Force also spoke to a wide range of stakeholders in Puerto Rico's health care community. In addition, numerous individuals and organizations made submissions via the Task Force's email portal that discuss this topic. Finally, the Task Force consulted an analysis of the subject prepared by CRS.[17]

A. Medicaid

The Task Force believes that the future financing of the Medicaid program in Puerto Rico is a serious and urgent issue facing federal policymakers attempting to address the territory's economic and social challenges.

Members of the Task Force have differing views regarding the proper role of the federal government in financing federal health programs in general and the Medicaid program in particular, as well as regarding the relative merits of the 2010 Patient Protection and Affordable Care Act (ACA; P.L. 111-148, as amended). However, Task Force members agree that, irrespective of these larger policy disagreements and the congressional debates they will continue to generate in the coming years, an equitable and sustainable legislative solution to the financing of Puerto Rico's Medicaid program should be enacted early in 2017.

Medicaid is a joint federal-state program that finances the delivery of medical services for low-income individuals. In Fiscal Year 2015, Medicaid (including the State Children's Health Insurance Program, or CHIP) is estimated to have provided health care services to 73 million individuals at a total cost of $509 billion in federal and state expenditures.

Puerto Rico's Medicaid program, known locally as Mi Salud, has about 1.4 million enrollees, which is over 40 percent of the island's population, a higher proportion than the 50 states and the District of Columbia. Like numerous states, Puerto Rico uses a managed care system to deliver Medicaid services. The territory's Medicaid agency contracts with managed care organizations that accept a set per-member, per-month payment, known as a capitation payment.

Federal Medicaid funding to the states and the District of Columbia is open-ended—that is, not subject to any cap. The federal government reimburses each state for a portion of the state's Medicaid expenditures. The federal share is known as the federal medical assistance percentage (FMAP). The FMAP is determined by a formula set in statute and varies by state, with a higher reimbursement rate provided to states with lower per capita incomes, and vice versa.[18] There is a statutory minimum FMAP rate of 50 percent and a statutory maximum FMAP rate of 83

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[17] See Annie L. Mach et al, Puerto Rico and Health Care Finance: Frequently Asked Questions, Congressional Research Service, June 27, 2016.

[18] As of Fiscal Year 1998, the District of Columbia's FMAP rate is set by statute at 70 percent. Without this exception, it would be at the statutory minimum of 50 percent.

percent.[19] In Fiscal Year 2016, nine states, including the District of Columbia, had an FMAP rate of 70 percent or above, with Mississippi having the highest at 74.17 percent.[20]

By contrast, in Puerto Rico and the other territories, federal Medicaid funding is subject to an annual cap pursuant to Section 1108 of the Social Security Act (42 U.S.C. 1308). The cap increases annually according to the change in the Consumer Price Index for All Urban Consumers (CPI-U). Once the annual federal funding cap is reached, the territory government is responsible for the remaining cost of all Medicaid services. Puerto Rico's annual cap in Fiscal Year 2016 was $335.3 million.[21]

Also in contrast to the states, the FMAP rates for the territories are not based on per capita income, but rather are fixed in federal statute. Prior to July 1, 2011, the statutory FMAP rate for the territories was 50 percent. If the FMAP rates for the territories were calculated based on per capita income, each territory would have an FMAP rate in the 70 to 80 percent range.[22]

Members of the Task Force recognize that the ACA contained both positive and negative elements for the territories' Medicaid programs, insofar as the law provided additional funding but made that funding temporary. Specifically, the ACA provided for a one-time increase in Medicaid funding for the territories of $7.3 billion, of which Puerto Rico received $6.4 billion. The ACA also permanently increased the territories' statutory FMAP rate from 50 percent to 55 percent—still below the FMAP rate each territory would receive if its rate were based on per capita income.

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[19] This discussion involves the "regular" FMAP rate. Current federal law provides for higher—"enhanced"—FMAP rates for certain services or population groups, which is not pertinent for present purposes.

[20] This information is drawn from Alison Mitchell, "Medicaid's Federal Medical Assistance Percentage (FMAP)," Congressional Research Service, February 9, 2016.

[21] According to the Centers for Medicare and Medicaid Services, Puerto Rico's annual cap was $45 million in Fiscal Year 1983, $79 million in Fiscal Year 1993, $207.3 million in Fiscal Year 2003, and $280 million in Fiscal Year 2010. The Fiscal Year 2016 cap was $11.1 million for American Samoa, $5.9 million for the Northern Mariana Islands, $16.3 million for Guam, and $16.8 million for the U.S. Virgin Islands.

[22] According to CRS, Puerto Rico's FMAP rate would likely be 83 percent, the maximum rate allowable under current Medicaid law. See Annie L. Mach et al, Puerto Rico and Health Care Finance: Frequently Asked Questions, Congressional Research Service, June 27, 2016, at page 25, footnote 88.

To date, according to CMS, Puerto Rico has drawn down all but approximately $1 billion of this $6.4 billion in supplemental funding.[23] Based on CMS's projections, Puerto Rico's supplemental funding will be depleted before the end of calendar year 2017, a date that has come to be known as the "Medicaid cliff." Once Puerto Rico depletes this supplemental funding, it will revert to receiving only its annual capped federal Medicaid allotment, which is expected to be $357.8 million in Fiscal Year 2018.[24]

Members of the Task Force understand the often-heard argument that Puerto Rico does not receive state-like treatment under Medicaid because the program is financed from the general fund of the United States, and individuals and businesses in Puerto Rico are not required under federal law to contribute to the general fund to the same degree and extent as their counterparts in the states. Some members of the Task Force believe that different treatment on the tax- contribution side of the ledger may warrant different treatment on the federal outlay side of the ledger. Other members of the Task Force do not subscribe to this view. However, all members of the Task Force believe that, even if differential tax treatment may potentially serve as an argument against *equal* treatment for Puerto Rico under Medicaid, more *equitable* treatment should still be considered.

While it would be wrong to attribute Puerto Rico's annual deficits and accumulated debt solely, or even mainly, to the disproportionate burden it bears in financing its Medicaid program, it would also be wrong to deny that this funding disparity has been a meaningful factor contributing to Puerto Rico's fiscal condition.

Inadequate federal financing for Puerto Rico's Medicaid program long pre-dates the 2010 ACA. It will remain an urgent problem whether the ACA is retained or not.

Inadequate federal financing for Puerto Rico's Medicaid program may "save" federal taxpayer dollars in the short term. However, over time, these savings are likely to be at least partially offset by the additional costs borne by the federal government and state governments as a result of conditions-based migration from Puerto Rico to the U.S. mainland. The costs will be

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[23] Puerto Rico drew down an average of $917 million in supplemental funding annually between Fiscal Year 2012 and Fiscal Year 2016. In Fiscal Year 2012, the first full year in which this funding was available, Puerto Rico drew down $564 million. In Fiscal Year 2016, the most recent completed fiscal year, Puerto Rico drew down $1.3 billion.

[24] In addition to its annual capped federal allotment under Section 1108 of the Social Security Act, Puerto Rico receives CHIP funding ($180 million in Fiscal Year 2016); so-called enhanced allotment program (EAP) funding under Section 1935 of the Social Security Act ($49 million in Fiscal Year 2016, less than half of which it was able to utilize, as detailed in the "Medicare Part D" section below); electronic health records (EHR) funding ($35 million in Fiscal Year 2014); and administrative funding for its Medicaid Management Information System (MMIS; $900,000 in Fiscal Year 2014).

particularly significant for states, like Florida, that are popular destinations for individuals from Puerto Rico.

If Congress does not enact legislation to avoid the impending Medicaid cliff, the consequences for the health care system in Puerto Rico are likely to be severe. The government of Puerto Rico, which currently lacks the ability to borrow money in the capital markets to fill the large hole that will be left by the loss of federal funding, would presumably be compelled either to drop hundreds of thousands of current enrollees from the Medicaid program (harming quality of life and spurring outmigration) or to reallocate funds from other areas, such as payments to creditors and the provision of public services.

The approaching Medicaid cliff, a foreseeable consequence of the funding structure established in the ACA's provisions regarding the territories, presents policymakers with the need to address this issue in the near term. Given its magnitude, the cliff is certain to disrupt any existing stability in the provision of health care services in Puerto Rico for a large number of beneficiaries.

The Task Force makes the following recommendations:

- The Task Force believes that Puerto Rico and the other territories should be treated in a more equitable and sustainable manner under the Medicaid program, in order to improve patient outcomes in the territories, to strengthen the health care systems in the territories, to enhance federal oversight of those systems, to reduce the incentive for migration from the territories to the states and the associated financial costs to state governments and the federal government, and to stabilize and strengthen the fiscal condition of the territory governments. To that end, the Task Force recommends that **Congress** enact fiscally-responsible legislation to address the impending Medicaid cliff established by the ACA. The Task Force recommends that Congress begin to address the funding issue early in calendar year 2017 to enable the Puerto Rico Medicaid agency to engage with more certainty when formulating capitation payment contracts with its managed care organizations for Puerto Rico Fiscal Year 2017-2018, which begins on July 1, 2017. In addition, the Task Force recommends that, going forward, federal financing of the Medicaid programs in Puerto Rico and the other territories should be more closely tied to the size and needs of the territory's low-income population. Finally, the Task Force recommends that any additional federal Medicaid funding provided to Puerto Rico must be paired with appropriate oversight of and safeguards on Puerto Rico's Medicaid program through use of the MFCU and MMIS mechanisms.

- Federal law requires every state, the District of Columbia, and each U.S. territory to operate a Medicaid Fraud Control Unit (MFCU) to investigate and prosecute Medicaid provider fraud and patient abuse or neglect under state law, unless the state or territory receives a waiver by

demonstrating to the satisfaction of the Secretary of HHS that the operation of a MFCU would not be cost-effective.[25] MFCUs are typically part of the state Attorney General's office; employ teams of investigators, attorneys, and auditors; and must be separate and distinct from the state Medicaid agency. Currently, 49 states (North Dakota being the exception) and the District of Columbia have MFCUs. Federal law provides for an enhanced
FMAP rate to support MFCUs. None of the five territories operate a MFCU, presumably inhibited from doing so because of the annual federal Medicaid funding cap that applies to the territories.[26] The Task Force recommends that **Congress** enact legislation to remove the current disincentive to establish MFCUs that exists in the territories as a consequence of the annual funding cap.[27] Once that occurs, the Task Force recommends that the government of Puerto Rico establish a MFCU.

- States and territories are required to operate an automated claims processing and information retrieval system, or Medicaid Management Information System (MMIS), to administer their state Medicaid plans. The overarching purpose of an MMIS is to enhance the efficiency and improve the internal controls over a jurisdiction's Medicaid program and to minimize the potential for waste, fraud and abuse. Puerto Rico is already working with CMS to develop an MMIS, with \$55 million—\$46 million in federal funding and \$9 million in local funding—having been committed to this effort to date. In the written agreements between CMS and the government of Puerto Rico, there are several clearly-delineated targets and milestones to be achieved. The Task Force recommends that **Congress** ensure that Puerto Rico's ongoing efforts to construct its MMIS continue to completion in compliance with the funding agreements with CMS, and believes that it is appropriate to require continued progress on the MMIS and achievement of targets and milestones set forth in the agreements with CMS as a condition for additional federal Medicaid funding.

[25] See Social Security Act 1902(a)(61), 1903(q).

[26] See Testimony of John Hagg, Director of Medicaid Audits, Office of Inspector General, U.S. Department of Health and Human Services, Hearing on "Strengthening Medicaid Program Integrity and Closing Loopholes," House Committee on Energy and Commerce, September 11, 2015, at page 5 (noting that "[t]he major barrier to establishing a MFCU in Puerto Rico and the other territories is the nature of Medicaid funding for the territories," since "the territories receive a capped appropriation to provide both Medicaid services and most administrative costs, which would include operation of a MFCU").

[27] See H.R. 3444, Medicaid and CHIP Territory Fraud Prevention Act (114th Congress; Rep. Pitts), bipartisan legislation that would accomplish this objective.

B. Medicare

I. Medicare Part A

Medicare is a federal program that pays for covered health care services to individuals over age 65 and certain individuals with disabilities. Medicare Part A provides coverage for inpatient hospital services, as well as services like skilled nursing, home health, and hospice care. Unlike hospitals in the other territories, which are paid on a cost basis, subject to certain limitations, hospitals in Puerto Rico are paid using a prospective payment system that is comparable to the Medicare inpatient prospective payment system (IPPS) created to pay hospitals in the 50 states. Hospitals in Puerto Rico are not included in Medicare's current definition of a "subsection (d) hospital"—which denotes hospitals located in the states. Congress enacted a separate prospective payment system for "subsection (d) Puerto Rico hospitals" in the Omnibus Budget Reconciliation Act of 1986, effective for payments starting in Fiscal Year 1986.

Eligible hospitals in the states and Puerto Rico that treat a certain share of low-income patients can receive additional payments—called Medicare Disproportionate Share Hospital (DSH) payments—to offset the financial effects of treating such patients. Prior to Fiscal Year 2014, DSH payments were provided by a single statutory formula that increased the inpatient prospective payment system (IPPS) reimbursement amount based on the disproportionate patient percentage (DPP). The DPP was based on a hospital's share of low-income patients, defined as the share of Medicare inpatient days for individuals entitled to federal Supplemental Security Income (SSI) benefits out of a hospital's total Medicare inpatient days (Medicare/SSI), plus the share of Medicaid inpatient days out of the hospital's total inpatient days.

In Fiscal Year 2014 and subsequent years, DSH funding has been split into two payments with separate methodologies: (1) "empirically justified" DSH payments, which continue to be based on the traditional DPP, but are limited to 25 percent of the DSH payments that they would have received under prior law; and (2) "uncompensated care pool" fixed DSH payments, which are defined as 75 percent of aggregated operating DSH payments as calculated under the prior DSH formula, multiplied by 1 minus the annual percentage decline in the national uninsured rate. In Fiscal Year 2017, as a proxy for hospital uncompensated care data, the uncompensated care pool will be allocated to hospitals based on their share of Medicaid and Medicare SSI days relative to all other hospitals that receive DSH payments. CMS currently projects a 44 percent decline in the national uninsurance rate between 2013 and 2017, estimating that approximately $6 billion will be allocated through the DSH uncompensated care pool in 2017.

Currently, Medicare/SSI is a factor in calculating each of the two different DSH payments. However, Congress has not extended the SSI program to Puerto Rico. Instead, Puerto Rico continues to use its own prior income-related disability payment program, called AABD. While

Puerto Rico hospitals may provide care to certain individuals living on the mainland who are eligible for SSI, the vast majority of Puerto Rico residents are ineligible for SSI. Therefore, using Medicare SSI days as a portion of total Medicare days to calculate the DSH uncompensated care pool payment formula—along with the failure to design a payment methodology that appropriately accounts for days provided to patients in both the Puerto Rico disability program and the SSI program—do place Puerto Rico hospitals at a disadvantage.

The Secretary of HHS, using administrative authority in the Fiscal Year 2017 Medicare IPPS final rule, modified the uncompensated care pool payment formula to use 14 percent of a Puerto Rico hospital's Medicaid days as a proxy for Medicare/SSI days. The Secretary did not use a proxy for Medicare/SSI in the empirically justified DSH payment formula, noting that the DPP is prescribed in statute for empirically justified DSH.

The Task Force makes the following recommendation:

- Because the SSI program does not apply in Puerto Rico, the Task Force recommends that **Congress** consider providing increased flexibility to the Secretary of HHS to identify data collection and analysis gaps that could be used to improve the accuracy and efficiency of Medicare DSH payments to Puerto Rico hospitals. For example, one possibility would be to develop a policy that uses a proxy that updates the empirically justified DSH payment formula calculation for subsection (d) Puerto Rico hospitals.

II. Medicare Part B

Medicare Part B provides coverage for physicians' services, outpatient hospital services, durable medical equipment, outpatient dialysis, and other medical services. Residents of every state and territory *other than Puerto Rico* who are receiving Social Security benefits are automatically enrolled in both Part A and Part B, with coverage beginning the first day of the month they turn 65. In addition, disabled individuals who have received cash payments for 24 months under the Social Security disability programs are automatically enrolled in Part B unless they decline such coverage. Because beneficiaries must pay a premium for Part B coverage, they have the option of opting out of Part B coverage.

Those individuals who are not automatically enrolled in Medicare—for example, because they have not filed for Social Security benefits—must file an application for Part A and Part B with the Social Security Administration during their seven-month initial enrollment period, which begins three months before the month in which they turn 65. Beneficiaries who do not sign up for Part B during this initial enrollment period may have to pay a late-enrollment penalty for as long as they are enrolled in Part B. The late-enrollment penalty increases Part B monthly premiums by 10 percent for each full 12-month period that one could have had Part B but did not sign up for it. Certain low-income beneficiaries may qualify for Part B premium assistance from Medicaid through a Medicare Savings Program (MSP). Beneficiaries in an MSP are not subject to late-enrollment penalties regardless of when they signed up for Medicare.

Under federal law, when residents of Puerto Rico turn 65 and start receiving Social Security benefits, they are automatically enrolled in Part A, but not automatically enrolled in Part B. Instead, beneficiaries in Puerto Rico are required to take the affirmative step of enrolling in Part B during their seven-month initial enrollment period. If they fail to enroll, they are subject to a lifetime late-enrollment penalty.[28]

The lack of an automatic Part B enrollment process in Puerto Rico has resulted in a disproportionate number of Medicare beneficiaries in Puerto Rico paying the lifetime late-enrollment penalty. Puerto Rico does not have an MSP program, so low-income beneficiaries subject to this penalty may be responsible for paying the full penalty amount in addition to their premiums. According to CMS, there are currently 5,739 Medicare beneficiaries in Puerto Rico who are paying a lifetime penalty for enrolling late in Part B. In addition, according to CMS, there are 108,678 individuals in Puerto Rico who are currently enrolled in Part A only, not Part B. Many of those individuals, if they do elect to enroll in Part B, will be subject to a lifetime late enrollment penalty.

The Task Force makes the following recommendations:

- The Task Force recommends that **Congress** amend federal law so that, going forward, Medicare beneficiaries in Puerto Rico are automatically enrolled in Medicare Part B with the option to opt out of coverage, the same way their counterparts in every state and other territory are treated.

- As long as Puerto Rico remains the only U.S. jurisdiction where Medicare beneficiaries are required to opt in to Part B coverage, the Task Force recommends that the **Centers for Medicare and Medicaid Services** and the **Social Security Administration** take timely and targeted steps to educate island residents about the existence of the opt-in requirement and the financial consequences of late enrollment.

III. Medicare Part C

The Medicare Advantage program, or Medicare Part C, gives Medicare beneficiaries the option to receive covered benefits from private health plans that are paid a per-member, per-month amount to provide services covered by the traditional Medicare fee-for-service program for Part A and B benefits. Many Medicare Advantage plans provide additional supplemental benefits,

[28] See Social Security Act 1837(f)(3).

such as dental and vision. According to CRS, in May 2015, 75 percent of Medicare beneficiaries in Puerto Rico were enrolled in an MA plan, compared with 32 percent of beneficiaries in the 50 states and the District of Columbia. More than half of MA enrollees in Puerto Rico are in a special type of MA plan called a Special Needs Plan (SNP). While there are three different types of SNPs, nearly half of Puerto Rico beneficiaries are enrolled in a Dual-Eligible SNP (D-SNP), which is a plan that enrolls individuals who are eligible for both Medicare and Medicaid.[29] Dual eligible beneficiaries tend to experience high rates of chronic illness and multiple chronic conditions.

To address the needs of this particular population, the 2017 Medicare Advantage Final Call Letter included a number of policies to improve stability in the Medicare Advantage program in Puerto Rico. These policies include a change in payment that CMS estimates will result in increased revenue for MA plans in Puerto Rico. More specifically, the following policies have been adopted through the 2017 Medicare Advantage Final Call Letter:

- A change in the risk adjustment model that will increase payments to plans with high proportions of full benefit dual eligible beneficiaries, which CMS estimates will benefit Puerto Rico more than any other state or territory;

- An adjustment to the fee-for-service payment basis for plans in 2017 to reflect the higher payments made to hospitals in Puerto Rico in 2016;

- An adjustment to the weighting of the enrollment and risk scores for Medicare beneficiaries based on the nationwide proportion (rather than Puerto Rico alone) of Medicare beneficiaries enrolled in both Parts A and B in fee-for-service that have no Medicare claim reimbursements for a year. CMS applied a 4.4 percent adjustment to the pre-standardized Puerto Rico fee-for-service rates to help develop the benchmarks for 2017; and

- Changes to the Star Ratings System to reflect socioeconomic status specifically related to low income subsidy/dual eligible and/or disability status.[30]

The Task Force makes the following recommendation:

- The Task Force notes that the Medicare Advantage penetration rate continues to grow in the United States more generally as well as in Puerto Rico specifically, where the penetration

[29] See Annie L. Mach et al, Puerto Rico and Health Care Finance: Frequently Asked Questions, Congressional Research Service, June 27, 2016, at page 15.

[30] See generally Centers for Medicare and Medicaid Services, Supporting Medicare in Puerto Rico, April 4, 2016.

rate is higher than in any other U.S. jurisdiction. As more Medicare beneficiaries choose to enroll in the Medicare Advantage program, the Task Force recommends that **Congress** and **the Centers for Medicare and Medicaid Services** consider whether additional legislative or administrative steps may be warranted to ensure that MA plans, including those in Puerto Rico, are being fairly and properly compensated for the services they provide to beneficiaries.

IV. Medicare Part D

Medicare Part D provides an outpatient prescription drug benefit, either through private prescription drug plans that offer only drug coverage or through Medicare Advantage prescription drug plans that offer coverage as part of broader, managed-care plans. In the states and the District of Columbia, Medicare beneficiaries with incomes up to 150 percent of the federal poverty level are eligible to receive a low-income subsidy (LIS) from the federal government, which reduces or eliminates their monthly premium and other out-of-pocket costs associated with Part D.

Pursuant to federal law, residents of the territories are not eligible for the LIS.[31] In lieu of the LIS, federal law provides a fixed amount of funding to each territory to provide *Medicaid* coverage of prescription drugs for low-income Medicare beneficiaries. This funding is provided pursuant to Section 1935(e) of the Social Security Act, and is referred to as the enhanced allotment program (EAP). Currently, annual EAP funding to Puerto Rico is between $40 million and $50 million. This is substantially less than the aggregate amount of financial support that low-income Medicare beneficiaries in Puerto Rico would receive if residents of the territories were eligible for the LIS.

Each territory government is required to match its EAP funding at its regular Medicaid FMAP rate of 55 percent. This means for every dollar a territory spends on providing Medicaid coverage for prescription drugs to low-income Medicare beneficiaries, the territory draws down 55 cents from its allotted Section 1935(e) funding, up to the annual limit, and is responsible for the remaining 45 cents.

Because of the local match requirement, the territories (to varying degrees) have struggled to draw down EAP funding, often leaving much of the funding unused despite a significant need for the funding. For example, between Fiscal Year 2010 and Fiscal Year 2016, Puerto Rico has

[31] See Social Security Act 1860D-14(a)(3)(F).

been able to draw down only about 51 percent of its EAP funding, as reflected in the following chart.[32]

	EAP Allotment	PR Draw Down	Percentage
FY 2010	$49,339,617	$49,339,618	100.0%
FY 2011	$51,701,315	$23,716,209	45.87%
FY 2012	$43,580,880	$17,357,642	39.83%
FY 2013	$44,156,704	$21,818,368	49.41%
FY 2014	$42,361,118	$16,936,666	39.98%
FY 2015	$44,040,604	$9,240,022	20.98%
FY 2016	$49,171,794	$28,332,152	57.61%
FY 2010 – FY 2016	**$324,352,032**	**$166,740,677**	**51.41%**

The Task Force makes the following recommendations:

- The Task Force recommends that **Congress** eliminate the requirement that each territory government meet a local Medicaid matching requirement in order to draw down its annual EAP funding. The Task Force notes that the matching requirement has prevented the government of Puerto Rico and other territory governments from effectively utilizing EAP funding to help low-income Medicare beneficiaries purchase prescription drugs. The Task Force further recommends that Congress consider increasing the annual EAP allotment for each territory by a reasonable amount and in a fiscally responsible manner, so that the allotment is more closely tethered to actual need in each territory. Finally, the Task Force recommends that Congress explore the feasibility and cost of extending the LIS to residents of the territories and eliminating the EAP program.[33]

V. CMS Administrative Flexibility

Because Puerto Rico and the other territories are treated differently than the states under federal health statutes, it is not uncommon for a literal interpretation by the Centers for Medicare and

[32] The data underlying this computation were provided by CMS. In addition, according to CMS data, the percentage of EAP funding utilized by the U.S. Virgin Islands between Fiscal Year 2010 and Fiscal Year 2016 was only 27 percent. The percentage utilized by American Samoa, Guam and the Northern Mariana Islands between Fiscal Year 2010 and Fiscal Year 2014 (more recent data have not been provided to the Task Force) was 94 percent, 81 percent, and 93 percent, respectively. However, there have been recent fiscal years in which both Guam and the Northern Mariana Islands drew down less than 55 percent of their EAP funding.

[33] See S. 2342, Territories Medicare Prescription Drug Assistance Equity Act of 2015 (114th Congress; Sen. Nelson); H.R. 4163, Territories Medicare Prescription Drug Assistance Equity Act of 2015 (114th Congress; Rep. Pierluisi); and Section 215 of S. 2675, Puerto Rico Recovery Act of 2016 (114th Congress; Sen. Menendez).

Medicaid Services of a statutory formula that provides for payments to physicians, hospitals or health plans to lead to anomalous results for Puerto Rico that may not have been intended by Congress, as evidenced by the Medicare Part A example discussed above.

The Task Force makes the following recommendation:

- The Task Force recommends that **Congress** consider providing the Centers for Medicare and Medicaid Services with flexibility to make reasoned and justifiable adjustments to a formula providing for payments to physicians, hospitals or health plans in Puerto Rico and the other territories. Use of this flexibility should be limited to any formula that is dependent in whole or in part on data that are not available or not reliable as it pertains to the territories, or dependent on factors that are inapplicable to the territories.

C. Family-to-Family Health Information Center Grant Program

The Family-to-Family Health Information Center Grant program, called the F2F program, is administered by the Health Resources and Services Administration (HRSA) within HHS.[34]

The F2F program was established as part of the Family Opportunity Act, which was included in the Deficit Reduction Act of 2005 (P.L. 109-171). Pursuant to the program, HRSA makes competitive grants on an annual basis to support Family-to-Family Health Information Centers. These centers are primarily non-profit organizations operated by families with children and youth with special health care needs, and they provide education, training, peer support, and expertise in navigating health care systems for other families of children and youth with special health care needs. The law establishing the program makes grants available to support a single center in each of the 50 states and in the District of Columbia, but not in Puerto Rico or the other U.S. territories.[35] The F2F program is currently funded at $5 million per year. Funding is distributed equally among centers in every state and the District of Columbia, with each center receiving about $95,000 per year, regardless of the state's population.[36]

The Task Force makes the following recommendation:

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[34] See Family Voices, Submission to Congressional Task Force on Economic Growth in Puerto Rico; Coralaidee Jimenez, Submission to Congressional Task Force on Economic Growth in Puerto Rico.

[35] See 42 U.S.C. 701(c)(5).

[36] In the 113th Congress, the Senate Finance Committee approved S. 1871, the SGR Repeal and Medicare Beneficiary Access Act of 2013. Section 323 of S. 1871, which did not ultimately become law, would have made the territories eligible for the F2F program. See Senate Report 113-135, at page 56.

- The Task Force recommends that **Congress** consider amending the law authorizing the Family-to-Family Health Information Center Grant program to enable Puerto Rico and the other territories to participate in the program, in a manner that does not dilute the funding currently available to the states and the District of Columbia.

D. Maternal, Infant, and Early Childhood Home Visiting Program

The Maternal, Infant, and Early Childhood Home Visiting Program, also known as the Federal Home Visiting Program, is administered by the Health Resources and Services Administration (HRSA) within HHS. The program supports home visiting services for families with young children who reside in communities that have concentrations of poor child health and other risk indicators. Home visits are conducted by nurses, mental health clinicians, social workers, or others with specialized training.

The law does not specify how funds are to be allocated to eligible entities in the states and territories. In practice, HRSA distributes Federal Home Visiting Program funds by both formula and competitive awards and, on its face, the funding formula treats states and territories the same. Between Fiscal Year 2010 and Fiscal Year 2015, funding was distributed according to the relative share of children under age five in families at or below 100 percent of the federal poverty line living in each state and territory. However, the poverty data are derived from the U.S. Census Bureau's Small Area Income Poverty Estimates (SAIPE), which are not available for the territories. There was a $1 million funding minimum for state and territory grantees, and HRSA allocated this minimum level of funding to each of the territories from Fiscal Year 2011 through Fiscal Year 2015.

For Fiscal Year 2016, HRSA redesigned the funding allocation for formula grants. About one-third of funding is still allocated based on the share of children under age five in families at or below 100 percent of the federal poverty line in each state and territory, using 2013 SAIPE data that are not available for the territories. About two-thirds of funding is allocated based on the amount of competitive awards a state or territory received under the Federal Home Visiting Program between Fiscal Year 2013 and Fiscal Year 2015. There continues to be a $1 million funding minimum for state and territory grantees, and each territory received the base allocation of $1 million in Fiscal Year 2016.

The Task Force makes the following recommendation:

- The Task Force recommends that the **Health Resources and Services Administration**, when allocating funds to Puerto Rico under the Federal Home Visiting Program, utilize an appropriate alternative source for child poverty data, such as the Puerto Rico Community Survey, given that the data source currently used by HRSA to make allocations—the U.S.

Census Bureau's Small Area Income Poverty Estimates (SAIPE)—does not include the territories.

2. Federal Tax Policy

A. Federal Tax Policy Toward Individuals and Families

The Task Force examined federal tax policy toward individuals and families residing in Puerto Rico and the other U.S. territories. The Task Force, which was directed by Section 409(g)(2) of PROMESA to recommend changes to federal law that could spur economic growth, reduce child poverty and attract investment to Puerto Rico, is making a specific recommendation related to the child tax credit. The Task Force is also making a broader recommendation on the subject of federal tax policy toward individuals and families in the territories to help guide federal policymakers going forward.

Under current law, the child tax credit (CTC) allows a family to reduce its federal tax liability—the taxes owed before tax credits are applied—by a maximum of $1,000 per child. The CTC phases out for higher-income families.[37]

The CTC is refundable, meaning that if the value of the credit exceeds the amount of tax a family owes, the family may be eligible to receive a full or partial refund of the difference. The refundable portion of the credit is often called the additional child tax credit (ACTC). Families may receive the child tax credit as a reduction in tax liability (the non-refundable portion of the credit), a refundable credit (the ACTC), or a combination of both. For example, a family with two qualifying children and a tax liability of $1,500 may receive the $2,000 child tax credit ($1,000 per child) as a $1,500 reduction in their tax liability and a $500 refund.

In the states and the District of Columbia, the amount of the ACTC is generally calculated using the earned income formula. Under this formula, a family may claim an ACTC equal to 15 percent of the family's earnings in excess of $3,000, not to exceed the maximum credit amount ($1,000 multiplied by the number of qualifying children). For example, a three-child family with annual earnings of $20,000 would be eligible for an ACTC of $2,550: [($20,000 - $3,000) x .15].

Families with three or more children in the states and the District of Columbia may choose to calculate the ACTC using either the earned income formula or an alternative formula. The alternative formula is the family's federal payroll taxes (7.65 percent of earnings) minus the value of any earned income tax credit (EITC) the family received, not to exceed the maximum credit amount ($1,000 multiplied by the number of qualifying children). In the relatively

[37] See Section 24 of the Internal Revenue Code.

infrequent event that the ACTC calculated under the alternative formula is larger than the ACTC calculated under the earned income formula, the larger credit can be claimed, but the credit can never exceed $1,000 per qualifying child.

Under current law, families in Puerto Rico with one child or two children are generally not eligible for the ACTC. While families in Puerto Rico with three or more children are eligible for the ACTC, they must calculate their credit using the alternative formula, which caps the ACTC at the amount of annual federal payroll taxes the family pays. This is in contrast to their stateside counterparts, who can calculate their credit using either the earned income formula or the alternative payroll tax formula.

Families in Puerto Rico with three or more children claim the ACTC by filing Form 1040-SS directly with the Internal Revenue Service within the U.S. Department of the Treasury. The Form and accompanying instructions both make explicit that the ACTC can only be claimed by island families with three or more children.

The Task Force makes the following recommendations:

- The Task Force recommends that **Congress** amend Section 24 of the Internal Revenue Code to authorize otherwise eligible families in Puerto Rico with one child or two children to claim the additional child tax credit, with the amount of the credit equal to the amount of annual federal payroll taxes paid by the family or $1,000 per qualifying child, whichever is lower.[38] This legislative change will provide the same treatment to families in Puerto Rico with one child or two children that is currently provided to island families with three or more children, reducing incentives for island families with less than three qualifying children to claim on Form 1040-SS that they have three or more qualifying children in order to receive the ACTC. It has been estimated that this proposal could benefit about 355,000 newly- eligible families and 404,000 newly-eligible children in Puerto Rico, with an average credit for all Puerto Rico families of $770, which will help reduce child poverty on the island.

- Although the Task Force reached consensus on the child tax credit, the Task Force does not intend to foreclose debate on whether further modifications to federal tax policy toward individuals and families in Puerto Rico may be appropriate. To the contrary, the Task Force recommends that **Congress** carefully consider this topic. Potential options for examination include: (1) authorizing Puerto Rico families to claim the additional child tax credit using the earned income formula, not merely the alternative payroll tax formula; (2) extending the

[38] The Task Force recommends that Congress make a functionally equivalent legislative change for American Samoa, Guam, the Northern Mariana Islands, and the U.S. Virgin Islands.

earned income tax credit to eligible Puerto Rico households,[39] and (3) providing federal wage subsidies to employees and employers in Puerto Rico.[40]

Because the Task Force received numerous recommendations to extend the earned income tax credit (EITC) to Puerto Rico, the Task Force will address this topic briefly even though no consensus was reached. While there is some disagreement among Task Force members regarding the appropriateness of extending the EITC to workers in Puerto Rico, there is agreement that Puerto Rico's low labor force participation rate significantly contributes to the island's economic and fiscal problems. Studies have shown that the EITC increases labor force participation and reduces child poverty, but may have other effects on work incentives in phase- out ranges.

As noted elsewhere in the report, members of the Task Force understand that residents of Puerto Rico are not required to pay federal income taxes on their Puerto Rico-source income. However, like many of their fellow American citizens in the 50 states and the District of Columbia who receive the EITC and do not earn enough to incur a federal income tax liability, workers in Puerto Rico are subject to all federal payroll taxes. Notwithstanding the current absence of consensus, members of the Task Force agree that extension of the EITC to Puerto Rico both poses challenges and presents opportunities, and recommends that Congress explore ways to minimize the challenges and maximize the opportunities.

B. Other Federal Tax Provisions

I. Cover Over of Rum Excise Tax Revenues to Puerto Rico and the U.S. Virgin Islands

Federal excise taxes collected on rum produced in Puerto Rico and transported to the states are covered over—paid—to the treasury of Puerto Rico, and federal excise taxes collected on rum produced in the U.S. Virgin Islands and transported to the states are covered over to the treasury of the U.S. Virgin Islands. In addition, federal excise taxes collected on rum imported to the United States from foreign countries are covered over to Puerto Rico and the U.S. Virgin Islands pursuant to a formula established by the Alcohol and Tobacco Tax and Trade Bureau within the U.S. Department of the Treasury.[41] The primary purpose of the cover-over program is to help

[39] See S. 2203, Earned Income Tax Credit and Child Tax Credit Equity for Puerto Rico Act of 2015 (114th Congress; Sen. Menendez); and H.R. 3553, Earned Income Tax Credit Equity for Puerto Act of 2015 (114th Congress; Rep. Pierluisi).

[40] See S. 3503, Economic Mobility for Productive Livelihoods and Expanding Opportunity (EMPLEO) Act (114th Congress; Sen. Rubio).

[41] See Section 7652 of the Internal Revenue Code.

the two territories provide essential public services. The use of funding for public purposes is particularly critical now that the government of Puerto Rico is struggling to fund its health, education and public safety systems.

Federal excise taxes are imposed on rum at the generally applicable distilled spirits rate of $13.50 per proof gallon.[42] Under current law, excise tax collections on imported rum, including rum produced in Puerto Rico and the U.S. Virgin Islands, are covered over to Puerto Rico and the U.S. Virgin Islands at the rate of $13.25 per proof gallon. Of this amount, $10.50 per proof gallon is in permanent law and the remaining $2.75 per proof gallon requires periodic reauthorization by Congress as part of tax extenders legislation. The additional $2.75 per proof gallon was most recently extended through December 31, 2016 as part of the Consolidated Appropriations Act, 2016 (P.L. 114-113).

The Task Force makes the following recommendations:

- The Task Force recommends that **Congress** make the full amount of the rum cover-over payment to Puerto Rico and the U.S. Virgin Islands permanent, rather than permanent in part and subject to tax extenders legislation in part. The Task Force further recommends that Congress increase the cover-over payment from the current rate of $13.25 per proof gallon to the generally applicable distilled spirits rate, currently $13.50 per proof gallon. At a minimum, the Task Force recommends that Congress extend the additional $2.75 per proof gallon component of the rum cover-over payment beyond 2016. Failure to extend the provision will cause harm to Puerto Rico's (and the U.S. Virgin Islands') fiscal condition at a time when it is already in peril.

II. Domestic Production Activities in Puerto Rico

The domestic production activities deduction, also known as the domestic manufacturing deduction, was established as part of the American Jobs Creation Act of 2004 (P.L. 108-357).[43] Under current law, Section 199 allows a company to receive a deduction equal to 9 percent of the taxable income that the company derives from "qualified production activities" within the United States. This effectively reduces the top federal tax rate that a company will pay on such income from 35 percent to 32 percent. "Qualified production activities" include, among other things: manufacturing; electricity, natural gas and water production; film production; and construction. Overall, about one-third of corporate activity nationwide qualifies for the deduction.

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[42] See Section 5001 of the Internal Revenue Code.

[43] See Section 199 of the Internal Revenue Code; see also Federal Tax Law And Issues Related To The Commonwealth Of Puerto Rico, Joint Committee on Taxation, September 28, 2015 (JCX-132-15).

Although the American Jobs Creation Act of 2004 did not authorize a company to receive the Section 199 deduction on income derived from qualified production activities within Puerto Rico, the Tax Relief and Healthcare Act of 2006 (P.L. 109-432) expanded Section 199 to include activities in Puerto Rico. However, the provision extending the Section 199 deduction to Puerto Rico applies on a temporary basis and therefore requires periodic reauthorization by Congress through tax extenders legislation. The provision has been extended five times since 2006, most recently in the Consolidated Appropriations Act, 2016 (P.L. 114-113), and is scheduled to expire on December 31, 2016. The Section 199 deduction is only available to U.S. companies that operate in Puerto Rico in branch form, which—in contrast to U.S. companies that operate in Puerto Rico in subsidiary form—are subject to full U.S. tax on the income from those operations on an immediate basis.

The Task Force makes the following recommendation:

- As long as the Section 199 domestic production activities deduction remains part of U.S. tax law, the Task Force believes that it should apply in Puerto Rico, a U.S. jurisdiction home to American workers. The Task Force recommends that **Congress** amend Section 199 so that it applies to Puerto Rico on a permanent basis. At a minimum, the Task Force recommends that Congress—for the sixth time since 2006—extend the provision beyond 2016. Failure to extend the provision will create a disincentive for existing and new U.S. businesses to conduct manufacturing operations in Puerto Rico, an outcome that Congress should seek to avoid.

III. Special Expensing Rules for Film and Television Productions

Section 181 of the Internal Revenue Code allows a U.S. taxpayer to immediately deduct the cost of a qualified film, television, or live theatrical production, up to $15 million (or $20 million in the case of a production in certain low-income or economically distressed areas). This provision was most recently extended in the Consolidated Appropriations Act, 2016 (P.L. 114-113), and is scheduled to expire on December 31, 2016. To be a "qualified production," 75 percent of the total compensation of the production must be "qualified compensation."[44] The term "qualified compensation" is defined as "compensation for services performed in the United States by actors, directors, producers, and other relevant production personnel."[45] The term "United States" means the 50 states and the District of Columbia, not Puerto Rico or the other U.S. territories.[46]

[44] See Section 181(d)(1).

[45] See Section 181(d)(3).

[46] See Treasury Regulation Section 1.181-3(d), September 30, 2011.

The Task Force makes the following recommendation:

- As long as Section 181 remains part of U.S. tax law, the Task Force recommends that **Congress** amend Section 181 to include Puerto Rico and the other territories within the definition of "United States." The Task Force believes that Puerto Rico should have the same opportunity as the 50 states and the District of Columbia to generate economic activity and employment opportunities through film, television, and theatrical production, and notes that the ability to showcase local culture and scenery before global film and television audiences can significantly stimulate tourism.

C. Federal Tax Policy Toward Businesses

As long as Puerto Rico remains a U.S. territory, and not a state or a sovereign nation, there will be a vigorous debate regarding how businesses with activities in Puerto Rico should be taxed by the federal government.

This debate has historical, philosophical and public policy dimensions. The debate is historical because there continues to be a dispute over the impact of a now-repealed provision in the Internal Revenue Code, the Section 936 "Puerto Rico and Possession Tax Credit," which was enacted in 1976 and fully phased out by 2006.

Section 936 provided tax preferences for territory activities, enabling U.S. corporations to pay preferred rates on income generated by their Puerto Rico affiliates, thereby creating a "substantial incentive for U.S. investment in [Puerto Rico]."[47] Some assert that enactment of Section 936 was critical in promoting economic development in Puerto Rico and that its repeal was detrimental to economic growth and investment on the island.[48] Others argue that the economic benefits for Puerto Rico of Section 936 were overstated and inefficient. Critics of 936 point to a GAO study which found that tax benefits to corporations often exceeded wages paid, sometimes by a ratio of more than two to one.[49] The GAO report noted that, while Section 936

[47] See Sean Lowry, Tax Policy and U.S. Territories: Overview and Issues for Congress, Congressional Research Service, October 7, 2016, at page 15; see also Federal Tax Law And Issues Related To The Commonwealth Of Puerto Rico, Joint Committee on Taxation, September 28, 2015 (JCX-132-15).

[48] See, e.g., Hon. Alejandro García Padilla, Submission to Congressional Task Force on Economic Growth in Puerto Rico; and Puerto Rico Private Sector Coalition, Submission #1 to Congressional Task Force on Economic Growth in Puerto Rico.

[49] See Puerto Rico and the Section 936 Tax Credit, Government Accounting [subsequently, Accountability] Office, June 8, 1993 (GAO-93-109), at pages 4, 5, 9 (observing that "[s]ignificant debate continues over the effectiveness of section 936 as an impetus for development in Puerto Rico," and noting "[c]oncerns about the tax benefits in relation to employment" on the island).

provided substantial incentive for U.S. investment in Puerto Rico, "an increasing portion of total income produced in Puerto Rico [went] to U.S. and foreign investors [rather] than to Puerto Rican residents."[50] In light of these and other data, some economists have argued that the decline of manufacturing jobs in Puerto Rico coincided with the repeal of Section 936, but was primarily attributable to other factors, including automation and other technological advancements at manufacturing facilities, increased import competition from other countries, and the reduction in manufacturing employment nationwide.[51]

Naturally, the debate over previous and current federal business tax policies toward Puerto Rico affects the debate over what federal tax policy toward Puerto Rico should be pursued by the next Congress. Speaking generally, those with more positive views toward Section 936 tend to look more favorably upon the prospect of a new tax incentive targeted at Puerto Rico, while those with more neutral or negative views toward Section 936 tend to look more skeptically upon the prospect of a new tax incentive aimed at the island. Those in the latter category do not necessarily oppose a new federal tax policy to encourage investment in Puerto Rico, but prefer that it be a policy of general applicability designed to encourage investment in economically-distressed areas throughout the country, including but not limited to Puerto Rico.[52]

The Task Force makes the following recommendations:

- The Task Force believes that Puerto Rico is too often relegated to an afterthought in congressional deliberations over federal business tax reform legislation. The Task Force recommends that **Congress** make Puerto Rico integral to any future deliberations over tax reform legislation.

- The Task Force recommends that **Congress** continue to be mindful of the fact that Puerto Rico and the other territories are U.S. jurisdictions, home to U.S. citizens or nationals, and that jobs in Puerto Rico and the other territories are American jobs.

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[50] See Puerto Rico and the Section 936 Tax Credit, Government Accounting [subsequently, Accountability] Office, June 8, 1993 (GAO-93-109), at page 12.

[51] See, e.g., Arthur MacEwan and J. Tomas Hexner, Submission #6 to Congressional Task Force on Economic Growth in Puerto Rico.

[52] See, e.g., Arthur MacEwan and J. Tomas Hexner, Submission #2 to Congressional Task Force on Economic Growth in Puerto Rico (urging Congress to enact legislation establishing "Investment Zones" in order to "supply a strong incentive for firms to establish new operations and expand existing operations in those economically depressed areas of the country"; noting that this legislation "would apply to the whole country as a national policy, [but] the benefits to Puerto Rico would be especially large").

- The Task Force is open to the prospect of **Congress** providing U.S. companies that invest in Puerto Rico with more competitive tax treatment as long as appropriate guardrails are designed to ensure the company is creating real economic activity and employment on the island.

3. Energy

On September 30th, the Task Force held a staff-level briefing with officials from the U.S. Department of Energy (USDOE) to discuss Puerto Rico's electricity generation and distribution system. There is a consensus that the high cost and low reliability of electric power in Puerto Rico is one of the most serious challenges confronting households and businesses, and a significant obstacle to economic growth on the island.[53]

Puerto Rico has no conventional energy resources, and relies heavily on shipments of imported fuel to generate electricity. According to the U.S. Energy Information Administration (EIA) profile on Puerto Rico, in 2015 Puerto Rico generated 51 percent of its electricity from petroleum, 31 percent from natural gas, 16 percent from coal, and 2 percent from renewable sources (predominantly wind, solar and hydropower). The numbers provided by the Puerto Rico Electric Power Authority (PREPA) are different than the EIA numbers, and appear to indicate that Puerto Rico currently generates close to 62 percent of its electricity from petroleum and less than 19 percent from natural gas. To place this in context, according to the EIA, in 2015 the 50 states and the District of Columbia generated 33 percent of their electricity from natural gas, another 33 percent from coal, 20 percent from nuclear, 13 percent from renewable sources, and only 1 percent from petroleum.[54] Few, if any, observers question the conventional wisdom that Puerto Rico should take steps to reduce its disproportionate reliance on petroleum and increase its use of natural gas—of which the United States is now the world's largest producer—and renewable energy sources like solar power if economically viable.[55]

The price of electricity in Puerto Rico is high, while the ability of some residents of Puerto Rico—where the median annual income is $18,626—to pay is low. According to the EIA, the average price of electricity sold to the residential sector in Puerto Rico between 2005 and 2015

[53] See, e.g., William C. Dudley, President and Chief Executive Officer, Federal Reserve Bank of New York, "Opportunities for Economic Growth in Puerto Rico," November 29, 2016.

[54] According to the EIA, American Samoa, Guam, the Northern Mariana Islands, and the U.S. Virgin Islands generate all or nearly all of their electricity from imported petroleum.

[55] See, e.g., the EIA profile of Hawaii ("In 2015, Hawaii generated more solar electricity per capita from distributed facilities than any other state, and solar energy from both utility-scale and distributed resources generated 35% of Hawaii's renewable electricity.").

was 20.5 cents per kilowatt hour, peaking at 30.6 cents per kilowatt hour in February 2013.[56] Currently, the price of electricity for residential customers in Puerto Rico is higher than the price of electricity in any of the 48 contiguous states, roughly the same as the price in Alaska, and lower than the price in Hawaii (27.45 cents per kilowatt hour in August 2016).[57]

The price of electricity in Puerto Rico is also volatile, rising or falling based on the shifting price of crude oil in the world market, whereas the price of electricity in the United States is relatively stable.[58] In addition to its high and variable cost, electricity in Puerto Rico is subject to periodic supply disruptions.[59]

Puerto Rico's energy system is dominated by the Puerto Rico Electric Power Authority (PREPA), a public corporation in deep financial distress. PREPA owns and operates all but two of the power plants in Puerto Rico and controls the island's transmission grid. PREPA has often operated inefficiently and been governed in an opaque manner. Long overdue efforts are underway to reform operations at PREPA and, while progress has been made, it is clear that additional progress is required.[60]

Puerto Rico did not have an electricity regulatory body to oversee PREPA or regulate electricity rates until May 2014, when a law was enacted establishing the Puerto Rico Energy Commission

[56] In this same time period, the average price of electricity sold to the residential sector in the 50 states and the District of Columbia was 11.4 cents per kilowatt hour.

[57] See EIA, Rankings: Average Retail Price of Electricity to Residential Sector, August 2016.

[58] See Report by the President's Task Force on Puerto Rico's Status, March 2011, at page 71 ("When the price of oil spikes, as it did in the summer of 2008, the effect on businesses and other consumers is devastating. Those high and unpredictable energy costs have made the Island less desirable for businesses, which, in turn, has contributed to a declining manufacturing base and increased unemployment. Moreover, Puerto Ricans have less disposable income because their utility bills are among the highest in the nation.").

[59] For example, in late September 2016, a fire at a Puerto Rico Electric Power Authority (PREPA) power plant in southern Puerto Rico left virtually all of its customer base of 1.5 million households without power—some for several days—and caused major disruptions to the island's economy.

[60] See Testimony of Lisa Donahue, Hearing on "Exploring Energy Challenges and Opportunities Facing Puerto Rico, House Committee on Natural Resources, Subcommittee on Energy and Mineral Resources, January 12, 2016.

(PREC).[61] The law required PREPA to prepare its first-ever Integrated Resource Plan (IRP), on terms established by PREC and subject to PREC's approval.[62]

The Task Force makes the following recommendations:

- The Task Force believes that the Puerto Rico Electric Power Authority's record of service has not inspired confidence among its customer base in Puerto Rico, and recommends that the **government of Puerto Rico** continue efforts to make operational reforms at PREPA, improve the efficiency of electricity generation and transmission, and diversify Puerto Rico's energy supply—all with the ultimate goal of making electric power more reliable and affordable.

- The Task Force recommends that **PREPA** and the **Puerto Rico Energy Commission** seek technical assistance from the U.S. Department of Energy, and recommends that the **U.S. Department of Energy** (USDOE) provide all authorized forms of technical and financial assistance. The Task Force has been advised that PREPA and other government of Puerto Rico agencies have shown reluctance in the past to request technical assistance from USDOE, including during the September 2016 blackout, and the Task Force recommends that any such reluctance be set aside.

- In December 2014, Congress enacted the Fiscal Year Consolidated and Further Continuing Appropriations Act, 2015 (P.L. 113-235). Section 9 of the law requires the Secretary of the Interior to appoint a team of technical, policy and financial experts to develop an "energy action plan" for each of the territories, including Puerto Rico. In Section 505(d) of PROMESA, Congress reassigned responsibility for crafting the plan for Puerto Rico from the U.S. Department of the Interior to the U.S. Department of Energy. The Task Force recommends that the **U.S. Secretary of Energy** appoint a team of experts as soon as practicable, but not later than the statutory deadline of March 27, 2017; that the team of experts prepare the energy action plan in a timely manner; that the U.S. Secretary of Energy publish the energy action plan on the U.S. Department of Energy's website; and that the U.S. Secretary of Energy annually update Congress on the efforts that Puerto Rico has made to implement the energy action plan, as required by statute.

[61] See Puerto Rico Law 57-2014, the "Puerto Rico Energy Transformation and RELIEF Act."

[62] On September 23, 2016, PREC issued its "Final Resolution and Order," disapproving the IRP submitted by PREPA, approving a modified IRP, ordering PREPA to modify the IRP in line with PREC's requirements, and ordering PREPA "to ensure that its future IRPs comply with its legal obligations and satisfy professional standards." For the complete PREC docket on this matter, see here (CEPR-AP-2015-0002).

- The Task Force recommends that the **U.S. Department of Energy** assess whether Puerto Rico receives equitable treatment relative to other jurisdictions under grant programs for energy-related research and, if it does not, recommends that USDOE resolve any inequities.

4. **Federal Statistical Programs**

A federal statistical agency is an agency or unit of the executive branch whose primary activities are the collection and publication of information for statistical purposes. The principal federal statistical agencies include the:

- U.S. Census Bureau, within the U.S. Department of Commerce;
- Bureau of Economic Analysis (BEA), within the U.S. Department of Commerce;
- Bureau of Labor Statistics (BLS), within the U.S. Department of Labor;
- National Agricultural Statistical Service (NASS), within the U.S. Department of Agriculture;
- Economic Research Service (ERS), within the U.S. Department of Agriculture
- National Center for Education Statistics (NCES), within the U.S. Department of Education;
- Bureau of Justice Statistics (BJS), within the U.S. Department of Justice;
- National Center for Health Statistics (NCHS), within the Centers for Disease Control and Prevention, within the U.S. Department of Health and Human Services;
- Bureau of Transportation Statistics (BTS), within the U.S. Department of Transportation;
- National Center for Science and Engineering Statistics (NCSES), within the National Science Foundation; and
- U.S. Energy Information Administration (EIA), within the U.S. Department of Energy.

Responsibility for coordinating the federal statistical system rests with the Office of Statistical and Science Policy (SSP), within the Office of Information and Regulatory Affairs, within the Office of Management and Budget. SSP is led by the U.S. Chief Statistician.

The U.S. Chief Statistician seeks to ensure the effectiveness of the federal statistical system by, among other things, (1) establishing statistical policies and identifying priorities for improving statistical programs; (2) promoting integration across the federal statistical system by serving as chair of the Interagency Council on Statistical Policy, consisting of the principal statistical agencies; (3) annually preparing the "Statistical Programs of the United States Government" document, most recently released in September 2015 for Fiscal Year 2016; and (4) preparing the "Strengthening Federal Statistics" chapter of the "Analytical Perspectives" volume of the President's annual budget request to Congress.

As the "Strengthening Federal Statistics" chapter notes:

The ability of governments, businesses, and the general public to make informed choices about budgets, employment, investments, taxes, and a host of other important matters depends critically on the ready and equitable availability of relevant, accurate, timely, and objective Federal statistics. Taken together, the data produced by the decentralized Federal statistical system form a robust evidence base to support both public and private decision-making.

This view was echoed by William C. Dudley, the president and chief executive officer of the Federal Reserve Bank of New York, in a 2010 speech delivered in Puerto Rico:

The private and public sectors both need accurate, timely and comprehensive economic statistics to perform effectively. It is impossible to make good decisions without a solid factual basis for those decisions. For example, the government needs good economic information to develop effective fiscal, economic development and regulatory policy. Likewise, to make the best production, investment and pricing decisions, businesses need accurate and timely information on things such as wages, income and prices. Poor quality information increases uncertainty and this uncertainty inhibits well-considered risk-taking and investment decisions.

In its September 15th status update, the Task Force wrote as follows:

Like other observers, the Task Force is concerned about the relative lack of reliable data pertaining to certain aspects of the economic, financial, and fiscal situation in Puerto Rico, which are necessary for productive analyses that may lead to sound public policy recommendations. Therefore, the Task Force intends to analyze the extent to which Federal statistical products that measure economic and financial activity in the states might also provide equivalent information for Puerto Rico and other territories, and the Task Force intends to explore ways in which any such data gaps can be responsibly closed.

On October 21st, the Task Force held a staff-level briefing with officials from three of the principal federal statistical agencies—the U.S. Census Bureau, the Bureau of Labor Statistics, and the National Agricultural Statistical Service. On October 26th, the Task Force held a staff- level briefing with officials from the Bureau of Economic Analysis (along with officials from other divisions within the U.S. Department of Commerce). The Task Force also communicated with the Bureau of Justice Statistics, which on September 14th sent a letter to a member of the Task Force regarding Puerto Rico's treatment under BJS statistical programs. The Task Force received multiple written submissions that discuss this topic, including a letter from the executive director of the Puerto Rico Institute of Statistics.

Based on the information it obtained, the Task Force has confirmed that Puerto Rico—and, to an even greater extent, the four smaller U.S. territories, where sample sizes can pose a problem— are currently excluded from a considerable number of the statistical programs conducted by the principal federal statistical agencies, including some of the most important programs.

To help illustrate the point, **Appendix 3** contains a table prepared by the Task Force with the assistance of the U.S. Census Bureau that lists the main statistical programs (censuses and surveys) conducted by the Census Bureau, either on its own or in conjunction with another federal agency. The table describes whether the program collects and publishes state-by-state information and, if so, whether Puerto Rico information is included as well. If the program provides only national or regional level data, the table describes whether Puerto Rico is included in the national or regional totals.

The Task Force recognizes that a federal statistical agency may need to take a number of steps before it can include Puerto Rico in a particular statistical program from which it is presently excluded—including conducting a feasibility study, expending or reprogramming current agency funding or requesting additional funding from Congress, and obtaining cooperation and collaboration from local partners, such as the Puerto Rico Institute of Statistics and the Puerto Rico Planning Board. The Task Force understands that there may be certain impediments to action and that the effort may need to proceed in incremental fashion. However, the Task Force believes this to be a worthwhile endeavor that will benefit federal and local policymakers, current and potential investors, and the Puerto Rico public.

The Task Force makes the following recommendations:

- The Task Force recommends that the **U.S. Chief Statistician** place the subject of Puerto Rico's inclusion in federal statistical programs on the agenda of the Interagency Council on Statistical Policy, develop an action plan consisting of short-term, medium-term, and long-term objectives, and describe this action plan in the "Statistical Programs of the United States Government" document submitted annually to Congress.

- The Task Force recommends that the **Census Bureau** take all reasonable steps to include Puerto Rico in its federal statistical programs, including the quinquennial Census of Governments (and its associated annual and quarterly surveys and summaries regarding public employment and payroll, public pensions, state government tax collections, and state and local government finances);[63] the Survey of Business Owners and Self-Employed

[63] See, e.g., Federal Reserve Bank of New York, An Update on the Competitiveness of Puerto Rico's Economy, July 31, 2014, at page 11 (noting that "the Census of Governments does not survey Puerto

Persons (SBO); the Building Permits Survey (BPS), which is currently published monthly for the states but only annually for Puerto Rico; and the Quarterly Workforce Indicators (QWI).[64]

- Puerto Rico is excluded from Census Bureau statistical programs that provide information on housing, such as the American Housing Survey (AHS), the Construction Progress Reporting Survey (CPRS), the Housing Vacancy Survey (HVS), the Manufactured Housing Survey (MHS; conducted jointly with the U.S. Department of Housing and Urban Development), and the Value of Construction Put in Place Survey (VIP). The Task Force recommends that the **Census Bureau**, in coordination with the government of Puerto Rico, examine the feasibility of including Puerto Rico in some or all of these products, or identify alternative means of collecting and publishing reliable data on the housing market in Puerto Rico.

- The Task Force recommends that the **Census Bureau** ensure that the quinquennial Economic Census of Island Areas (IA), which does include Puerto Rico, is producing data that is roughly equivalent in terms of both substance and timing to the data produced by the quinquennial Economic Census, which does not include Puerto Rico. The Task Force further recommends that the Census Bureau assess whether it would be preferable to include Puerto Rico in the national Economic Census rather than the Census of Islands Areas.

- The Task Force recommends that the **Bureau of Labor Statistics** and the **Census Bureau** take all reasonable steps to include Puerto Rico and the other territories in the Current Population Survey (CPS), the primary source of labor statistics in the United States. The Task Force notes that Section 404 of PROMESA expresses the "Sense of Congress" that a study should be conducted to "determine the feasibility of expanding data collection to include Puerto Rico and the other United States territories" in the CPS and that, if necessary, the Census Bureau "should request the funding required to conduct this feasibility study as part of its budget submission to Congress for fiscal year 2018." The Task Force notes that BLS and the Census Bureau worked with the Task Force to begin to determine the feasibility and costs of such expansion.

- Puerto Rico's K-12 public education system falls short in numerous, troubling respects.[65] As described in the table in Appendix 2, funding for Puerto Rico is capped under various federal

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Rico as part of its annual program to collect information on the fiscal policies of the states and their constituent localities").

[64] The Task Force notes that the Census Bureau recently added Puerto Rico to its web-based application, My Congressional District, which was established in 2003 as a way to provide policymakers and the public with easy access to Census Bureau statistics about each congressional district.

education programs; nevertheless, according to CRS, Puerto Rico still receives more federal education funding per public elementary and secondary school student than any state or the District of Columbia ($2,841 in school year 2012-2013). Given the importance of education, the Task Force recommends that the **National Center for Education Statistics** (NCES) collect and publish data for Puerto Rico in the same manner that it collects and publishes data for the states, to the greatest extent possible.[66]

- Although the agricultural sector in Puerto Rico is relatively small, with about 17,000 of the one million employed individuals on the island working directly in "farming, forestry and fishing," the sector has grown in recent years according to local government statistics, and has the potential to expand further and create jobs.[67] The National Agricultural Statistical Service includes Puerto Rico in the Census of Agriculture, which was last produced in 2012 and will next be produced in 2017. The Task Force recommends that the **National Agricultural Statistical Service** include Puerto Rico in its relevant commodity surveys or that it identify an alternative method of producing reports on the island's agricultural sector on at least an annual basis. The Task Force further recommends that NASS explore the feasibility of reestablishing a physical presence in Puerto Rico.

- As discussed elsewhere in this report, Puerto Rico has a higher homicide rate than any state, and the relative lack of public safety on the island undermines economic growth and quality of life. Puerto Rico is excluded from most statistical programs sponsored by the Bureau of Justice Statistics, including programs that provide information on crime victims, identity theft, prisoners and prisons, probationers, parolees, criminal justice expenditures, and contacts between the police and the public. The Task Force recommends that the **Bureau of Justice Statistics** take all reasonable steps to include Puerto Rico in its statistical programs.

- The National Survey on Drug Use and Health (NSDUH) is an annual survey funded by the Substance Abuse and Mental Health Services Administration (SAMHSA) within HHS, and it provides both state-level and national-level data on drug and substance abuse, among other

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[65] See, e.g., Federal Reserve Bank of New York, Human Capital and Education in Puerto Rico, Liberty Street Economics, August 11, 2016; National Center for Education Evaluation and Regional Assistance, A Comparison of Two Methods of Identifying Beating-the-Odds High Schools in Puerto Rico, December 2016.

[66] To cite one instance where this does not occur, NCES provides a State Education Data Profile on its website for each state and the District of Columbia, but not for Puerto Rico or the other territories. Although NCES does provide information on Puerto Rico elsewhere on its website, for example here and here, the data furnished are not as extensive or user-friendly.

[67] See Statistical Appendix, Puerto Rico Planning Board's Fiscal Year 2015 Economic Report to the Governor and Legislative Assembly, at pages A-26, A-27, A-65; see also Danica Coto, Puerto Rico Finds Unexpected Source of Growth in Agriculture, Associated Press, September 28, 2016.

topics. NSDUH data are used by multiple federal agencies, including by the National Guard Bureau to make annual allocations to state and territory national guards under the National Guard Counterdrug Program. Puerto Rico and the other territories are excluded from the NSDUH. The Task Force recommends that the **Substance Abuse and Mental Health Services Administration**, and the non-profit company it has selected to administer the NSDUH through Fiscal Year 2017, provide an update to the appropriate congressional committees on the status of its effort to include Puerto Rico and the other territories in this survey.

- Puerto Rico is excluded from a number of statistical programs conducted by the National Center for Health Statistics, such as the National Health Interview Survey, which is the principal source of information on the health of the U.S. population. The Task Force recommends that the **National Center for Health Statistics** take reasonable steps to include Puerto Rico and the other territories in its programs, particularly when state-level data are produced.

- As discussed elsewhere in this report, the high cost and unreliability of electric power in Puerto Rico is a challenge facing island households and businesses, hampering economic growth. The Task Force notes that, while the U.S. Energy Information Administration website does provide information for Puerto Rico and the other territories in its "State Profiles" section, the information furnished for Puerto Rico is not as detailed or as up-to-date as the information furnished for the states. The Task Force recommends that the **U.S. Energy Information Administration** work to close the remaining data gaps.

- In its numerous meetings with federal agencies, the Task Force heard that the Puerto Rico Institute of Statistics, which was established under Puerto Rico law in 2003 but did not begin operating until 2007, has emerged as a highly professional, autonomous, and apolitical organization that is bringing greater transparency to economic, financial and fiscal conditions on the island. Recognizing that the government of Puerto Rico faces a difficult fiscal environment, the Task Force recommends that the **government of Puerto Rico** consider appropriating a level of funding to the Puerto Rico Institute of Statistics that is commensurate with its important responsibilities. The Task Force also recommends that the **Institute of Statistics** continue to protect its independence and take all feasible steps to publish its products in English in addition to Spanish so these products can have the widest possible audience.

5. Support for Small Businesses

The Small Business Administration (SBA) promotes the interests of small businesses. SBA has 10 regional offices, and Puerto Rico—along with New York, New Jersey, and the U.S. Virgin

Islands—fall within Region II, which is based in New York. SBA has a district office in Puerto Rico, which currently has 12 employees, and also covers the U.S. Virgin Islands.

On September 20th, the Task Force held a staff-level briefing with officials from the SBA. In addition, the Task Force received numerous submissions via the email portal from small business owners in Puerto Rico, from trade organizations representing small businesses on the island, and from national-level associations with an interest in SBA programs, namely the National Association of Development Companies and the National Association of Government Guaranteed Lenders.

Small firms play a significant, and often underappreciated, role in Puerto Rico's economy. According to the Office of Advocacy at the SBA, about 80 percent of private sector workers in Puerto Rico are employed at small establishments, which is slightly higher than the percentage in the U.S. mainland. Specifically, there are about 553,000 workers employed by about 45,000 small businesses. Each year for the last decade or so, the number of Puerto Rico establishments that started up (hired at least one employee for the first time) has been less than the number of establishments that exited (went from having at least one employee to having none, and remained closed for at least a year).

The SBA administers a range of programs to support small businesses, including capital access programs to help small firms obtain loans and other forms of capital; procurement programs to help small firms compete more effectively for federal government contracts; and entrepreneurial development programs to provide small firms with training and technical assistance.

There are presumably many small businesses in Puerto Rico operating in the informal economy, and therefore not subject to regulation or taxation. An objective of ongoing economic reforms in Puerto Rico should be to incentivize small firms to move from the informal to the formal economy, and it should be noted that SBA programs are only available to small firms operating in the formal economy.

A. SBA Capital Access Programs

Outside of its disaster assistance program, the SBA does not make direct loans to businesses. Instead, the agency typically guarantees loans made by approved private sector lenders to small firms that cannot obtain affordable credit elsewhere, or it makes direct loans to non-profit intermediaries that, in turn, make loans to small firms. The SBA's largest loan programs include the 7(a) loan guaranty program, the 504/Certified Development Company (504/CDC) loan guaranty program, and the Microloan program.

The Task Force believes that, for a variety of structural and other reasons, these programs are not producing satisfactory results in Puerto Rico. The Task Force believes that Congress and the SBA should take steps to improve the operation of these programs in Puerto Rico. The Task Force further believes that these steps should be targeted, should safeguard the effective operation and financing of these programs on the national level, and should be temporary in duration, *expiring when the Oversight Board established by PROMESA terminates*. The Task Force also believes these steps should be made applicable to the four other territories wherever feasible.

The Task Force makes the following recommendations:

- Under the 7(a) program, loans are made by SBA partners—mostly banks, but also some other financial institutions—and are partially guaranteed by the SBA. Proceeds from 7(a) loans may be used to establish a new business or to operate, acquire, or expand an existing business. The SBA's current guaranty rate is 85 percent for loans of $150,000 or less and 75 percent for loans greater than $150,000. The Task Force recommends that **Congress** enact legislation to increase the guaranty rate and require a separate subsidy calculation for 7(a) loans made in Puerto Rico.

- The SBA generally assesses a fee on loans it guarantees under the 7(a) program, based on the loan's maturity date and the dollar amount guaranteed. The lender initially pays the fee and may pass that expense on to the small business borrower at closing. The Task Force recommends that **Congress** direct the SBA to waive or reduce this fee in the case of a lender who makes an approved 7(a) loan to a borrower located in Puerto Rico.

- The 504/CDC loan guaranty program utilizes Certified Development Companies, which are private, nonprofit corporations established to contribute to economic development within their communities. Under the 504/CDC program, a commercial lender provides up to 50 percent of the financing, the CDC provides up to 40 percent of the financing (by issuing SBA-guaranteed debentures), and the small business contributes at least 10 percent of the financing—essentially a "down payment." The Task Force recommends that, in the case of small businesses in Puerto Rico, **Congress** consider reducing the small business contribution and increasing the CDC contribution.

- Under the 504/CDC program, the SBA is authorized to charge CDCs five fees to help recoup the SBA's expenses, including a participation fee. For their part, CDCs are authorized to charge borrowers a variety of fees, including a processing fee. The Task Force recommends that Congress direct the SBA to waive the participation fee that the SBA charges to CDCs located in Puerto Rico and/or to waive the processing fee that those CDCs charge to borrowers on the island.

- Under the Microloan program, the SBA provides direct loans to qualified nonprofit intermediary lenders that, in turn, provide loans of up to $50,000 to small firms. Under current law, an intermediary in the Microloan program may not borrow more than $750,000 in the first year of participation in the program and, in later years, the intermediary's obligation to the SBA may not exceed an aggregate of $5 million. The Task Force recommends that **Congress** consider increasing that aggregate limit in the case of intermediaries located in Puerto Rico.

- In Fiscal Year 2016, the SBA received $25 million in appropriations from Congress to make grants to Microloan intermediaries to provide Microloan borrowers and prospective borrowers with technical assistance. Under current law (known as the "25/75 rule"), no more than 25 percent of Microloan technical assistance grant funding received by an intermediary from the SBA may be used by the intermediary to provide pre-loan assistance (assistance to a prospective Microloan borrower), as opposed to post-loan assistance (assistance to an approved Microloan borrower). The Task Force recommends that **Congress** authorize an intermediary in the Microloan program to use more than 25 percent of its SBA-provided technical assistance grants on pre-loan assistance if the intermediary provides at least 25 percent of its loans to small firms in Puerto Rico.

- Should the new lending authority recommended in this section be enacted, the Task Force recommends that the **SBA** and the **Government Accountability Office** conduct regular and rigorous oversight of the effectiveness of this expansion.

B. SBA Procurement Programs

The federal procurement process is the process whereby federal agencies acquire supplies and services for the agency's use or benefit. Government-wide and agency-specific goals for the percentage of contract and subcontract dollars awarded to small businesses have long been part of the federal procurement process. Congress has enacted, and the SBA administers, various programs to help small firms obtain and perform federal contracts and subcontracts. These include the 8(a) program for businesses owned by persons who are socially and economically disadvantaged, the Historically Underutilized Business Zone (HUBZone) program, the Women-Owned Small Business program, and the Service-Disabled Veteran-Owned Small Business program. By some metrics, Puerto Rico ranks low with respect to its participation in the federal procurement process.[68]

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[68] According to the 2016 edition of the Annual Review of Government Contracting, federal spending on procurement contracts totaled $439.6 billion in Fiscal Year 2015. The Annual Review includes a table that ranks all 56 U.S. jurisdictions—the 50 states, the District of Columbia, and the five territories—by the total dollar value of federal contracts performed within each jurisdiction in Fiscal Year 2015. Puerto Rico ranks 50th, with $430.6 million—$307 million in defense contracts and $123.6 million in non- defense contracts—performed on the island. The three states and three territories that fall below Puerto

The Task Force makes the following recommendations:

- The Task Force recommends that **Congress** consider establishing a contracting preference for small businesses in Puerto Rico with respect to federal contracts performed in Puerto Rico.[69]

- The SBA administers a mentor/protégé program. The program provides benefits to both the mentor firm and the protégé firm. In the case of the protégé, the relationship is designed to help the protégé firm better compete for federal contracts and subcontracts, including through joint venture arrangements with the mentor firm, and to otherwise enhance the capabilities of the protégé firm. Mentor firms can be businesses of any size that are in good financial standing and can impart knowledge to the protégé firm regarding general business operations and government contracting. Protégé firms must meet certain criteria as well. Typically, a mentor has one protégé at a time, but can have up to two or three if the mentor can demonstrate that the additional relationship(s) will not adversely affect the development of any of the protégé firms. Current federal law prohibits a mentor from having more than three protégés. The Task Force recommends that **Congress** authorize an exception to this three-protégé rule if the protégé firms are located in Puerto Rico or another territory.

Rico each has a smaller population than Puerto Rico. When the total dollar value of federal contracts performed in each jurisdiction is calculated on a per capita basis, Puerto Rico ranks 55th, ahead of only American Samoa. Furthermore, according to the Federal Procurement Data System, of the 571 federal contracts that were performed in Puerto Rico in Fiscal Year 2015, 346 (approximately 61 percent) were awarded to firms located outside of Puerto Rico. The Task Force selected three states to serve as points of comparison, and asked CRS to run the searches of the Federal Procurement Data System. Of the 30,501 federal contracts performed in Oregon—which has a similar-sized population to Puerto Rico—in Fiscal Year 2015, 5,445 (18 percent) were awarded to firms located outside of Oregon. Of the 23,005 federal contracts performed in Mississippi in Fiscal Year 2015, 7,321 (32 percent) were awarded to firms located outside of Mississippi. Of the 96,463 federal contracts performed in Washington State in Fiscal Year 2015, 13,271 (14 percent) were awarded to firms located outside of Washington.

[69] Congress has the authority to require federal agencies to preference local contractors in connection with the awarding of federal contracts under certain circumstances, and Congress has exercised that authority on occasion. For example, the Robert T. Stafford Disaster Relief Act establishes a contracting preference for "organizations, firms, and individuals residing or doing business primarily in the area affected by [a] major disaster or emergency." In addition, Section 15 of the Small Business Act requires that federal agencies give "priority" to small businesses that perform a substantial proportion of the production "within areas of concentrated unemployment or underemployment or within labor surplus areas" when setting aside contracts for small businesses. The Task Force is concerned that, on a per capita basis, the total dollar value of federal contracts performed in Puerto Rico is less than in any U.S. jurisdiction other than American Samoa. The Task Force is also concerned that, of the small number of federal contracts that are performed in Puerto Rico, about 6 of every 10 are awarded to firms outside of Puerto Rico.

C. Small Business Innovation Research and Technology Transfer Programs

The Small Business Innovation Research (SBIR) program is designed to increase the participation of small innovative companies in federally-funded research and development. Federal agencies with extramural R&D budgets of $100 million or more set aside a portion of these funds to finance an agency-run SBIR program that makes competitive awards to small businesses. Currently, 11 federal agencies participate in the SBIR program. Another competitive grant program, the Small Business Technology Transfer (STTR) program, facilitates the commercialization of university and federal R&D by small companies. Federal agencies with extramural R&D budgets of $1 billion or more set aside a portion of these funds to finance an agency-run STTR program. Currently, five agencies participate in the STTR program. The SBA helps to coordinate the SBIR and STTR programs.

As of Fiscal Year 2014, federal agencies had made more than 133,000 awards totaling $33.7 billion under the SBIR and STTR programs. However, according to the SBA's website, Puerto Rico firms have received only 30 awards (26 SBBR awards and 4 STTR awards) totaling $5.5 million, and no firms in any other territory have received any awards. Each state has received many more awards than Puerto Rico. Particularly in light of the number of science, technology, engineering and mathematics (STEM) professionals in Puerto Rico, the paucity of SBBR and STTR awards to small firms on the island is concerning.

In addition, the SBA administers the Federal and State Technology (FAST) partnership program, a competitive grant program that aims to help socially and economically disadvantaged firms compete in the SBIR and STTR programs. The program began in Fiscal Year 2001, expired at the end of Fiscal Year 2005, and was reestablished in Fiscal Year 2010. Pursuant to the FAST program, the SBA provides annual awards to state and local economic development agencies, business development centers, and colleges and universities, who use this funding to provide assistance to science-driven and technology-driven small businesses, including assistance to help them compete for SBIR and STTR awards. FAST grantees are required to meet a local matching requirement, which ranges from 50 cents for every $1 in federal funding received (in the case of states and territories, such as Puerto Rico, with the fewest SBIR and STTR awards) to $1 dollar for every $1 in federal funding (in the case of states and territories with the most SBIR and STTR awards). Since the FAST program was reestablished in 2010, two Puerto Rico entities have received grants—the InterAmerican University of Puerto Rico and the Puerto Rico Trade and Export Company, a government-owned corporation. However, in Fiscal Year 2016, no Puerto Rico entity was awarded a FAST grant.

The Task Force makes the following recommendation:

- The Task Force recommends that **Congress** require the SBA to make an annual FAST partnership grant to a Puerto Rico grantee, and to waive the local matching requirement. If the SBA cannot find a suitable grantee, the Task Force recommends that Congress require the SBA to use the funding to help small businesses in Puerto Rico navigate the SBIR and STTR process, from application, to award, to successful completion of each phase of the program.

D. SBA Disaster Assistance

The SBA provides assistance to help individuals and businesses affected by disasters. Assistance is provided in the form of loans that must be repaid, rather than grants. As distinct from the SBA's other lending programs, disaster assistance loans are made directly by the SBA to the borrower.

Under current law, the term "disaster" means a "sudden event which causes severe damage." It can include events like hurricanes, earthquakes, tornadoes, fires, floods, droughts, oil spills, and civil disorders.[70] The SBA's disaster loan program includes economic injury disaster loans (EIDLs). EIDLs are available to businesses located in a declared disaster area, that have suffered substantial economic injury, are unable to obtain credit elsewhere, and are defined as small by SBA size regulations, which vary from industry to industry. Substantial economic injury occurs where "the business concern is unable to meet its obligations as they mature or to pay its ordinary and necessary operating expenses." The maximum loan amount for an EIDL is $2 million. Loan proceeds can be used for working capital necessary to enable the business to alleviate the specific economic injury and to resume normal operations. The loan can have a maturity of up to 30 years and has an interest rate of 4 percent or less.

Over the past year, the United States, including Puerto Rico and other territories, has been adversely affected by Zika, a mosquito-borne virus that has been linked to birth defects and other severe health problems. To date, three U.S. territories—Puerto Rico, the U.S. Virgin Islands, and American Samoa—and two states—Florida and Texas—have experienced locally-acquired cases of Zika, and nearly every state and territory has experienced travel-associated cases of Zika. Puerto Rico is, by far, the most affected U.S. jurisdiction. According to the Centers for Disease Control and Prevention (CDC), as of early December, there were over 33,000 confirmed Zika cases in Puerto Rico. The Puerto Rico Department of Health has placed the number of confirmed cases at over 35,000, including approximately 2,800 pregnant women, and the number of presumed cases at about 65,000. According to the CDC, there are about 800 locally- transmitted cases in the U.S. Virgin Islands, about 185 locally-transmitted cases in Florida (plus

[70] See 3(k)(1) of the Small Business Act.

about 785 travel-associated cases), about 55 locally-transmitted cases in American Samoa, and one locally-transmitted case in Texas.

In response to this unprecedented outbreak, the CDC took the equally unprecedented step of issuing Level 2 travel advisories for U.S. citizens traveling domestically to Puerto Rico, the U.S. Virgin Islands, American Samoa, and parts of Miami-Dade County, Florida.[71] These Zika- related travel advisories have had an adverse economic impact, particularly in the travel and tourism sector, although it is difficult at this time to estimate the impact with precision.

- The Task Force recommends that **Congress** amend the definition of "disaster" in the Small Business Act to encompass "communicable diseases for which the federal government issues a travel alert or travel warning" in order to authorize the SBA, at the request of the governor of an affected U.S. state or territory, to issue a disaster declaration and make economic injury disaster loans (EIDLs) available to help small firms in that state or territory recover from any substantial economic injuries they have experienced as a result of health-related travel advisories, such as those issued by the CDC in connection with Zika.[72]

6. Supplemental Security Income

The Supplemental Security Income (SSI) program was enacted in 1972 and took effect in 1974.[73] SSI, which is administered by the Social Security Administration (SSA), is a cash assistance program that provides monthly benefits directly to low-income aged, blind, or disabled persons in the 50 states, the District of Columbia, and one U.S. territory—the Northern Mariana Islands.

To receive SSI benefits based on age, an individual must be at least 65 years old. To receive SSI benefits based on disability, an individual must meet the same definition of disability that applies under the Social Security Disability Insurance (SSDI) program. To receive SSI benefits based on blindness, an individual must have visual impairments meeting certain criteria. In addition to age, disability, or blindness, an individual must meet income and resource tests to qualify for SSI benefits.

Congress has not extended the program to four of the five U.S. territories—Puerto Rico, the United States Virgin Islands, Guam, and American Samoa. Instead, Puerto Rico, the U.S. Virgin

[71] CDC Travel Health Notice types are: Watch Level 1 (practice usual precautions); Alert Level 2 (practice enhanced precautions); and Warning Level 3 (avoid nonessential travel).

[72] See S. 3301, the Small Business Relief from Disease Induced Economic Hardship Act (114th Congress; Sen. Rubio).

[73] See Social Security Amendments of 1972 (P.L. 92-603).

Islands, and Guam participate in a federal program called Aid to the Aged, Blind and Disabled (AABD), which used to apply nationwide until it was replaced by the SSI program in the 50 states and the District of Columbia. American Samoa is not currently eligible to participate in either SSI or AABD.

While the SSI program is administered by SSA, the AABD program is administered by the Administration for Children and Families (ACF) within the U.S. Department of Health and Human Services. The AABD program operates as an annual grant, with the federal government providing funding to the local territory government, which in turn distributes it to eligible individuals. In the case of Puerto Rico, ACF provides the annual AABD grant to the Puerto Rico Department of the Family, which then distributes it to eligible individuals. Pursuant to Section 1118 of the Social Security Act, the AABD program includes a 25 percent territory government matching requirement, meaning that for every $100 in AABD benefits, the government of Puerto Rico must provide $25. There is a 50 percent territory government matching requirement with respect to administrative, as distinct from assistance, expenditures; for every $100 the government of Puerto Rico spends to administer the AABD program, it is reimbursed $50 by the federal government. By contrast, the SSI program has no state government matching requirement and the federal government pays the entire cost of the program, although certain state governments and the District of Columbia government voluntarily choose to provide a supplement to the federal benefit.

Puerto Rico and the other territories that participate in AABD are each subject to an overall annual federal funding cap set forth in Section 1108 of the Social Security Act. The four federal programs subject to the Section 1108 cap are: (1) the AABD program under Titles I, X, XIV, and XVI of the Social Security Act; (2) the Temporary Assistance for Needy Families (TANF) program under Title IV-A of the Social Security Act; (3) various child welfare funding streams under Title IV-E of the Social Security Act; and (4) the so-called Matching Grant under section 1108(b) of the Social Security Act. Section 1108(b) matching grants, which include a 25 percent territory government matching requirement, may be used for TANF, including child care, and/or Title IV-E programs.

The annual Section 1108 cap for Puerto Rico is $107,255,000, and has not been increased since enactment of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104-193). The government of Puerto Rico decides how to use the federal funds among the four programs that are subject to the Section 1108 cap. However, the TANF program—an annual block grant—is capped at $71,562,501 for Puerto Rico pursuant to Section 403 of the Social Security Act. A territory may request funds less than its TANF cap and substitute claims from the other three programs to fill the deficit. In other words, there are two caps that operate in tandem with respect to the territories: the first is applicable to the cumulative amount of the four programs (the Section 1108 cap) and the second is applicable to the maximum amount of the TANF grant (the Section 403 cap). The two caps are not adjusted for inflation and have remained at their current levels since Fiscal Year 1997. The effective funding cap after applying the basic TANF block grant is $35,692,499: $107,255,000 - $71,562,501.

Based on a 2014 GAO report, and on information supplied to the Task Force by ACF, the federal government provides approximately $24 to $26 million annually to the Puerto Rico Department of the Family under the AABD program, which is used to provide benefits to approximately 34,000 to 38,000 individuals, who receive an average monthly benefit of approximately $74 to $77 per recipient, 25 percent of which is government of Puerto Rico funding.[74]

The GAO calculated that, if Puerto Rico were to be included in SSI, Puerto Rico beneficiaries would directly receive between $1.5 billion and $1.8 billion per year in federal funding (compared to the current $24-$26 million under AABD), 300,000 to 350,000 individuals would receive benefits (compared to the current 34,000-38,000 under AABD), and the average monthly benefit would be around $540 (compared to $74-$77 under AABD). Under SSI, the government of Puerto Rico would have no matching requirement for benefit payments or administrative costs.

Over the years, numerous bills have been introduced in Congress to extend the SSI program to Puerto Rico and the other territories that are excluded from the program.[75]

Some argue against including Puerto Rico and the other territories in the SSI program, at least in part because such inclusion would require substantial new federal outlays through mandatory appropriations from the general fund, yet beneficiaries of the outlays would include residents of the territories who do not pay into the general fund because Congress has exempted residents of Puerto Rico and the other territories from paying federal taxes on income earned within their respective territories. Of course, this argument would apply with equal force in the case of the Northern Mariana Islands, a territory to which Congress has extended the SSI program.

Others argue that it is not appropriate to exclude U.S. citizens living in the territories from the SSI program, especially considering that residents of the territories can simply relocate to the states and obtain full SSI benefits, and that virtually none of the 8.3 million SSI recipients earns sufficient income to owe federal income taxes.

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[74] As a point of comparison, the average monthly AABD benefit in Guam is $150, the average monthly AABD benefit in the U.S. Virgin Islands is $176, the average monthly SSI benefit in the Northern Mariana Islands is $591, and the average monthly SSI benefit nationwide is $540.

[75] See, e.g., H.R. 1822, the Supplemental Security Income Equality Act (114th Congress; Rep. Pierluisi).

Some argue that SSI subjects beneficiaries to earnings and asset tests, which provide disincentives to saving and work activities. Disincentives to work would impose further labor- market challenges in Puerto Rico, given the already poor labor force participation rate.

The Task Force makes the following recommendation:

- The Task Force believes that it is important for Congress to debate the adequacy of the AABD program in Puerto Rico. The Task Force reviewed the historical record and was unable to identify a hearing conducted in the House or the Senate on this issue. The Task Force recommends that **Congress** examine the costs and benefits of either: (1) including Puerto Rico and the other territories in the SSI program with full benefits; (2) including Puerto Rico and the other territories in the SSI program with reduced benefits; (3) increasing the annual AABD grant provided to Puerto Rico and the other territories; (4) indexing the AABD and TANF caps to inflation; or (5) maintaining current law. In any examination, incentives to work should be considered.

The Task Force found it challenging to obtain up-to-date, publicly-available information about the operation of the AABD program in Puerto Rico, including basic information about the number of AABD beneficiaries, eligibility requirements for receiving AABD benefits, the average monthly AABD benefit, and the differences between the AABD program and the SSI program. As a result, the Task Force asked CRS to prepare a memorandum on this subject, and the Task Force has made that memorandum available to the public.[76]

The Task Force makes the following recommendation:

- The Task Force recommends that the **Administration for Children and Families**, working in conjunction with the Puerto Rico Department of Family, make publicly available—ideally on its website—a document that provides an up-to-date, detailed description of the AABD program in Puerto Rico and the other territories, in order to help federal policymakers better assess the AABD program.

7. U.S. Department of Commerce

The Secretary of the U.S. Department of Commerce made a written submission to the Task Force. On October 28th, the Task Force held a staff-level briefing with officials from the Office

[76] See William R. Morton, Cash Assistance for the Aged, Blind, and Disabled in Puerto Rico, Congressional Research Service, October 26, 2016; see also Robin Respaut, Deserted Island: The Disabled in Puerto Rico Fend for Themselves After Decades of U.S. Neglect, Reuters, December 9, 2016.

of the Secretary, the Bureau of Economic Analysis, the International Trade Administration, the Economic Development Administration, and the Minority Business Development Agency.

A. Bureau of Economic Analysis

The Bureau of Economic Analysis (BEA) prepares and publishes a wide variety of economic statistics. BEA produces a quarterly estimate of U.S. gross domestic product (GDP), which covers only the 50 states and the District of Columbia, not the five U.S. territories. In addition, BEA produces quarterly GDP estimates for each of the 50 states and the District of Columbia. Moreover, since 2010, the BEA has been producing annual GDP estimates for each U.S. territory other than Puerto Rico, reaching back in time to cover 2002 to 2014. In recent years, these territory estimates have been expanded to cover GDP by industry and compensation by industry. The GDP estimates for the four territories are calculated by BEA pursuant to a Statistical Improvement Program funded by the Office of Insular Affairs (OIA) in the U.S. Department of the Interior, which has jurisdiction over the territories other than Puerto Rico.

In late 2010 and early 2011, pursuant to an August 2010 request made by the Secretary of the Puerto Rico Department of Economic Development and Commerce to the U.S. Secretary of Commerce and a recommendation contained in the March 2011 report by the President's Task Force on Puerto Rico, the BEA began an effort to help the government of Puerto Rico modernize its economic statistics programs. In the autumn of 2011, BEA produced a report describing its efforts and making recommendations, including the recommendation that Puerto Rico change its featured measure of production from GNP to GDP.[77] As a consequence of the change of administration in Puerto Rico in 2013, BEA stopped receiving cooperation from local officials and was unable to continue its provision of technical assistance for a period of years, and did not resume its work until 2015. In total, BEA estimates that it has spent $350,000 in direct support to Puerto Rico, which it funded out of its core budget.

The Task Force makes the following recommendations:

- The Bureau of Economic Analysis currently publishes GDP estimates for each state, the District of Columbia, and every territory other than Puerto Rico. The Task Force supports BEA's efforts to help the government of Puerto Rico modernize its economic statistics

[77] As described by BEA: "GDP is the market value of goods and services produced by labor and property within a country's (or territory's) borders, regardless of nationality. GNP is the market value of goods and services produced by labor and property supplied by resident producer units, regardless of where they are located. For GNP, as long as the labor and property are supplied by Puerto Rican residents, they may be located either in Puerto Rico or abroad. GDP refers to production taking place in Puerto Rico. It is, therefore, the appropriate measure for much of the short-term monitoring and analysis of the Puerto Rican economy. In particular, GDP is consistent in coverage with indicators such as employment, industry output, and investment in equipment and structures."

programs, including the methods used to measure the island's GDP (and GNP). However, the Task Force recommends that **BEA** should calculate GDP for Puerto Rico, just as BEA does for every other U.S. jurisdiction. The Task Force recognizes that a transition period will likely be required, during which BEA and the government of Puerto Rico may need to share data collection and calculation responsibilities pursuant to a hybrid model. The Task Force further recommends that, in the same way that the U.S. Department of Interior is funding BEA's efforts to estimate GDP for each of the smaller territories, the federal government should fund BEA's efforts to calculate GDP for Puerto Rico. Finally, the Task Force believes that BEA's longer-term objective should be to include the U.S. territories (collectively, home to about 3.8 million people), alongside the states and the District of Columbia, in BEA's *national-level* GDP estimates, which will require the territory-level GDP data to meet all of BEA's quality standards.

B. International Trade Administration

The International Trade Administration (ITA) seeks to boost foreign direct investment in the United States (including its territories) through the SelectUSA program and other programs; to help U.S. companies (including companies in the territories) increase their exports to foreign markets through the National Export Initiative and other programs; and to promote travel by foreign nationals to the United States (including its territories). ITA's National Travel and Tourism Office (NTTO) supports the U.S. travel and tourism industry. It is the principal liaison in the federal government to Brand USA, the non-profit, public-private partnership that serves as the destination marketing organization for the United States, including all territories. Brand USA aims to attract international visitors, which constitute the largest services export for the United States, through advertising campaigns; providing information on required documents, fees, and procedures; correcting misperceptions about U.S. entry policies; and assisting both rural and urban areas in bringing international tourists.

ITA does *not* promote domestic investment (including investment by stateside companies in Puerto Rico), interstate commerce (including commerce between the states and Puerto Rico) or interstate travel (including travel between the states and Puerto Rico).

With respect to foreign direct investment, notwithstanding Lufthansa Technik's 2014 decision to open a maintenance, repair and overhaul (MRO) facility in Puerto Rico, an achievement for which ITA deserves significant credit, foreign direct investment (FDI) in Puerto Rico appears to be minimal in recent years, based on state-by-state data from 2014 and 2015 in BEA's Survey of New Foreign Direct Investment in the United States.[78] It is difficult to measure FDI in Puerto Rico, since the government of Puerto Rico has not published relevant data since Fiscal Year

[78] See BEA's New Foreign Direct Investment in the United States, 2014 and 2015.

1984.[79] The Task Force is advised that BEA is working to help the government of Puerto Rico resume collection of these data after a 30-year hiatus.

With respect to exports, the situation appears challenging as well. According to the U.S. Census Bureau's foreign trade statistics, exports from Puerto Rico to foreign nations totaled $20.4 billion in Calendar Year 2015, while the Puerto Rico Institute of Statistics places the estimate somewhat lower at $17.5 billion. Either way, this is a significant sum, but it is clear that the vast majority (over 90 percent) of these exports are from foreign subsidiaries of U.S. companies operating in the pharmaceutical product, organic chemical, and medical equipment and supply industries. Apart from these large multinational firms, Puerto Rico-based companies appear to export relatively little to foreign countries. Small firms seem to fare particularly poorly. In the November 2016 Puerto Rico Small Business Survey, released by the New York Federal Reserve Bank, 81 percent of firms surveyed say they derive no revenue from exports, 14 percent of firms derive less than 25 percent of their revenue from exports, 3 percent of firms derive 25 to 50 percent of their revenue from exports, 0 percent of firms derive 51 to 75 percent of their revenue from exports, and 2 percent of firms derive more than 75 percent of their revenues from exports. Moreover, based on the ambiguous phrasing of the question posed, it is possible—perhaps probable—that surveyed firms included sales to customers in the U.S. mainland within the definition of "exports." If so, the actual export figures may be even worse than the survey suggests.

With respect to travel and tourism, they are an important component of Puerto Rico's economy, currently constituting about 7 percent of GNP. However there is clearly room for significant improvement, particularly as it relates to visitors from foreign nations. According to the government of Puerto Rico, the number of annual visitors to Puerto Rico over the last decade (2006 to 2015) has averaged about 4.6 million. In 2015, there were about 5.0 million visitors who spent a total of $3.8 billion. Of those 5.0 million visitors, 3.5 million (70 percent) were "tourists" and 1.5 million (30 percent) were "excursionists" who arrived to the island on cruise ships. Of the 3.5 million tourists, 3.1 million (88 percent) came from the mainland U.S. and only 473,000 (12 percent) came from foreign countries.[80]

Based on the observations above, Puerto Rico is in significant need of the various services that ITA provides related to FDI, exports, and travel and tourism.

On the one hand, Puerto Rico should be an attractive location for capital investors (as well as for tourists). The island has natural beauty, a superb climate, a rich culture, and a fascinating history. Puerto Rico is part of the U.S. banking, currency, trade, and legal systems. Puerto Rico

[79] See Puerto Rico Planning Board, Balance of Payments 2015, at page 19, note a.

[80] See Statistical Appendix, page A-38.

has access to U.S. markets, including—until recently—financial markets. It has free flows of labor and capital and participates in the U.S. trade regime with the rest of the world. It is strategically located in the Caribbean region, approximately 1,000 miles from both the southern United States and the Andean region of South America. Although Puerto Rico's elementary and secondary public school system requires reform, and migration to the states has taken a considerable toll on the available labor pool, both skilled and unskilled, there is still a large pool of well-educated professionals on the island. According to the Census Bureau, of Puerto Rico's population age 25 and older, 30.5 percent have a college or graduate degree, virtually the same percentage as in the states. Ninety-five percent of Puerto Rico residents speak Spanish at home and, while 77 percent profess to speak English "less than very well," there are many fully bilingual or proficient English speakers, particularly among the island's youth.

On the other hand, there are number of factors in Puerto Rico that tend to inhibit capital investment, including the government's fiscal challenges; poor financial reporting; the high cost of electricity and other utilities; a burdensome permitting system and other bureaucratic issues; a relatively high level of violent crime; labor market rigidities; complicated and often idiosyncratic tax policies; relatively weak infrastructure; and a high degree of politicization, which causes even productive investments, policies, and programs to be halted by one political party because they were instituted under the other political party.

The Task Force makes the following recommendations:

- The Task Force was advised by multiple federal agencies that the government of Puerto Rico has yet to establish a comprehensive economic development strategy that exploits the island's many comparative advantages, both intrinsic and acquired, and that endures after power passes from one local party to the other. The Task Force recommends that the **government of Puerto Rico** take this constructive criticism to heart.

- The Task Force recommends that the **International Trade Administration** take all reasonable steps to educate stakeholders in Puerto Rico about the multiple services that ITA provides, including by holding educational or technical assistance events in Puerto Rico. The Task Force is especially concerned about the relatively low level of export activity on the part of Puerto Rico firms, particularly small firms, and believes there is room for significant improvement in this area, if properly facilitated by ITA.

- The Task Force was advised by federal agencies that the government of Puerto Rico has a history of opening and operating trade offices in other nations to promote foreign direct investment, trade, and other commercial arrangements. The federal agencies observed that, while there is absolutely nothing inherently wrong with this practice, the government of Puerto Rico may not fully appreciate that it can obtain these services from the International

Trade Administration at little to no cost and with (presumably) equal or better results. The Task Force recommends that the **government of Puerto Rico** take additional steps to leverage the available resources and programs of ITA and carefully consider whether the economic benefits of operating trade offices in other nations outweigh the financial costs, particularly if the sought-for benefits can be realized by tapping into existing ITA resources and expertise.

- Adhering to the principle that it is difficult to improve what you cannot measure, the Task Force recommends that the **government of Puerto Rico** collect and publish annual statistics about foreign direct investment on the island, making sure to disaggregate the data so that investment from the U.S. mainland and investment from foreign nations are tabulated separately. The Task Force further recommends that any federal government statistical products that provide state-by-state data on foreign direct investment also include equivalent data on Puerto Rico and the other territories.

- The United States Travel and Tourism Advisory Board (TTAB) serves as the advisory body to the Secretary of Commerce on matters relating to the travel and tourism industry in the United States. The Board consists of up to 32 members appointed by the Secretary of Commerce, who typically serve for a two-year term. Members represent companies and organizations in the travel and tourism industry from a broad range of products and services, company sizes and geographic locations. The current board includes individuals from many states, including the president of the American Indian Alaska Native Tourism Association. The Task Force recommends that the **Secretary of Commerce** take reasonable steps to appoint at least one member who has special expertise on tourism in Puerto Rico and/or the other territories.

- The Task Force believes that more can be done to increase the relatively low level of travel and tourism in Puerto Rico by foreign nationals. The Task Force notes that the ITA's National Travel and Tourism Office (NTTO) conducts a Survey of International Air Travelers (SIAT). The SIAT provides key market intelligence on the characteristics of visitors to a U.S. jurisdiction. This information can then be used by the jurisdiction's tourism promotion body to develop targeted marketing strategies to attract visitors and help ensure they obtain the experience they desire. The Task Force has been advised that, despite efforts by NTTO, the SIAT is not conducted at the San Juan International Airport, evidently because of opposition from the airport's private operator. The Task Force believes the SIAT could provide valuable information to help Puerto Rico increase tourism from foreign nationals, and recommends that the **airport's private operator**, the **Puerto Rico Ports Authority**, and the **Puerto Rico Tourism Company** work with NTTO with the goal of authorizing the SIAT to be conducted at the San Juan International Airport on mutually-acceptable terms. The distribution and collection of surveys would be completed by the Puerto Rico Tourism Company (a public corporation), the airport staff, or a private sector company from Puerto

Rico. The NTTO would supply the questionnaire (available in 12 languages) and pay for the entry, verification, processing, and publication of the data. The NTTO would provide the survey results to a lead contact in Puerto Rico, and prepare an annual "Overseas Visitors to Puerto Rico" report for use by the Puerto Rico Tourism Company and others.

C. Economic Development Administration

The U.S. Economic Development Administration (EDA) describes itself as "the only federal government agency focused exclusively on economic development." Through multiple competitive grant programs, the agency provides assistance to economically-distressed regions and areas.[81] In Fiscal Year 2016, the EDA received $222 million for its programs and activities.

Between Fiscal Year 2010 and Fiscal Year 2015, EDA made over 4,100 grants totaling more than $1.7 billion to applicants throughout the United States. In that time period, Puerto Rico applicants received 10 grants totaling $6.2 million, among the lowest of all jurisdictions.[82]

In Fiscal Year 2010, EDA made a $400,000 grant to the Puerto Rico Planning Board, which was used to develop a Comprehensive Economic Development Strategy (CEDS) for Puerto Rico. The CEDS was prepared by the CEDS Committee, which consists of representatives of the government of Puerto Rico, universities, non-profit organizations, and trade organizations. The EDA approved the 2010 CEDS, and approved updates to the CEDS made by the CEDS Committee in 2012 and 2014.[83] The CEDS Committee is currently in the process of preparing a new CEDS, which is expected to be released in early 2017, but could be delayed somewhat as a result of the forthcoming change in local administration. Unlike the 2010 CEDS, EDA is not funding this effort through a grant, but is providing technical assistance to ensure that the new CEDS complies with all EDA guidelines.

EDA has six regional offices. Puerto Rico is one of 16 jurisdictions covered by the Philadelphia Regional Office. The EDA's Economic Development Representative for Puerto Rico is currently based in Philadelphia, not Puerto Rico. An Economic Development Representative provides a variety of services, including offering technical assistance to potential applicants for EDA funding, monitoring the implementation of EDA-funded projects by grantees, and interacting with the CEDS Committee.

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[81] EDA's main grant programs include: Public Works (funded at $100 million in Fiscal Year 2016); Economic Adjustment Assistance ($35 million); Partnership Planning Assistance ($32 million); Regional Innovation Strategies ($15 million); Trade Adjustment Assistance ($13 million); and Technical Assistance ($10.5 million).

[82] See EDA, Annual Reports to Congress for Fiscal Year 2010 to Fiscal Year 2015, available here.

[83] EDA provided the Task Force with a copy of the 2010 and 2014 CEDS.

The Task Force makes the following recommendations:

- The Task Force is aware that EDA recently determined that its Economic Development Representative (EDR) for Puerto Rico can more effectively serve the island if the Representative is based in Puerto Rico, rather than in the Philadelphia Regional Office. The Task Force recommends to **EDA** that a Puerto Rico-based EDR begin work as soon as possible. The Task Force urges the Puerto Rico-based EDR to provide technical assistance to potential grantees and to identify projects on the island that may be suitable for EDA support. Similarly, the Task Force recommends to potential Puerto Rico-based applicants for EDA funding that they affirmatively seek technical assistance from EDA and incorporate feedback from EDA into their applications, a step that EDA says does not always occur. The Task Force believes that the ultimate objective should be to arrive at a point where the quantity of EDA grants to Puerto Rico-based applicants better corresponds with the size of Puerto Rico's population and the scale of its economic development needs.

- The Task Force was advised by multiple federal agencies that the government of Puerto Rico has yet to establish a comprehensive economic development strategy that exploits the island's many advantages. The 2017 Comprehensive Economic Development Strategy (CEDS) for Puerto Rico that the CEDS Committee is in the process of preparing, with technical assistance from EDA, could help in this regard. The Task Force recommends that the **CEDS Committee** obtain input from a diverse array of stakeholders, particularly from the private and non-profit sectors. The Task Force further recommends that that CEDS Committee, once the CEDS has been approved by EDA, make the CEDS available on-line and otherwise publicize the CEDS to stakeholders on the island, in the U.S. mainland, and abroad. The Task Force notes that, although the Puerto Rico Planning Board purports to provide a link to the current CEDS (last updated in 2014) on its website, the Task Force was unable to access the report. An economic development strategy document not accessible by the general public, potential and current investors in the island, and other stakeholders is of questionable utility, no matter how sound its contents might be.

- The Puerto Rico Department of Agriculture has advised the Task Force that over 80 percent of the food consumed in Puerto Rico is transported to the island from the U.S. mainland and from foreign countries. According to information provided to the Task Force, an extended disruption in maritime trade could result in Puerto Rico's supply of food being exhausted within a matter of weeks or less. The Task Force notes that, in Fiscal Year 2011, EDA made a $100,000 Economic Adjustment Assistance grant to the Hawaii State Office of Planning to develop a plan to improve Hawaii's agricultural sector and food distribution systems, with Hawaii contributing $100,000 in matching funds. In 2012, the Hawaii government released a three-volume report, with Volume 1 entitled "Increased Food Security and Food Self-

Sufficiency Strategy." The Task Force believes that a similar EDA-funded effort may be appropriate and valuable in the case of Puerto Rico and recommends to **EDA**, the **CEDS Committee**, and other stakeholders that they explore this possibility.

D. Electronic Export Information

Under 13 U.S.C. Chapter 9 (Section 301 to Section 307), the U.S. Census Bureau—within the U.S. Department of Commerce—is responsible for collecting and publishing export trade statistics. The Census Bureau has issued regulations—15 CFR 30—to fulfill this responsibility. Except in specified instances, these regulations require an exporter to provide Electronic Export Information (EEI), which includes the identity of the exporter and detailed information regarding the exported product. While the Census Bureau uses the EEI solely for statistical purposes, other federal agencies use EEI to prevent unauthorized exports. EEIs are generally filed electronically through the Automated Export System (AES). EEIs are completed and filed by either the exporter (known as the U.S. Principal Party in Interest, or USPPI) or by the maritime or air carrier (the freight forwarder) transporting the goods.

EEI filings are required for shipments between the United States (including its territories) and a foreign nation, although EEI filings are not generally required for shipments from the United States to Canada.[84] EEI filings are not required for shipments between one U.S. state and another U.S. state.

With respect to shipments between the 50 states and a U.S. territory, the situation is more complex. For example:

- EEI filings *are* required for shipments from the states to Puerto Rico, and *are* required for shipments from Puerto Rico to the states.[85]

- EEI filings *are* required for shipments from the states (or from Puerto Rico) to the U.S. Virgin Islands, but are *not* required for shipments from the U.S. Virgin Islands to the states (or to Puerto Rico).[86]

- EEI filings are *not* required for shipments between the states and American Samoa, Guam, or the Northern Mariana Islands.[87]

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[84] See 15 CFR 30.36.

[85] See 15 CFR 30.2(a)(1)(i)(A) and (B).

[86] See 15 CFR 30.2(a)(1)(i)(C).

[87] See 15 CFR 30.2(d)(2).

The U.S. territories are not foreign countries, and Puerto Rico—unique among the five territories—is within "the customs territory of the United States."[88] Trade between the states and Puerto Rico is therefore more accurately described as interstate commerce than international commerce.

The Task Force received a written submission from the Express Association of America, which consists of the four largest express delivery service providers in the world—Deutsche Post DHL Group, FedEx, TNT and United Parcel Service (UPS). The Express Association asserted the following:

> Requiring EEI filings is tantamount to placing a boundary that separates Puerto Rico from the United States to the detriment of the Island's economic well-being. The EEI filing requirement adds a cost which increases the price of many goods purchased in Puerto Rico and imposes an unnecessary burden on interstate commerce, restricting the flow of trade within the United States. As a result, some stateside companies simply decide not to ship their merchandise to Puerto Rico. The EEI requirement is equally burdensome on companies exporting from Puerto Rico, particularly for small and medium sized business which do not have large brokerage and customs compliance staffs to generate the data. [Bullet points in original removed].

The Task Force makes the following recommendation:

- The Task Force recommends that the **U.S. Department of Commerce**—in consultation with its internal departments and other stakeholders, such as the U.S. Census Bureau and the Bureau of Economic Analysis; other appropriate federal agencies; the Puerto Rico Institute of Statistics; the Puerto Rico Planning Board; and the trade community—conduct a thorough evaluation of its regulations requiring EEI filings for shipments between the states and Puerto Rico. The Task Force is concerned about the possible adverse impact that required EEI filings may have on commerce between the states and Puerto Rico. At the same time, as described elsewhere in this report, the Task Force is intent on ensuring that timely and reliable economic statistics are available for Puerto Rico. The Task Force has been advised by federal officials that elimination of the EEI requirement may (1) negatively impact the ongoing, joint federal-local effort to modernize the methodology used to calculate Puerto Rico's gross domestic product (GDP) and other macroeconomic statistics, and (2) make it more difficult to measure trade between the states and Puerto Rico. As part of the recommended evaluation, the Department of Commerce should identify and weigh the

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[88] See 19 CFR 101.1.

benefits and costs of required EEI filings. The Department should assess whether alternate datasets, such as the government of Puerto Rico's SURI system (Sistema Unificado de Rentas Internas), could be used with or without modification to achieve the same statistical objective, while imposing a lesser burden on commerce. The recommended examination should also attempt to quantify any economic benefits that would be achieved by eliminating the EEI filing requirement.

8. U.S. Department of the Treasury

A. CDFI Fund

The Community Development Financial Institutions Fund (CDFI Fund), an office within the Department of the Treasury, seeks to generate economic growth in low-income communities that lack access to capital, credit and financial services. On October 4th, the Task Force held a staff-level briefing with the director of the CDFI Fund to discuss the Fund's programs and whether they are having their intended effects in Puerto Rico.

The CDFI Fund administers a number of competitive programs that invest in, train, and otherwise support CDFIs, including the core CDFI program, the Bank Enterprise Award program, and the Capital Magnet Fund. CDFIs are banks, credit unions, loan funds, or venture capital providers that provide loans, investments, financial services, and technical assistance to individuals and businesses with the goal of promoting community development in underserved areas.[89]

Under the core CDFI program, the CDFI Fund provides two types of monetary awards though an annual competitive application process: financial assistance awards up to $2 million and technical assistance awards up to $125,000.[90] Under the Bank Enterprise Award (BEA) program, the CDFI Fund makes awards to FDIC-insured banks and thrifts on a competitive basis. BEA program awardees are recognized for increasing their investments in certified CDFIs and their activities in economically-distressed communities. BEA program awards are retrospective, rewarding applicants for activities they have already completed.[91] Under the Capital Magnet

[89] There are nearly 1,000 certified CDFIs operating nationwide, but only six based in Puerto Rico, all loan funds.

[90] Since the inception of the CDFI program in 1994, the CDFI Fund has made about 3,000 FA and TA awards to CDFIs, totaling about $2 billion. The CDFI Fund has made a total of five FA awards and three TA awards to Puerto Rico-based CDFIs, totaling $2.3 million, and has made no awards since 2009. At least 9 CDFIs based in the states have made investments in Puerto Rico as well.

[91] Since the inception of the BEA program in 1994, no FDIC-insured bank in Puerto Rico has applied for a BEA.

Fund, the CDFI Fund makes competitive grants to CDFIs and non-profit housing organizations to finance affordable housing and other community revitalization projects.[92]

In addition, the CDFI Fund administers the New Markets Tax Credit (NMTC) program, which utilizes Community Development Entities (CDEs). CDEs are financial intermediaries through which private capital flows from investors to a qualified business located in a low-income community. Specifically, CDEs uses their authority to offer federal income tax credits to investors in exchange for the investors making equity investments in the CDE. The federal tax credit totals 39 percent of the original investment amount and is claimed over a period of seven years. Using the capital from these equity investments, CDEs can lend to and invest in businesses operating in low-income communities.[93]

While members of the Task Force agree on the ultimate goals of CDFI programs, members have varying views about the efficacy of the programs in achieving those objectives. In addition, some members of the Task Force have concerns about the adequacy of controls in CDFI programs.[94] Nevertheless, members of the Task Force agree that Puerto Rico should receive equitable opportunities under all CDFI Fund programs authorized and funded under current law.

The Task Force makes the following recommendations:

- The CDFI Fund website contains a "Searchable Awards Database." The database includes a user-friendly map. By clicking on any state or the District of Columbia, a visitor to the website receives a detailed summary of all CDFI Fund awards made to CDFIs and CDEs in that jurisdiction. Puerto Rico and the other territories are not included on the map, even though territory-based CDFIs and CDEs are eligible for all CDFI Fund programs. Similarly, the CDFI website contains a "NMTC Allocatee States Served" page, which features a map that also excludes Puerto Rico and the other territories. The Task Force recommends that the **CDFI Fund** update the maps on its website to include Puerto Rico and the other territories, and provide the same level of detailed award information for the territories that it provides for the states and the District of Columbia.

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[92] No Puerto Rico-based CDFI or non-profit housing organization has received a Capital Magnet Fund award.

[93] Nationwide, there are approximately 6,000 certified CDEs, including 18 based in Puerto Rico. Beginning in 2002, the CDFI Fund has completed 13 NMTC allocation rounds. The Fund has made 1,032 allocation awards totaling $50.5 billion in tax credit allocation authority. Puerto Rico-based CDEs have received three allocations, one for $45 million in 2009, one for $10 million in 2009, and one for $70 million in 2016.

[94] See, e.g., New Markets Tax Credit: Better Controls and Data Are Needed to Ensure Effectiveness, Government Accountability Office, July 10, 2014 (GAO-14-500).

- Although there are CDFIs based in the states that have made important investments in Puerto Rico, that does not diminish the need for additional Puerto Rico-based CDFIs that are familiar with Puerto Rico's particular economic and social needs and are focused exclusively on community development on the island. Puerto Rico has among the fewest CDFIs per capita of any state, and *the* fewest CDFIs per capita when the population is limited to individuals living below the federal poverty level. The Task Force recommends that the **CDFI Fund** take all reasonable steps to increase the number of CDFIs in Puerto Rico and the other territories, consistent with the House Appropriations Committee's language to that effect in the report accompanying the Financial Services and General Government Appropriations Act, 2017.[95] The Task Force further recommends that the CDFI Fund, as part of its Capacity Building Initiative, conduct at least one outreach event in Puerto Rico in the near future, something the Fund has not done to date. In addition, the Task Force recommends that the CDFI Fund continue its ongoing work with the U.S. Department of Commerce's Minority Business Development Agency, the Federal Reserve Bank of New York, the Opportunity Finance Network (a member-based organization of CDFIs), and other stakeholders to expand the number of CDFIs in Puerto Rico and to improve their capacity to apply for, obtain and make optimal use of CDFI Fund awards. Finally, the Task Force notes that there are 11 credit unions in Puerto Rico that are insured by the National Credit Union Administration (NCUA) and that, in January 2016, the CDFI Fund and the NCUA signed a memorandum of understanding to streamline the process for low-income credit unions to be certified as CDFIs. The Task Force recommends that the CDFI Fund take steps to educate the 11 NCUA-insured credit unions in Puerto Rico about the potential benefits of becoming a certified CDFI and about the process that exists for low-income credit unions to become certified on an expedited basis.

- Puerto Rico has fared poorly under the NMTC program to date, particularly in light of the fact that it has a higher poverty rate and unemployment rate than any state, making it precisely the kind of economically-distressed jurisdiction that the NMTC program is designed to assist. The Task Force recognizes that this problem cannot be resolved from one day to the next, but rather requires determined efforts on the part of the CDFI Fund, current and potential Puerto Rico-based CDEs, and other stakeholders. The CDFI Fund indicated in a memorandum to the Task Force that the preference that the Fund provides to applicants who commit to making "innovative use" of its NMTC allocation "serves as an incentive" for applicants to invest in states and territories, like Puerto Rico, that have historically received lower levels of NTMC-supported investments. At this juncture, however, there is insufficient evidence to confirm that the "innovative use" preference is, in fact, having such an incentivizing effect. Therefore, the Task Force recommends that the **CDFI Fund** include in its annual NMTC program award report any examples of allocation awards that were

[95] See page 19.

advanced through the NMTC review process as a result of the "innovative use" criteria. By highlighting these success stories, the CDFI Fund could encourage future applicants to pursue development strategies in geographic areas that have been historically underserved by NMTC-supported investments as a means of being selected from a highly-competitive pool of applicants.

- The Task Force recommends that the **CDFI Fund** take steps to educate FDIC-insured banks in Puerto Rico about the potential benefits of applying for retrospective awards under the Bank Enterprise Award program, and reinvesting any award funding it receives into distressed communities on the island. The Task Force further recommends that the CDFI Fund take steps to educate Puerto Rico-based CDFIs about the Capital Magnet Fund.

- The director of the CDFI Fund is advised by a 15-member Community Development Advisory Board.[96] Six Board members represent federal agencies, while nine are private citizens appointed by the President. Federal law requires that these nine individuals "be selected, to the maximum extent practicable, to provide for national geographic representation and racial, ethnic, and gender diversity." No resident of Puerto Rico or any other territory has ever served on the Advisory Board. The Task Force believes that the lending and community development issues in the territories are unique in certain respects, and that CDFI Fund leadership could benefit from the counsel of an Advisory Board member with specialized expertise in this area. The Task Force recommends that the **CDFI Fund** make good-faith efforts to appoint an individual to the Community Development Advisory Board with personal experience and specialized expertise in the unique lending and community development issues facing U.S. territories.

B. Technical Assistance to the Government of Puerto Rico

Beginning in Fiscal Year 2016, Congress has expressly authorized the U.S. Department of the Treasury to provide "technical assistance" to the government of Puerto Rico on "stabilizing and strengthening public financial management and financial management systems." [97]

On October 11th, the Treasury Department provided a staff-level briefing for some, but not all, members of the Task Force. The Treasury Department indicated that it is currently using its technical assistance authority to help the government of Puerto Rico in the following five areas: (1) tax collection enforcement, (2) revenue forecasting and receipts estimation, (3) large taxpayer

[96] See 12 U.S.C. 4703.

[97] See Division E, Financial Services and General Government Appropriations Act, 2016, part of the Consolidated Appropriations Act, 2016 (P.L. 114-113); see also House Report 114-94, accompanying the Financial Services and General Government Appropriations Act, 2016, at page 11.

unit and general audit of taxpayers, (4) budget and cash management, and (5) information technology (tax administration).[98]

The Task Force makes the following recommendation:

- The Task Force recommends that **Congress** continue to provide the U.S. Department of the Treasury with the authority to provide technical assistance to the government of Puerto Rico, in order to help it stabilize and strengthen its financial management, financial management systems, and tax collection systems, with robust periodic reporting requirements. The Task Force recommends that the **Treasury Department** continue to provide technical assistance pursuant to this authority, and that the Treasury Department report to Congress on a regular basis regarding these efforts and the progress that is being made.

9. Investor Protection

On May 25, 2016, H.R. 5322, the U.S. Territories Investor Protection Act of 2016, was introduced in the House of Representatives.[99] The bill amends Section 6(a)(1) of the Investment Company Act of 1940 to terminate an exemption for investment companies located in Puerto Rico or any other U.S. territory. Under current law, such companies are exempt from registration under the Act provided that their shares are sold solely to the residents of the territory in which they are located. The bill provides a three-year safe harbor for investment companies that currently enjoy this exemption. Additionally, the bill authorizes the Securities and Exchange Commission (SEC) to further delay the effective date (that is, the end of the exemption) for a maximum of three years following the initial three year safe harbor.

H.R. 5322 was unanimously approved by the House Committee on Financial Services on June 16, 2016.[100] On July 11th, the full House approved H.R. 5322 by voice vote. On September 9th, an identical companion bill to H.R. 5322, S. 3467, was introduced in the Senate.[101]

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98 The Chairman of the Task Force, who is also the Chairman of the Senate Finance Committee, which has oversight and authorization responsibilities with respect to the Treasury Department, expresses his view that Treasury officials have chosen not to provide briefings requested by the Chairman regarding use of this technical assistance authority, or to explain why the Treasury Department has signed confidentiality agreements with two component units of the government of Puerto Rico, or to substantively respond to questions put forward by the Chairman. The Chairman expresses his view that this lack of transparency and accountability does not serve Congress or the people of Puerto Rico.

99 H.R. 5322 was introduced by Rep. Nydia Velázquez of New York.

100 See House Report 114-673.

101 S. 3467 was introduced by Senator Robert Menendez of New Jersey and cosponsored by Senator Orrin Hatch of Utah.

The Task Force makes the following recommendations:

- The Task Force recommends that **Congress** pass the U.S. Territories Investor Protection Act of 2016. The Task Force believes that the original justification for the exemption of investment companies located in Puerto Rico and the other territories from the Investment Company Act of 1940 (namely, the logistical challenges associated with SEC personnel traveling to the territories in order to inspect investment companies) is no longer valid; that repealing this exemption will provide important protections for investors residing in the U.S. territories that they currently lack; and that the U.S. Territories Investor Protection Act of 2016 provides investment companies in the territories with sufficient opportunity to come into compliance, and therefore does not unduly burden those companies.

- Municipal securities are subject to rules set by the Municipal Securities Rulemaking Board (MSRB), a self-regulatory organization charged with regulating financial companies that sell, purchase and underwrite municipal securities. SEC Rule 15c2-12 requires that dealers, when underwriting certain municipal securities, ensure that the state or local government issuing the bonds agrees to disclose certain information to the MSRB on an ongoing basis. Timely disclosure helps investors make informed decisions about investments in municipal bonds, including instances in which material changes to an issuer's financial condition occur, and helps protect them against fraud involving the bonds. The Task Force observes that Puerto Rico has too often missed its continuing disclosure obligations to provide audited financial statements. Failure to meet such obligations may have contributed to an inability of all stakeholders to fully understand the nature and extent of Puerto Rico's economic and fiscal challenges in a timely manner. The Task Force encourages further debate in Congress about the efficacy of SEC and MSRB rules and regulations governing failures to meet disclosure requirements.

10. Public Safety

Violent crime in a jurisdiction harms quality of life, spurs migration, and hinders economic growth by creating an overall environment that is less conducive to business activity and investment.

According to the FBI's Uniform Crime Reporting program for 2015, Puerto Rico has a higher homicide rate—16.8 homicides per 100,000 inhabitants—than any U.S. state. The state with the highest homicide rate is Louisiana, at 10.3 homicides per 100,000 inhabitants. The number of homicides in Puerto Rico peaked in 2011, at 1,164—or 31.4 homicides per 100,000 residents. There was a steady downward trend in the following years, with 1,005 homicides in

2012, 902 homicides in 2013, 684 homicides in 2014, and 588 homicides in 2015.[102] However, the number of homicides in 2016 exceeds the number in 2015, with over 630 homicides having occurred as of mid-December.

Many, if not most, of the homicides and other violent crimes in Puerto Rico are connected to the international narcotics trade.[103] Puerto Rico is an important transshipment point for drug trafficking organizations transporting narcotics from South America, Central America and the Caribbean to the mainland United States. Puerto Rico is also a final destination point for narcotics.

The Task Force makes the following recommendation:

- The Task Force recommends that **Congress** continue to exercise its oversight authority to ensure that federal agencies and departments—including the United States Attorneys, the Federal Bureau of Investigation, the Drug Enforcement Administration, the Bureau of Alcohol, Tobacco, Firearms and Explosives, the United States Marshals Service, United States Immigration and Customs Enforcement, the Transportation Security Administration, U.S. Customs and Border Protection, the United States Coast Guard, the Office of National Drug Control Policy (ONDCP), the Puerto Rico/U.S. Virgin Islands High Intensity Drug Trafficking Area (a law enforcement program funded by ONDCP), the National Guard Bureau, the Deputy Assistant Secretary of Defense for Counternarcotics and Global Threats, U.S. Northern Command (whose area of responsibility includes Puerto Rico and the U.S. Virgin Islands), and U.S. Southern Command (whose area of responsibility includes the nations of South America, Central America, and the Caribbean, as well as the air and sea approaches to Puerto Rico from the south)—are working in coordination with each another, and with local law enforcement officials, to reduce drug trafficking and associated violence in Puerto Rico and the neighboring U.S. Virgin Islands.

The ONDCP, a component of the Executive Office of the President, prepares and publishes the annual National Drug Control Strategy, which outlines the Administration's efforts to reduce the supply of, and demand for, illegal drugs. ONDCP also prepares and publishes various reports that supplement the National Drug Control Strategy. The Office of National Drug Control Policy Reauthorization Act of 2006 (P.L. 109-469) requires ONDCP to prepare a National Southwest Border Counternarcotics Strategy, and ONDCP has published four such strategy documents. Likewise, the Northern Border Counternarcotics Strategy Act of 2010 (P.L. 111-356) requires ONDCP to prepare a Northern Border Counternarcotics Strategy, and ONDCP has

[102] These annual homicide statistics are from the Puerto Rico police, and—in certain cases—vary from statistics published by other sources.

[103] See Puerto Rico/U.S. Virgin Islands High Intensity Drug Trafficking Area, Drug Market Analysis 2011, September 2011, at page 4.

published two such strategy documents. In House Report 113-72, which accompanied H.R. 2786, the Financial Services and General Government Appropriations Act, 2014, the House Appropriations Committee directed ONDCP "to develop a biennial Caribbean Border Counternarcotics Strategy, on terms equivalent to the existing Southwest Border Counternarcotics Strategy and the Northern Border Counternarcotics Strategy." The joint explanatory statement accompanying H.R 3547, the Consolidated Appropriations Act, 2014— enacted as P.L 113-76 on January 17, 2014—expressly adopted this directive, but modified the time given to ONDCP to prepare the Caribbean Border Counternarcotics Strategy from 90 days from the date of enactment to 120 days from the date of enactment. ONDCP published the Caribbean Border Counternarcotics Strategy on January 15, 2015. Assuming ONDCP adheres to the congressional directive to publish the Caribbean Border Counternarcotics Strategy on a biennial basis, an updated strategy document will be published in 2017.

The Task Force makes the following recommendations:

- The Task Force recommends that **Congress** enshrine in permanent law—as distinct from a committee report accompanying a single-year appropriations bill—the requirement that ONDCP prepare and publish a Caribbean Border Counternarcotics Strategy, just as Congress has enshrined in permanent law the requirement that ONDCP prepare a National Southwest Border Counternarcotics Strategy and a Northern Border Counternarcotics Strategy.

- Whether or not Congress does enshrine this requirement in permanent law, the Task Force recommends that **ONDCP** update the Caribbean Border Counternarcotics Strategy every two years, and ensure that the strategy document places particular emphasis on reducing drug supply, drug demand and drug-related violence in Puerto Rico and the U.S. Virgin Islands, the two U.S. jurisdictions in the Caribbean region.

For over a century, federal law has provided that the collection of certain duties, taxes and fees in Puerto Rico by U.S. Customs and Border Protection (CBP)—or its predecessor agencies—are to be deposited in what is often referred to as the Puerto Rico Trust Fund.[104] Pursuant to federal law and an implementing agreement between the federal government and the government of Puerto Rico, a significant portion of that revenue is used to fund certain federal operations in Puerto Rico, including the maritime operations of CBP's Office of Air and Marine Operations. Because of a shortfall in the Puerto Rico Trust Fund due to reduced customs collections in Fiscal Year 2011, CBP closed a maritime unit in San Juan that, in prior years, had seized a significant quantity of illegal drugs. CBP took this action because it interpreted current federal law to require that it use either the Puerto Rico Trust Fund or the CBP Salaries and Expenses appropriation, but not both, in order to fund its operations in Puerto Rico. As a result, the Department of Homeland Security appropriations bill for Fiscal Year 2015 and Fiscal Year 2016

[104] See 48 U.S.C. 740 and 48 U.S.C. 795.

each include language authorizing CBP to supplement funding from the Trust Fund with general appropriations when necessary to maintain or to temporarily increase operations in Puerto Rico.

The Task Force makes the following recommendation:

- The Task Force recommends that **Congress** continue its current policy of providing CBP's Office of Air and Marine Operations with flexibility to use both the Puerto Rico Trust Fund and general appropriations to maintain or temporarily increase its operations in Puerto Rico.

11. Municipal Solid Waste Landfills

On October 14th, the Task Force held a staff-level briefing via phone with officials from the U.S. Environmental Protection Agency to discuss the subject of Puerto Rico's municipal solid waste landfills. Some members of the Task Force also met with representatives from Puerto Rico Limpio ("Clean Puerto Rico"), a Puerto Rico-based organization that has pursued an aggressive public campaign to raise awareness about the troubled state of Puerto Rico's landfills and about what Puerto Rico Limpio believes to be inadequate efforts on the part of EPA and the Puerto Rico Environmental Quality Board to address this matter. Although this issue falls somewhat outside of the Task Force's domain, the Task Force would be remiss if it did not discuss it briefly, given the risks to public health and the environment that appear to be posed by the status quo.

The Resource Conservation and Recovery Act of 1976 (RCRA) instituted the first federal permit program for hazardous waste management programs and prohibited open dumps. According to EPA's briefing to the Task Force and EPA's website, there used to be approximately 70 landfills in Puerto Rico, many of which were "open dumps" and were closed post-RCRA. Currently, there are "approximately 29 operating landfills in Puerto Rico, the majority of which are beyond capacity." Most of these landfills are owned by the government of the municipality in which the landfill is located, and operated by the municipal government or a private company.

EPA notes that the Puerto Rico Environmental Quality Board (EQB) has had primary responsibility for regulating solid waste landfills on the island since 1994, when EPA approved EQB's solid waste compliance and enforcement program. Since 2007, EPA has reached legal agreements with 12 municipal governments to improve landfill operations and to place those landfills on a schedule for closure, and EPA indicates that it is "continuing to assess landfills throughout Puerto Rico and to develop legal agreements where appropriate." EPA reached these legal agreements pursuant to Section 7003 of RCRA, which authorizes EPA to take appropriate action if the handling or storage of solid waste "may present an imminent and substantial endangerment to health or the environment." According to a chart provided to the Task Force by EPA, about 70 percent of Puerto Rico's landfills are in violation of 40 CFR 258, EPA's regulations governing solid waste management, including a number of landfills that EPA has not yet scheduled for closure.

Puerto Rico Limpio argues that EPA's efforts are insufficient, and that the agency should move more quickly to close non-compliant landfills and even rescind its 1994 approval of EQB's solid waste program. EPA responds that it is not practical to immediately close most landfills in Puerto Rico (particularly since proper closure requires significant funding, something the government of Puerto Rico and the island's municipal governments lack); that rescinding its approval of EQB's solid waste program would not improve the situation; and that the agency is doing the most it can in light of all of the factual and legal circumstances.

The Task Force makes the following recommendation:

- The Task Force is concerned with the state of Puerto Rico's municipal solid waste landfills, and the potential impact on public health and the environment. The Task Force recommends that the committees of jurisdiction in **Congress** examine this issue, which has only recently attracted significant public attention, to determine whether there are additional steps that can and should be taken.

12. Arecibo Observatory

The National Science Foundation (NSF) owns the Arecibo Observatory, a scientific research and education facility located on 118 acres of federal land in west-central Puerto Rico. The Department of Defense funded construction of the Observatory in the early 1960s to study the ionosphere. In 1969, the facility was transferred from DOD to NSF and converted to a national research center, with operations led by Cornell University. In 2011, the cooperative agreement between Cornell University and NSF expired. Following a competition, a new cooperative agreement was awarded by NSF to SRI International, with sub-awards made to Universities Space Research Association and the Universidad Metropolitana (UMET). Together, these entities form the Arecibo Management Team, which maintains and operates the Observatory on behalf of NSF. The cooperative agreement has a five-year term, ending in September 2016, although the parties have agreed to extend the agreement through March 31, 2018.

The Observatory is a leading research institution, enabling research in space and atmospheric sciences, radio astronomy and solar system radar studies. The iconic feature of the Observatory is a 305-meter-diameter spherical radio telescope, which has been used to make significant contributions to astronomy. The telescope is recognized as an engineering landmark and scientists from all over the world compete to utilize it and its supporting facilities. Currently, the Observatory serves scientific communities in various fields, while also hosting an active education and public outreach program. Observatory infrastructure includes office and laboratory buildings, instrumentation for astronomy and physics, and lodging facilities for visiting scientists. The Observatory employs 128 people, including approximately 16 scientific staff, telescope operators, and support personnel. Many academic and research staff remotely access the Observatory to conduct research at their home institutions in the U.S. and abroad.

The Observatory has shared the results of its scientific investigations with the public since the opening of the Angel Ramos Foundation Science and Visitor Center in 1997. The visitor center provides science exhibits and a large auditorium, while the adjacent Angel Ramos Foundation Conference Center offers a classroom setting for workshops and professional meetings. The visitor center receives approximately 20,000 students per year and offers a variety of STEM-related opportunities for schoolchildren, teachers, and university students. As a result of the visitor center's role in making important research available to the public, it is included in the National Register of Historic Places (NRHP). Approximately 90,000 tourists visit the Arecibo Observatory annually, with local guided services and tour bus operators from San Juan providing day trips to the facility for a $13 entrance fee. The Observatory attracts tourism to the Municipality of Arecibo, where the annual per capita income is less than $10,000, and to the western part of Puerto Rico more generally.

The Observatory receives federal funding from NSF and the National Aeronautics and Space Administration (NASA). In Fiscal Year 2016, NSF provided $8.2 million—with half provided by the NSF Division of Astronomical Sciences and half provided by the NSF Division of Atmospheric and Geospace Science—and NASA's Planetary Science Division provided $3.7 million.

NSF has indicated that it needs to reduce funding for the Observatory, and has set forth possible alternative courses of action. On May 23, 2016, NSF published in the Federal Register a Notice of Intent to prepare an environmental impact statement.[105] On October 28th, NSF released its Draft Environmental Impact Statement (DEIS).

The DEIS analyzes five action alternatives, in addition to a no-action alternative. They are: (1) collaboration with interested parties for continued science-focused operations (NSF's preferred alternative); (2) collaboration with interested parties for transition to education-focused operations; (3) mothballing of facilities; (4) partial deconstruction and site restoration; and (5) complete deconstruction and site restoration.

As NSF acknowledges, reducing or ending operations at the Observatory would have numerous adverse socioeconomic effects in Arecibo and in Puerto Rico more generally, impacting job-creating economic activity currently generated by researchers, students and tourists. Moreover,

[105] See page 32349.

the Observatory is a unique STEM resource in a low-income U.S. jurisdiction that nonetheless manages to produce some of the top STEM professionals in the nation, and the Observatory's shuttering would come at a significant social and educational cost to the island.

The Task Force received two submissions regarding the Arecibo Observatory via the email portal. One is from the Angel Ramos Foundation, which emphasized the Center's STEM-related initiatives for students and researchers in Puerto Rico. The other is from the Universidad Metropolitana, which provided background on the Observatory and the Arecibo Management Team. Both submissions strongly opposed the decommissioning of the Observatory and recommended that operations be maintained or expanded instead.

The Task Force makes the following recommendation:

- The Task Force recognizes that the Arecibo Observatory is vital to Puerto Rico in a variety of ways, and believes that science-focused and education-focused operations should be continued at the site. The Task Force recommends that the **National Science Foundation**, in collaboration with other government and non-government stakeholders, take all feasible steps to achieve this result.

13. Former Naval Station Roosevelt Roads

The Naval Station Roosevelt Roads (NSRR), a large naval installation in northeastern Puerto Rico consisting of approximately 8,720 acres, closed on March 31, 2004 after supporting U.S. military operations for over 60 years.[106] The closure of a major military base can pose significant economic challenges to the surrounding communities, particularly in the short term, but it can also present substantial economic opportunities if the transition from military use to civilian use of the property is handled properly. A key role is played by the Local Redevelopment Authority (LRA)—an entity established by a state or local government, recognized by the Secretary of Defense through its Office of Economic Adjustment, and responsible for preparing and implementing the redevelopment plan for the former base.

In 2004, the government of Puerto Rico enacted a law creating an LRA for Roosevelt Roads. According to a publically-available source, the LRA consists of 11 staff members and has an annual budget of about $3 million, of which 56 percent is from the government of Puerto Rico, 41 percent is from the federal government, and 3 percent is generated by the LRA itself.

[106] See Report by the President's Task Force on Puerto Rico's Status, March 2011, at page 68-69; see also Naval Facilities Engineering Command, Former Naval Station Roosevelt Roads.

According to the LRA, the Department of Defense transferred 1,370 acres to the LRA in January 2012, and transferred 2,039 acres to the LRA in May 2013, for a total of 3,409 acres. The LRA has control of these lands and is able to execute redevelopment projects on nearly all of them. The transfer of lands from the Department of Defense to the LRA is now complete. (Of the remaining 5,000-plus acres of the former base, about 3,300 acres were transferred to the Puerto Rico Department of Natural and Environmental Resources and are being administered by the Puerto Rico Conservation Trust; the 1,600-acre airport was transferred to the Puerto Rico Ports Authority; a 140-acre beach was transferred to the municipality of Ceiba; 90 acres were transferred to other federal agencies; and a 30-acre hospital was transferred to the LRA.)

The redevelopment of NSRR has the potential to create many jobs and generate extensive economic activity in a geographic area of Puerto Rico that has high rates of unemployment and poverty. For example, the average 2015 unemployment rate in the municipality of Ceiba (population 12,000), where the NSRR is located, was 13.8 percent, while the unemployment rate in the neighboring municipalities of Naguabo (population 26,000) and Fajardo (population 33,000) was 13.3 percent and 14.8 percent, respectively.[107]

Recently, the federal government has taken steps to support the redevelopment of the NSRR. For example, in August 2015, the U.S. Small Business Administration (SBA) announced the designation of the NSRR as a Historically Underutilized Business Zone (HUBZone), which will enable small firms located within the former base to better compete for contracts to supply the federal government with goods and services. In addition, in June 2016 the federal government designated the NSRR as one of 22 "Promise Zones" throughout the United States. Promise Zones are federal-local partnerships in which economically-distressed areas receive priority access to federal investments and other forms of federal assistance.

Based on the foregoing, all of the pieces are in place for the former base to be redeveloped for the economic benefit of the people of Puerto Rico.

However, now that over 12 years have transpired since the base was closed and over three years have passed since the transfer of property from the Department of Defense to the LRA was completed, a candid assessment is in order. The effort to redevelop the former base has been slow. It has suffered from the same excessive degree of political interference that delays and disrupts far too many economic development projects in Puerto Rico. And it has been characterized by a redevelopment strategy that lacks coherence and consistency, shifting from one local administration to the next, and even from year to year within the same administration. To date, all of these efforts have resulted in the creation of less than 50 jobs.

[107] See generally Tri-City Partnership (consisting of the mayors of Ceiba, Naguabo and Fajardo), Submission to Congressional Task Force on Economic Growth in Puerto Rico.

The Task Force makes the following recommendation:

- The Task Force is concerned by the slow pace of the effort to redevelop the former Naval Station Roosevelt Roads (NSRR) for the economic benefit of the people of Puerto Rico. The Task Force believes a well-planned and well-executed redevelopment strategy has the potential to transform eastern Puerto Rico. The Task Force recommends that the **government of Puerto Rico,** working in conjunction with the Revitalization Coordinator established in Section 502 of PROMESA, elected leaders of the surrounding communities, federal government partners, and the private sector, prioritize the efficient and effective redevelopment of the NSRR. The Task Force urges the Local Redevelopment Authority responsible for overseeing the redevelopment effort to develop a sensible and sustained strategy.

14. Caño Martín Peña (Martín Peña Channel)

For approximately three decades, plans have been developed but not implemented to restore the Caño Martín Peña (Martín Peña Channel), a natural channel that connects the San Juan Bay with the San José Lagoon in metropolitan San Juan. The tidal flow between these two bodies of water and the flushing of the San José Lagoon has been impeded by persistent sedimentation and debris accumulation in the Caño. Many of the communities along the Caño lack sewer systems. Health studies have determined that frequent flooding in these communities is associated with high rates of gastrointestinal disease, asthma, and skin rashes among residents, particularly children. Habitat for fish and wildlife has also been lost due to water quality degradation.

Through the Water Resources Development Act of 2007 (WRDA), Congress provided a process for authorizing the restoration of Caño Martín Peña as a U.S. Army Corps of Engineers civil works project. On May 18, 2016, the Assistant Secretary of the Army for Civil Works signed a record of decision approving the final feasibility report and environmental impact statement for this project. The plan generally calls for the Corps of Engineers to dredge approximately 2.2 miles of the eastern half of the Caño to a width of 100 feet and a depth of 10 feet. The walls of the dredged Caño are to be constructed with concrete and steel. The project, once completed, will restore the natural tidal connection between the San Juan Bay and the San José Lagoon. Residents of the eight communities along the Caño would benefit from a healthy waterway, revitalized neighborhoods, and greater economic opportunities. Their homes and critical infrastructure in the area—including the runway for the San Juan International Airport adjacent to the San José Lagoon—would face reduced flood risks.

Obstacles to project construction, which is estimated to cost a total of $222 million, include the lack of an appropriation from Congress for the project; the limited ability of the non-federal sponsor ENLACE, an entity of the government of Puerto Rico, to satisfy its cost sharing obligations; and legal considerations related to the relocation of households located in the project area.

The Task Force makes the following recommendation:

- The Task Force believes that the project to restore Caño Martín Peña can provide a significant return on investment for the federal government in terms of improving the economy, protecting public health, and restoring the natural environment in some of Puerto Rico's most distressed communities. The Task Force recommends that the **U.S. Army Corps of Engineers** and the **non-federal sponsor ENLACE** finalize the Project Partnership Agreement (PPA) for the project as soon as feasible; that **Congress** consider appropriating funding to construct this project; and that **Congress** consider relaxing the cost-sharing obligations of the non-federal sponsor or otherwise taking steps to ensure that the government of Puerto Rico's fiscal crisis does not result in forward progress on this project being halted.

15. Federal Interagency Advisory Council on Child Poverty

The Task Force notes a proposal made to the Task Force by the Boys and Girls Clubs of Puerto Rico and the Youth Development Institute (*Instituto de Desarrollo de la Juventud)* to temporarily establish a "Federal Interagency Advisory Council on Child Poverty," consisting of experts from inside and outside of government, that would examine and report to Congress on steps that can be taken at the federal level to reduce child poverty, with a particular emphasis on those U.S. jurisdictions—like Puerto Rico, where nearly 64 percent of young children live below the federal poverty level—that have persistently high rates of child poverty. Under this proposal, a principal goal of the Council would be to help craft an overarching strategic framework to address multi-generational poverty. The Task Force wishes to express its appreciation to the dedicated representatives of the Boys and Girls Clubs of Puerto Rico, who took the time to arrange for Task Force staff visiting the island to meet with families residing in government- provided housing in Puerto Rico, with unemployed and underemployed individuals seeking employment, and with other community members. Individuals who are fourth-generation public housing residents underscore the need for efforts to improve economic opportunities in Puerto Rico and to address enduring child poverty on the island.

The Task Force makes the following recommendation:

- The Task Force recommends that the **federal government** consider establishing, either through congressional or executive action, a "Federal Interagency Advisory Council on Child

Poverty" or a functionally equivalent entity, which would examine and report to Congress on ways to address persistent child poverty in the United States, including its territories.

16. Unemployment Compensation Demonstration Project

The Unemployment Compensation (UC) program provides income support to eligible workers through the payment of UC benefits during a period of unemployment. The UC system operates in each state, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Puerto Rico is considered a state under UC law. The UC program is financed by federal taxes under the Federal Unemployment Tax Act (FUTA) and by state payroll taxes under the State Unemployment Tax Acts (SUTA). These taxes are deposited in the appropriate accounts within the Unemployment Trust Fund (UTF). Most businesses in the United States, including those in Puerto Rico, are subject to both state and federal unemployment taxes. An estimated $5.8 billion in federal unemployment taxes and $40.9 billion in state unemployment taxes were collected in Fiscal Year 2016.

UC benefits are available for up to 26 weeks in most states, including Puerto Rico. These benefits are mostly paid for by the state out of state unemployment taxes. The federal government pays certain administrative costs only.

Federal law prescribes how a state may use its state unemployment taxes, generally requiring a state to utilize those taxes only to pay unemployment benefits. However, as part of a bipartisan compromise to extend federal unemployment insurance, Section 2102 of the Middle Class Tax Relief and Job Creation Act of 2012 (P.L. 112-96) authorized states to use the revenues from their SUTA taxes for certain purposes other than paying benefits. Specifically, Section 2102 authorized the U.S. Department of Labor to allow up to 10 states, including Puerto Rico, to conduct demonstration projects to improve and accelerate the reemployment of UC claimants. Pursuant to these demonstration projects, states could provide subsidies for employer- provided training, such as wage subsidies, or provide direct disbursements, not to exceed the weekly benefit amount of an individual, to employers who hire individuals receiving UC to pay part of the cost of wages that exceed the individual's prior benefit level. No demonstration project could be approved for more than three years and all projects were required to end by December 31, 2015.

It is generally agreed that Section 2102, and the April 2012 guidance that DOL issued to states regarding its implementation of that section, proved cumbersome and ultimately unworkable. Only one state submitted an application, no state demonstration project was approved by DOL, and the program has now expired. In 2014, legislation was introduced in the

U.S. House of Representatives to make various modifications to Section 2012 and to extend the demonstration project authority from December 31, 2015 to December 31, 2019.[108]

Proponents of allowing states to use UC benefits to subsidize employment assert that such initiatives can help unemployed workers receive job training and expedite reentry into the workforce. Critics raise concerns over the "quality" of jobs in which participants are often placed and point to the low percentage of participants retained after the subsidy ends.[109]

The Task Force makes the following recommendation:

- Given that Puerto Rico has a higher unemployment rate and lower labor force participation rate than any state, the Task Force recommends that **Congress** consider the merits and demerits of legislation to authorize Puerto Rico to have greater flexibility in its use of Unemployment Compensation benefits for the purpose of increasing employment.

17. Administrative Order 346

Section 409(g)(3) of PROMESA requires the Task Force to examine the "economic effect" of Administrative Order 346, issued by the Secretary of the Puerto Rico Department of Health on February 9, 2016.[110]

The Order required manufacturers and distributors of "natural products" and "dietary supplements" to register with, and pay certain fees to, the government of Puerto Rico. The Puerto Rico Secretary of Health characterized the Order as an effort to ensure the quality of products sold in Puerto Rico and to protect consumer health on the island. Affected manufacturers and distributors asserted that the Order constituted administrative overreach, suffered from substantive and procedural defects, and was intended primarily to raise revenue for the government, rather than to protect public health.

On September 21, 2016, the Task Force received a letter from the Puerto Rico Secretary of Health. The letter indicated that the Department of Health would issue an administrative order to place a 120-day "moratorium" on Administrative Order 346, draft a "new regulation" to replace

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[108] See H.R. 2509, Flexibility to Promote Reemployment Act (114th Congress; Rep. Renacci).

[109] See Julie M. Whittaker, "Expediting the Return to Work: Approaches in the Unemployment Compensation Program," Congressional Research Service, May 1, 2013.

[110] For the English-language text of the Order, see National Products Association, Submission #1 to Congressional Task Force on Economic Growth in Puerto Rico. For the Spanish-language text of the Order, see Council for Responsible Nutrition, Submission to Congressional Task Force on Economic Growth in Puerto Rico, Attachment #1.

the Order that complied with Puerto Rico law, and hold "public hearings" so that all affected parties could provide their "comments and recommendations."

On September 26th, Task Force staff held a phone conversation with the Secretary of Health and her advisors to discuss this subject.

The Task Force makes the following recommendation:

- If the Puerto Rico Department of Health does choose to replace Administrative Order 346 with a new regulation, the Task Force recommends to the **Puerto Rico Department of Health** that it follow through on the Secretary's pledge to hold public hearings on the proposed regulation so that all stakeholders, whether they support or oppose administrative action, can provide comments. If a new regulation is approved, and if any affected party believes the regulation violates Puerto Rico or federal law, the Task Force notes that the affected party may avail itself of the local or federal courts in Puerto Rico, just as it could in any other U.S. jurisdiction.

18. Puerto Rico's Political Status

Puerto Rico—along with American Samoa, Guam, the Northern Mariana Islands and the U.S. Virgin Islands—is an unincorporated territory of the United States. As a territory, Puerto Rico is subject to Congress's plenary powers under the Territory Clause of the United States Constitution.[111] The U.S. Supreme Court has held that, so long as Congress does not abridge the fundamental rights of individuals living in the territories, Congress can enact laws that treat the territories differently than the states if there is any rational basis for the differential treatment. Puerto Rico and the other territories are treated differently than the states under a variety of federal programs.

Each of the five U.S. territories elects a single delegate to the U.S. House of Representatives, who (under current House rules approved by the membership of the House) can introduce legislation, serve on House committees, and vote on legislation at the committee stage. However, the territorial delegates cannot vote on legislation on the floor of the House. The territories do not elect U.S. senators. The territories can—and, currently, each of the five territories does—participate in presidential primaries, but the territories cannot participate in the general election for president.

[111] See U.S. Constitution, Article IV, Section 3, Clause 2 (granting Congress the "Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States").

The term "unincorporated" territory denotes that Puerto Rico retains the potential—legally speaking—to: become a state of the United States; become a sovereign nation, either fully independent from the United States or with a voluntary compact of free association with the United States; or maintain its current status.

As a practical matter, in order for Puerto Rico to change its political status, the people of Puerto Rico—through an exercise of their right to self-determination—must first request a change in status in a fair and impartial plebiscite. If the people of Puerto Rico do request a change in status, the federal government would have to enact legislation to approve the requested change.

Puerto Rico has held four plebiscites on the territory's political status, each of which was conducted pursuant to Puerto Rico law. These plebiscites were held in 1967, 1993, 1998, and 2012.

In January 2014, Congress enacted the Consolidated Appropriations Act, 2014 (P.L. 113- 76). The law includes an appropriation of $2.5 million to the State Elections Commission of Puerto Rico to be used for "objective, nonpartisan voter education about, and a plebiscite on, options that would resolve Puerto Rico's future political status."[112] The House Committee on Appropriations' report explains this appropriation as follows:

"Puerto Rico plebiscite.—The recommendation includes $2,500,000 for objective, nonpartisan voter education about, and a plebiscite on, options that would resolve Puerto Rico's future political status. The funds provided for the plebiscite shall not be obligated until 45 days after the [United States] Department [of Justice] notifies the Committees on Appropriations that it approves of an expenditure plan from the Puerto Rico State Elections Commission for voter education and plebiscite administration, including approval of the plebiscite ballot. This notification shall include a finding that the voter education materials, plebiscite ballot, and related materials are not incompatible with the Constitution and laws and policies of the United States."[113]

Section 402 of PROMESA states: "Nothing in this Act shall be interpreted to restrict Puerto Rico's right to determine its future political status, including by conducting the plebiscite as authorized by Public Law 113–76."

The Task Force makes the following recommendation:

[112] See Consolidated Appropriations Act, 2014, at page 57.

[113] See House Report 113-171, at page 53.

- If the government of Puerto Rico conducts a plebiscite authorized and funded by Public Law 113-76, the Task Force recommends that **Congress** analyze the result of this plebiscite with care and seriousness of purpose, and take any appropriate legislative action.

Appendix 1: Submissions to Puerto Rico Task Force Email Portal

		Attachment		
Individual or Organization	**Date of Submission**	**1**	**2**	**3**
Manuel Abreu	8/5/16			
Antonio M. Abradelo (Submission 1)	9/16/16			
Antonio M. Abradelo (Submission 2)	9/17/16			
ACME Team Agriculture, Inc.	9/2/16			
Aeronautical and Aerospace Institute of Puerto Rico	9/15/16	1		
AFL-CIO	9/2/16			
AFSCME and UAW	9/2/16			
ALAS (The Alliance for Free Association)	9/16/16			
Alliance for Alternative Education	10/14/16			
Alliance for Healthcare Transformation	10/13/16			
Carlos Aleman	8/4/6			
Carlos Alicea	9/18/16			
Carmen Alicea	8/8/16			
Alvin Almodovar Molinary (Submission 1)	8/7/16			
Alvin Almodovar Molinary (Submission 2)	8/19/16			
Pedro L. Alvarado Reyes	8/7/16			
Angel Alvarez	9/18/16			
Raymond Amaral	9/15/16			
Ambac Assurance Corporation	9/2/16			
American Maritime Partnership	9/2/16			
Angel Ramos Foundation	9/1/16			
Anonymous	9/15/16			
Aqua Pura Sustainable Water Corporation	10/14/16			
Argos Productivity Solutions, Inc.	10/22/16 (Late)			
Ariel Investment Management, LLC (Delaware)	9/2/16			
Ariel Investment Management, LLC (Puerto Rico)	9/1/16			
Emilio Arsuaga Garrido (Submission 1)	8/6/16			
Emilio Arsuaga Garrido (Submission 2)	8/11/16			
Emilio Arsuaga Garrido (Submission 3)	8/13/16			
Emilio Arsuaga Garrido (Submission 4)	8/20/16			
Emilio Arsuaga Garrido (Submission 5)	9/2/16			
Emilio Arsuaga Garrido (Submission 6)	9/12/16			
Emilio Arsuaga Garrido (Submission 7)	9/13/16			
Emilio Arsuaga Garrido (Submission 8)	9/13/16			
Emilio Arsuaga Garrido (Submission 9)	10/16/16 (Late)			
David Ashe	8/6/16			
Asociación de Jubilados de la Universidad de Puerto Rico, Inc.	9/1/16			
Asociación Nacional de Tiendas de Autoservicio y Departamentales	8/19/16			
Associated General Contractors of America, Puerto Rico Chapter	10/14/16	1		

Association of Financial Guaranty Insurers (AFGI)	9/2/16			
Association of Information Technology Professionals, Puerto Rico Chapter	9/2/16			
Association of Primary Health Care in Puerto Rico, Inc. (ASPPR)	9/2/16			
Association of Private Colleges and Universities of Puerto Rico	10/14/16			
Aurorita	8/7/16			
Bacardi North America Corporation	8/23/16			
John Bacon	10/5/16			
Backyard Bondholders from Puerto Rico	10/14/16			
Pedro Barcelo	9/8/16			
Jaime Benson	9/13/16			
Luis Bermudez, Municipality of Vieques	9/3/16	1		
Hon. David Bernier	8/29/16			
Edgar Berrios Collazo	8/7/16			
Fernando Betancourt	8/15/16			
Hon. Eduardo Bhatia	9/1/16	1		
Birling Capital, LLC	9/8/16			
Roberto Bonilla Acosta	8/7/16			
Jason Borschow	9/5/16			
BRISA International	8/31/16			
Lisa Brown Masters	10/3/16			
Richard E. Brown	8/30/16			
Janeiri Burgos Rosario	8/5/16			
Jorge Bustelo	8/27/16			
Cámara de Comercio del Oeste de Puerto Rico	8/27/16			
CAMBIO Puerto Rico	9/2/16			
Campbell Soup Company	8/18/16			
Jorge M. Canellas Fidalgo	9/2/16			
Ignacio Canto (Submission 1)	8/5/16			
Ignacio Canto (Submission 2)	8/8/16			
Ignacio Canto (Submission 3)	8/8/16			
Ignacio Canto (Submission 4)	8/10/16			
Ignacio Canto (Submission 5)	8/15/16			
Raymond Capo	8/10/16			
Caras	10/14/16			
Caribbean CAGE, LLC	9/7/16			
José B. Carrion III	10/14/16			
Miguel A. Casellas Sastre (Submission 1)	8/15/16			
Miguel A. Casellas Sastre (Submission 2)	8/15/16			
Center for Budget and Policy Priorities (CBPP) (Submission 1)	9/2/16			
Center for Budget and Policy Priorities (CBPP) (Submission 2)	9/28/16			
Center for a New Economy (CNE) (Submission 1)	8/22/16			
Center for a New Economy (CNE) (Submission 2)	10/14/16			
Minerva Centevo	8/30/16			
Ricia Chansky	10/6/16			
Jose Chaparro	8/4/16			
Cobian Media	9/1/16			
Coca-Cola Company	9/3/16			

Carlos Colon	8/10/16			
Carlos A. Colón De Armas	9/2/16			
Hector M. De Gracia Colon	8/14/16			
Gerald Colvin	9/9/16			
Computype, Inc.	9/2/16			
Congressional Hispanic Caucus	9/9/16			
ConPRmetidos	9/8/16			
Consultiva Internacional, Inc.	8/23/16			
Francis Coto	8/5/16			
Council for Responsible Nutrition	10/14/16	1	2	3
Council of Former Mayors of the New Progressive Party	9/2/16			
Mary Crespo	8/10/16			
Alan R. Crumley	10/14/16			
Arnaldo Cruz Colón	8/5/16			
CSA Group	8/29/16			
Oscar Cucurullo	8/25/16			
Cutting Edge Superconductors	9/2/16			
Wolfgang Daszynik	9/11/16			
Sally Devin	9/2/16			
Jose Diaz (Submission 1)	8/22/16			
Jose Diaz (Submission 2)	8/24/16			
Jose Diaz (Submission 3)	8/30/16			
Jose Diaz (Submission 4)	9/1/16			
Jose Diaz (Submission 5)	9/1/16			
Jose Diaz (Submission 6)	9/13/16			
Jose Diaz (Submission 7)	9/13/16			
Jose Diaz (Submission 8)	9/13/16			
Jose Diaz (Submission 9)	9/30/16			
Jose Diaz (Submission 10)	9/30/16			
Jose Diaz (Submission 11)	10/11/16			
Jose A. Diaz	9/16/16			
Roque Diaz	8/5/16			
Dennis Dinzeo	8/7/16			
Dipak	10/14/16			
DISH Network Puerto Rico LLC	9/2/16			
Sonia Domínguez	9/2/16			
James Dornacker	9/13/16			
Eaton	9/2/16			
EC Waste, LLC	10/14/16			
ENLACE Martín Peña	10/14/16			
Entrepreneurs for Puerto Rico	10/11/16			
Equipco, LLC	9/2/16			
Javier Espinosa	8/6/16			
Evertec	10/14/16			
Express Association of America	10/12/16			
Family Voices	9/2/16			
Hon. Antonio J. Fas-Alzamora	10/13/16			

Edgar J. Febles	8/15/16			
Fabian Fejgielman	9/7/16			
Claribel Feliciano	8/7/16			
Miguel A. Ferrer	9/8/16			
Julio Figueroa	8/6/16			
Santos Figueroa Beltran	8/8/16			
Ana M. Flores Cuadrado (Submission 1)	8/8/16			
Ana M. Flores Cuadrado (Submission 2)	8/22/16			
Jorge A. Flores	9/8/16			
Raymond Flores	9/8/16			
Thomas Forester	9/18/16			
Foundation for Puerto Rico	9/2/16			
Dennis Freytes (Submission 1)	8/11/16			
Dennis Freytes (Submission 2)	9/6/16			
Alejandro Fuentes	9/13/16			
Fundacion Libertad	9/2/16			
Gallardo	9/8/16			
André M. Garcia (Submission 1)	8/7/16			
André M. Garcia (Submission 2)	8/8/16			
Arturo J. Garcia	9/16/16			
Idalia Garcia and Other Puerto Rico Small Business Owners	9/2/16			
Juan Garcia	8/5/16			
Hon. Alejandro Garcia Padilla (Governor of Puerto Rico)	8/11/16			
Gardy BR	8/10/16			
David Gaynor	8/5/16			
Ramón Gil	10/14/16			
Laureano A. Giraldez-Rodriguez	8/10/16			
Radames Gomez Rivera	9/17/16			
Roger P. Gonsalves	8/5/16	1	2	
Aura Gonzalez	8/7/16			
David Gonzalez and Annette Cedeño	8/30/16			
Giancarlo Gonzalez	9/13/16			
Guillermo Gonzalez	8/14/16			
Jorge Gonzalez Garcia (Submission 1)	8/30/16			
Jorge González Garcia (Submission 2)	8/31/16			
Jorge González Garcia (Submission 3)	9/23/16			
Juan Marcos Gonzalez (Submission 1)	9/2/16			
Juan Marcos Gonzalez (Submission 2)	9/8/16			
Harvey Gonzalez	8/5/16			
Mario Gonzalez	9/3/16			
Francisco R. Gonzalez-Colón	9/2/16			
Tomas Gonzalez	8/4/16			
Alfredo Gonzalez Martinez and Jose I. Alameda-Lozada	8/10/16			
Ydelio Gonzalez	9/19/16			
GreenLatinos	9/2/16			
Elias R. Gutierrez and Walter Ruiz	9/16/16			

Yamilet Gutierrez	8/6/16			
Hugo Guzman	8/12/16			
Jose Enrique Guzman-Virella	8/4/16			
Patrick Harrigan	9/8/16			
Joseph W. Heiser	9/2/16			
Ivan D. Hernandez	8/19/16			
Hispanic Federation	9/3/16			
Holding Company Grupo Cooperativo Seguros Múltiples	10/14/16			
Hunt Development Group/Moss Construction Managers	10/14/16			
William O. Hurtado Santiago	9/15/16			
Igualdad	9/2/16			
Impactivo, LLC	8/31/16			
Frank D. Inserni (Submission 1)	8/14/16			
Frank D. Inserni (Submission 2)	8/29/16			
Juan Irizarry	8/31/16			
José M. Izquierdo Encarnación	9/8/16			
William Jaeger	8/5/16			
Glenn P. Jenkins	10/11/16	1	2	3
Carlos Jiménez	8/30/16			
Coralaidee Jiménez	9/2/16			
Marc Joffe	9/2/16			
Jubilee USA	9/2/16			
Junte de Asociaciones con Pensionados del Gobierno de Puerto Rico	8/31/16			
Cathy Kunkel et al, Institute for Energy Economics and Financial Analysis	9/6/16	1		
Desmond Lachman, American Enterprise Institute	8/17/16			
Luis E. Lao Gonzalez	9/2/16			
Leadership Council of Aging Organizations	10/14/16			
Jeronimo Lectora (Submission 1)	8/23/16			
Jeronimo Lectora (Submission 2)	9/1/16			
Jeronimo Lectora (Submission 3)	10/7/16			
Jeronimo Lectora (Submission 4)	10/14/16			
Hon. Ricardo J. Llerandi Cruz	9/6/16			
Cate Long, Puerto Rico Clearinghouse	9/6/16			
Antonio M. Longo	8/10/16			
Carmen Lopez	8/7/16			
Carlos Lopez	9/10/16			
Franklin Lopez	8/5/16			
Hector Lopez Cardona	8/10/16			
Gilberto Lopez-Padro	9/8/16			
John Lugo Ruiz	9/27/16			
Arthur MacEwan and J. Tomas Hexner (Submission 1)	8/25/16			
Arthur MacEwan and J. Tomas Hexner (Submission 2)	8/25/16			
Arthur MacEwan and J. Tomas Hexner (Submission 3)	8/25/16			
Arthur MacEwan and J. Tomas Hexner (Submission 4)	8/25/16			
Arthur MacEwan and J. Tomas Hexner (Submission 5)	8/25/16			
Arthur MacEwan and J. Tomas Hexner (Submission 6)	8/25/16			

Alfredo Machado	9/7/16				
Miguel A. Maldonado-Peña	10/14/16				
Hon. Kenneth Mapp (Governor of the U.S. Virgin Islands)	10/12/16				
Luis R. Marin	8/28/16	1			
Raul Marrero	8/10/16				
David R. Martin	9/6/16				
Julio Mateo Rodriguez	9/2/16				
Maymijuan	8/5/16				
Mc367700	8/5/16				
Mech-Tech College	10/13/16				
Medical Card System, Inc.	9/2/16	1			
Edwin Melendez et al. (Submission 1)	10/14/16				
Edwin Melendez et al. (Submission 2)	10/14/16				
Luis Melendez	8/6/16				
Francisco Mendez	10/14/16				
Jan Carlos Miranda	8/5/16				
Military Retiree Community of Puerto Rico	9/28/16				
Rafael J. Molina	8/5/16				
Angel Montes	8/5/16				
Luis E. Morales Falcon	8/15/16				
Jaime Morales	9/8/16				
Manuel Morales	9/29/16				
Municipal Securities Rulemaking Board (MSRB)	9/2/16				
Jose J. Muñiz	9/26/16				
Harry Narvaez Munet	8/13/16				
National Association of Development Companies	10/14/16				
National Association of Government Guaranteed Lenders	10/14/16				
National Grocers Association	9/2/16				
National Products Association (Submission 1)	9/6/16				
National Products Association (Submission 2)	9/6/16				
National Products Association (Submission 3)	9/6/16				
National Products Association (Submission 4)	9/6/16				
National Products Association (Submission 5)	9/6/16				
National Taxpayers Union	9/2/16				
Manuel F. Navedo	8/4/16				
Cesar Negrette	9/2/16				
George R. Nethercutt	10/14/16	1	2		
NETS Educational Institution	10/5/16				
Non-Profit Community Service Organizations in Puerto Rico	9/2/16				
Rosario Ojeda (Submission 1)	8/4/16				
Rosario Ojeda (Submission 2)	8/7/16				
Luis Oliveras	9/6/16				
Jose Olmos	9/1/16				
Opportunity Finance Network	10/14/16				
Orlando	9/7/16				
Julita Ortiz	8/7/16				
Julio Ortiz	9/8/16				

Jose Ortiz	8/31/16			
Juan J. Otero	8/6/16			
Dr. Hernan Padilla	10/13/16			
Johel Padilla	8/6/16			
Dr. Samuel Padilla et al.	10/14/16			
Carlos M. Padin Bibiloni	9/2/16			
Elena M. Pagán	10/17/16 (Late)			
David Paitsel	9/15/16			
Paul Palen	8/8/16			
Parallel18	9/2/16			
Mariano Parlato	9/7/16			
PathStone Corporation	10/18/16 (Late)			
Efrain Pena	8/8/16			
Jose Perez Canabal	9/12/16			
Ignacio Pino	8/4/16			
Alex J. Pollock, American Enterprise Institute	8/31/16			
Ponce Health Science University	9/2/16			
Power Technologies Corporation	10/13/16	1	2	
Professional College of Engineers and Land Surveyors of Puerto Rico (CIAPR)	9/2/16			
Puerto Rican Diaspora for the University of Puerto Rico	10/17/16 (Late)			
Puerto Rico Association of REALTORS	9/2/16			
Puerto Rico Association of Renewable Energy Producers	9/2/16			
Puerto Rico Bankers Association	9/2/16			
Puerto Rico Builders Association	9/2/16			
Puerto Rico Chamber of Commerce	9/15/16	1	2	
Puerto Rico Chapter of the American College of Cardiology	10/14/16			
Puerto Rico College of Healthcare Service Administrators	9/16/16			
Puerto Rico College of Physicians and Surgeons	9/2/16			
Puerto Rico Community Foundation	9/2/16			
Puerto Rico Community Pharmacies Association (Submission 1)	10/24/16 (Late)			
Puerto Rico Community Pharmacies Association (Submission 2)	10/24/16 (Late)			
Puerto Rico Conservation Trust	8/18/16	1		
Puerto Rico District Export Council	8/31/16			
Puerto Rico Eastern Region Tri-City Partnership	9/2/16			
Puerto Rico Electric Power Authority	9/2/16			
Puerto Rico Electric Power Authority Bondholders	9/2/16			
Puerto Rico Equality Forum	9/2/16			
Puerto Rico Export Council	10/14/16			
Puerto Rico Farm Bureau	10/14/16			
Puerto Rico Fast Ferries, LLC	10/14/16			
Puerto Rico Food Marketing, Industry and Distribution Chamber (MIDA)	9/2/16			

Puerto Rico Fundación Agenda Ciudadana	9/2/16			
Puerto Rico Gasoline Retailers Association	8/29/16			
Puerto Rico Healthcare Community	8/4/16	1	2	3
Puerto Rico Health Information Network	9/2/16			
Puerto Rico Hospital Association	8/26/16			
Puerto Rico Hotel & Tourism Association (Submission 1)	9/2/16			
Puerto Rico Hotel & Tourism Association (Submission 2)	10/14/16			
Puerto Rico Information Technology Cluster (PRITC)	9/1/16			
Puerto Rico Institute of Statistics	9/2/16			
Puerto Rico International Insurers Association	9/6/16			
Puerto Rico Limpio	9/2/16			
Puerto Rico Minority Supplier Development Council	9/2/16			
Puerto Rico Mutual Funds	9/2/16			
Puerto Rico Private Sector Coalition (Submission 1)	9/2/16	1	2	
Puerto Rico Private Sector Coalition (Submission 2)	10/14/16			
Puerto Rico Religious Leaders	9/2/16			
Puerto Rico Retailers Association	9/2/16			
Puerto Rico Science, Technology, and Research Trust	9/2/16			
Puerto Rico Senate Committee on Civil Rights, Citizen Participation and Social Economy	9/2/16	1		
Puerto Rico Society of CPAs	9/2/16			
Puerto Rico Statehood Council (Submission 1)	9/2/16			
Puerto Rico Statehood Council (Submission 2)	10/5/16			
Puerto Rico Telecommunications Industry Alliance	9/2/16			
Puerto Rico Telecommunications Regulatory Board	9/2/16			
Puerto Rico United Retailers Association	9/2/16			
Puerto Rico-USA Foundation	9/2/16	1		
Juan Carlos Puig (Submission 1)	8/31/16			
Juan Carlos Puig (Submission 2)	10/9/16			
Maggie Puig	8/7/16			
PUMA Energy Caribe, LLC	9/2/16			
William Radinson	9/2/16			
Gabriel Ramirez	8/5/16			
Gerardo Ramirez (Submission 1)	8/4/16			
Gerardo Ramirez (Submission 2)	8/10/16			
Jose B. Ramirez	8/7/16			
Miriam J. Ramirez (Submission 1)	8/7/16			
Miriam J. Ramirez (Submission 2)	8/10/16	1		
Miriam J. Ramirez (Submission 3)	8/14/16			
Miriam J. Ramirez (Submission 4)	8/30/16			
Joselín E. Ramirez-Johnson	8/4/16			
Stuart J. Ramos	8/7/16			
Yamel Ramos	9/16/16			
Omar Y. Reyes Martínez	9/7/16			
Edwin Rivera	9/2/16			
Jorge A. Rivera	8/5/16			
Maria Isabel Rivera (Submission 1)	9/8/16			

Maria Isabel Rivera (Submission 2)	9/8/16			
Miguel Rivera	8/7/16			
Frederick Rivera Clement (Submission 1)	8/5/16			
Frederick Rivera Clement (Submission 2)	8/27/16			
Olivia Rivera Quiñones	8/9/16			
Lester Rivera Rigau	9/15/16			
Manuel Rivera Rivera	8/5/16			
Mariano Robledo Diaz	8/6/16			
Francisco Rodriguez-Castro	10/14/16			
Jorge L. Rodriguez	8/23/16			
Sirio Rodriguez	8/5/16			
William Rodriguez	8/6/16			
Jose Rojas	8/5/16			
Maria del Carmen Roman	8/7/16			
Hon. Carlos Romero-Barceló	9/2/16			
Miguel A. Romero-Lugo	10/10/16			
Tavo Rosado	8/7/16			
Raul Eduardo Rosas (Submission 1)	8/4/16	1		
Raul Eduardo Rosas (Submission 2)	9/29/16			
Raul Eduardo Rosas (Submission 3)	10/4/16			
Hon. Ricardo Rossello Nevares and Hon. Jenniffer Gonzalez-Colon	8/29/16			
Abelardo M. Ruiz	8/6/16			
Annette Ruiz	8/7/16			
Jose Samhan (Submission 1)	8/7/16			
Jose Samhan (Submission 2)	8/7/16			
Jose Samhan (Submission 3)	9/4/16			
Michele Sanchez	9/17/16			
Ramon A. Sanchez	9/2/16			
San Juan Tech Meetup	9/1/16			
Nelson R. Santana	10/11/16			
Zoilo G. Santana Sabino	9/16/16			
Joanna Santiago	8/13/16	1		
Liliana Santiago	8/7/16			
Victor M. Santiago	8/29/16			
Carmen Santiago-Marrero	8/5/16			
Dave Santos	8/5/16			
SeaOne Caribbean, LLC	8/26/16			
Seaport Consultants Asia and Torrado Developments	9/28/16			
Hon. Lawrence “Larry” Seilhamer (Submission 1)	10/10/16			
Hon. Lawrence “Larry” Seilhamer (Submission 2)	10/3/16			
Nan Selman	9/16/16			
Semillero Ventures LLC	9/2/16			
Roberto J. Serralles	9/12/16			
Congressman Jose E. Serrano	8/30/16			
Ivan Serrano	8/6/16			
Servidores Públicos Unidos de Puerto Rico (Council 95)	9/2/16			
Sindicato de Policías Puertorriqueños	9/2/16			

Gary C. Smith (Submission 1)	9/2/16			
Gary C. Smith (Submission 2)	9/7/16			
Gary C. Smith (Submission 3)	9/23/16			
Gary C. Smith (Submission 4)	9/27/16			
Society, Education, and Rehabilitation of Puerto Rico, Inc. (SER)	9/2/16			
Spaceinnova LLC	9/1/16			
Carlos Sumpter (Submission 1)	8/4/16			
Carlos Sumpter (Submission 2)	8/15/16			
Tavaosiris	8/4/16			
Rudy Thomassen	9/6/16			
T-Mobile	10/14/16			
Evelyn Tirado (Submission 1)	8/4/16			
Evelyn Tirado (Submission 2)	8/4/16			
Evelyn Tirado (Submission 3)	8/4/16			
Jorge L. Tirado	10/12/16			
Tourism Association of Rincon	8/30/16			
Loren Trigo Ferre	9/23/16			
United Automobile Importers Group	10/14/16	1		
United Medical Corporation	9/2/16			
United Way of Puerto Rico	9/1/16			
U.S. Department of Commerce	9/2/16			
U.S. Department of Treasury and U.S. Department of Health and Human Services	8/26/16			
Kenneth Valle	9/15/16			
Alberto M. Varela	8/24/16			
Hon. Victor L. Vassallo	9/25/16			
Rafael Vazquez Leon	8/17/16			
Héctor L. Vélez Cruz	10/14/16			
Vieques Libre Corporation	9/2/16			
Ricardo Villa Guillen	8/5/16			
Manuel Villalon Silva	8/5/16			
Tom Vincent	9/7/16			
Miguel A. Vivaldi-Oliver	9/2/16			
Waste Reduction Technologies, LLC	8/31/16			
Eugene Weil	10/14/16			
Richard Weisskoff	10/10/16			
Christopher Young	9/2/16			
Congressman Don Young	10/14/16			
Youth Development Institute	9/2/16	1		
Ismael Zapater	9/2/16			
Sergio Zeligman	8/16/16			

Appendix 2: Federal Programs Under Which Puerto Rico Receives Differential Treatment

Federal Programs Under Which Puerto Rico Receives Differential Treatment			
Program	**Federal Agency that Administers Program**	**Congressional Committees With Jurisdiction Over Program (114th Congress)**	**Description of Differential Treatment**
Supplemental Nutrition Assistance Program (SNAP)/Nutrition Assistance Program (NAP)	U.S. Department of Agriculture (USDA), Food and Nutrition Service (FNS)	House Committee on Agriculture Senate Committee on Agriculture, Nutrition and Forestry	SNAP is designed to increase the food purchasing power of eligible low-income households so they can buy a nutritionally adequate diet. The states, DC, Guam and the U.S. Virgin Islands participate in SNAP. Maximum monthly benefit allotments are tied to the cost of purchasing a nutritionally adequate low-cost diet, as measured by the USDA-created and USDA-calculated Thrifty Food Plan (TFP). Maximum allotments are standard across the 48 contiguous states and DC, but are higher in Alaska, Hawaii, Guam, and the U.S. Virgin Islands. Puerto Rico, the CNMI and American Samoa do not participate in SNAP, although the 2014 Farm Bill authorized a pilot program that may result in the CNMI's inclusion in SNAP. Effective in 1982, Congress ended Puerto Rico's participation in SNAP (then, the Food Stamp Program), which is an open-ended entitlement, and provided a nutrition assistance block grant, known as the Nutrition Assistance Program (NAP). The NAP block grant is adjusted annually for inflation as measured by the change in the cost of the contiguous states' TFP. In Fiscal Year 2016, the NAP block grant was $1.959 billion. According to a June 2010 FNS report required by Congress, based on Fiscal Year 2009 funding levels, converting Puerto Rico from NAP to SNAP would increase the number of households that receive nutrition assistance by 15.3 percent, increase the average monthly benefit per household by 9.6 percent, and increase annual spending on benefits by $420 million.
Supplemental Nutrition Assistance Program Education (SNAP-Ed)	U.S. Department of Agriculture (USDA), Food and Nutrition Service (FNS)	House Committee on Agriculture Senate Committee on Agriculture, Nutrition and Forestry	A goal of SNAP-Ed is to improve the likelihood that persons eligible for SNAP will make healthy choices within a limited budget. The Healthy, Hunger-Free Kids Act of 2010 (P.L. 111–296) redesigned this program's funding, transitioning from (1) an open-ended funding stream for SNAP "state agencies" that put up matching funds to (2) a formula grant that provides an allocation for all SNAP "state agencies." The authorizing statute allocates formula funding to "state agencies" and, under 7 U.S.C. 2012(r)- (s), Guam and the U.S. Virgin Islands (who participate in SNAP) are "state agencies," but Puerto Rico, the CNMI and American Samoa are not. In Fiscal Year 2017, FNS will apportion $414 million in SNAP-Ed funding to the states, DC, Guam, and the U.S. Virgin Islands. In Fiscal Year 2015, Puerto Rico used $516,000 of its NAP block grant for its Nutrition Education Program.
Title I-A: (1) Basic Grants, (2) Concentration Grants, (3) Targeted Grants, and (4) Education Finance Incentive	U.S. Department of Education (USDE)	House Committee on Education and the Workforce Senate Committee on Health,	Title I-A authorizes aid to local educational agencies (LEAs) for the education of disadvantaged children. Funds are allocated to LEAs via states using four different allocation formulas specified in statute: (1) Basic Grants, (2) Concentration Grants, (3) Targeted Grants, and (4) Education Finance Incentive Grants. Under each of the four formulas, Puerto Rico is treated as a state

Grants		Education, Labor and Pensions	for determining grant amounts. However, there are special caps that apply to the amount of funding that Puerto Rico is able to receive. CRS has estimated that Puerto Rico's Fiscal Year 2016 Title I-A grants would be $51.9 million (12.7 percent) higher in the absence of these caps, increasing from $408 million to $460 million.
Title I-C: Migrant Education Programs	U.S. Department of Education (USDE)	House Committee on Education and the Workforce Senate Committee on Health, Education, Labor and Pensions	Title I-C authorizes grants to state educational agencies (SEAs) for the education of migratory students. Funds are allocated by formula on the basis of each state's number of migratory students aged 3-21 and average per pupil expenditure (APPE) in the state. The allocation for Puerto Rico is based on the number of migratory children and a reduced APPE. Because Puerto Rico terminated its participation in the program in Fiscal Year 2006, CRS was unable to estimate how much funding for Puerto Rico might increase if a reduced APPE were not used.
Title I-D: Neglected, Delinquent and At-Risk Students Programs	U.S. Department of Education (USDE)	House Committee on Education and the Workforce Senate Committee on Health, Education, Labor and Pensions	Title I-D authorizes a pair of programs intended to improve education for students who are neglected, delinquent, or at risk of dropping out of school. The funds appropriated for Title I-D are used to provide state grants. Under this formula, Puerto Rico is treated as a state with one exception related to the expenditure factor used to determine Puerto Rico's grant amount. CRS has estimated that Puerto Rico's Fiscal Year 2016 Title I-D grant of $1.0 million would be $828,000 in the absence of this exception, which is $174,000 lower.
Title III-A: English Language Acquisition Grants	U.S. Department of Education (USDE)	House Committee on Education and the Workforce Senate Committee on Health, Education, Labor and Pensions	Title III-A is designed to help ensure that English learners (ELs) and immigrant students attain English proficiency. Formula grant allocations are made to states based on the proportion of ELs and immigrant students in each state relative to all states. Grants to Puerto Rico are capped at 0.5 percent of the total amount available for state grants. USDE estimated Puerto Rico's Fiscal Year 2016 Title III-A grant to be $3.4 million. CRS calculated that, if the cap were increased from 0.5 percent to 2.0 percent (rather than eliminated altogether), Puerto Rico's Title III-A grant would increase by $10.2 million, to $13.6 million.
Title IV-A: Student Support and Academic Enrichment Grants	U.S. Department of Education (USDE)	House Committee on Education and the Workforce Senate Committee on Health, Education, Labor and Pensions	Title IV-A of the Every Student Succeeds Act (ESSA) authorizes Student Support and Academic Enrichment Grants to provide students with access to a well-rounded education, improve school conditions for student learning, and improve the use of technology. Funds are allocated via formula to state educational agencies (SEAs) based on their Title I-A grant amounts. The minimum state grant amount is 0.5 percent of the amount available to states. Puerto Rico's grant is capped at the minimum state grant amount. The block grant is authorized at $1.65 billion for Fiscal Year 2017. CRS used a funding level of $1.0 billion (the amount approved by the House Appropriations Committee) to estimate Fiscal Year 2017 grant amounts, and calculated that Puerto Rico's grant would be $4.9 million with the cap and $24.9 million without the cap, an increase of $20.1 million.

Title IV-B: 21st-Century Community Learning Centers	U.S. Department of Education (USDE)	House Committee on Education and the Workforce Senate Committee on Health, Education, Labor and Pensions	The 21st Century Community Learning Centers program supports activities during non-school hours that offer academic enrichment and additional services, such as counseling and nutrition and health education, for school-aged children. Funds may also be used to support expanded learning programs. Formula grant allocations are made to states in proportion to their Title I-A grant amounts. Because Puerto Rico's Title I-A grant amount is affected by special caps and other provisions that have the effect of reducing the grant amount Puerto Rico would otherwise receive, the amount of funding Puerto Rico receives under the 21st Century Community Learning Centers is less than the amount Puerto Rico would receive if its Title I-A grant amount was not reduced by special provisions. CRS has estimated that Puerto Rico's Fiscal Year 2016 Title IV-B grants would be $4.1 million (14.1 percent) higher in the absence of these caps, increasing from $29.4 million to $33.5 million.
Title V-B: Rural Education Achievement Program	U.S. Department of Education (USDE)	House Committee on Education and the Workforce Senate Committee on Health, Education, Labor and Pensions	Like Hawaii and DC, Puerto Rico is a "single LEA state"—meaning that the entire territory is considered one LEA. To be eligible for funds under Title V-B, the locale code for each school in an LEA must be classified as rural according to the National Center for Education Statistics (NCES) classification system. Since multiple schools in Puerto Rico are classified as non-rural, the territory is not eligible to receive Title V-B funds.
Title V-B: Rural and Low-Income School Program (Rural and Low-Income School Grant Program; RLIS)	U.S. Department of Education (USDE)	House Committee on Education and the Workforce Senate Committee on Health, Education, Labor and Pensions	Like Hawaii and DC, Puerto Rico is a "single LEA state"—meaning that the entire territory is considered one LEA. To be eligible for funds under Title V-B, the locale code for each school in an LEA must be classified as rural according to the National Center for Education Statistics (NCES) classification system. Since multiple schools in Puerto Rico are classified as non-rural, the territory is not eligible to receive Title V-B funds.
Education for Homeless Children and Youths—Grants for State and Local Activities	U.S. Department of Education (USDE)	House Committee on Education and the Workforce Senate Committee on Health, Education, Labor and Pensions	The Education for Homeless Children and Youths (EHCY) program authorized under the McKinney-Vento Homeless Assistance Act provides assistance to SEAs and LEAs to ensure that all homeless children and youth have equal access to the same free, appropriate public education that is provided to other children and youth. Formula grant allocations are made to states in proportion to their Title I-A grant amounts with no hold harmless provisions applied. As Puerto Rico's Title I-A grant amount is affected by special caps and other provisions which have the effect of reducing the grant amount Puerto Rico would otherwise receive, the amount of funding Puerto Rico receives under the Homeless Education program is less than the amount Puerto Rico would receive if its Title I-A grant amount was not reduced by the Title I-A special provisions. CRS used a funding level of $70 million to estimate Fiscal Year 2016 grant amounts, and calculated that Puerto Rico's grant would be $263,000 (14.6 percent) higher in the absence of these caps, increasing from $1.8 million to approximately $2.1 million.
TRICARE	U.S. Department of Defense (DOD)	House Committee on Armed Services Senate Committee on Armed Services	TRICARE is the health care program of the U.S. Department of Defense Military Health System. TRICARE has four main benefit plans: a fee-for-service option (TRICARE Standard), a health maintenance organization option (TRICARE Prime), a preferred provider option (TRICARE Extra), and a Medicare wrap-around

			option for Medicare-eligible military retirees (TRICARE for Life). Military retirees are veterans who served on active duty for at least 20 years or were medically retired. Under current law, military retirees in the territories are eligible for TRICARE Standard, but not TRICARE Prime. This is because the territories are considered "overseas" locations for purposes of military health care services, and are therefore treated as the functional equivalent of foreign countries. In the states, access to TRICARE Prime is available to retirees who reside in "Prime Service Areas," or PSAs. According to a 2015 Department of Defense report to Congress, there are PSAs in 46 of the 50 states (the exceptions being Iowa, Minnesota, Vermont, and Wisconsin) and DC. There are over 635,000 military retirees enrolled in TRICARE Prime nationwide, and approximately one million family members of retirees enrolled in TRICARE Prime, who also receive coverage under Prime. The Department of Defense has the authority under current law to extend TRICARE Prime to some or all of the territories.
Supplemental Security Income (SSI)/Aid to the Aged, Blind, or Disabled (AABD)	SSI: Social Security Administration (SSA) AABD: U.S. Department of Health and Human Services (HHS), Administration for Children and Families (ACF)	House Committee on Ways and Means Senate Committee on Finance	SSI, administered by the SSA, provides monthly cash benefits to low-income aged, blind, or disabled persons in the 50 states, DC, and the Northern Mariana Islands. In 2016, the maximum monthly SSI payment is $733 for an individual and $1,100 for a couple if both members are eligible for SSI. In August 2016, the average monthly SSI payment was $540 for all recipients, $645 for children, $561 for working-age adults, and $435 for seniors. Congress has not extended the SSI program to Puerto Rico, which instead participates in AABD, administered by ACF within HHS. While SSI provides monthly benefits directly to eligible individuals, the federal government provides AABD funding to the Puerto Rico government, which distributes it to eligible individuals. The Puerto Rico government must provide certain local matching funds. Based on a 2014 GAO report, and on information supplied to the Task Force by ACF, the federal government provides approximately $24 to $26 million annually to the Puerto Rico government, which is used to provide benefits to approximately 34,000 to 38,000 individuals, who receive an average monthly benefit of approximately $74 to $77 per recipient. The GAO calculated that, if Puerto Rico were included in SSI in Fiscal Year 2011, Puerto Rico beneficiaries would receive between $1.5 billion and $1.8 billion per year, 305,000 to 354,000 individuals would receive benefits, and the average monthly benefit would be around $540. The Puerto Rico government would have no matching requirement for benefit payments or administrative costs. NOTE REGARDING SOCIAL SERVICES FUNDING CAP: Puerto Rico is subject to an overall annual federal funding cap of $107,255,000 set forth in Section 1108 of the Social Security Act. The four federal programs subject to the Section 1108 cap are (1) *the AABD program*, (2) the Temporary Assistance for Needy Families (TANF) program, (3) various child welfare funding streams under Title IV-E of the Social Security Act, and (4) the Matching Grants to the territories under Section 1108(b) of the Social Security Act.

Temporary Assistance for Needy Families (TANF, Title IV-A of the Social Security Act)	U.S. Department of Health and Human Services (HHS), Administration for Children and Families (ACF)	House Committee on Ways and Means Senate Committee on Finance	The TANF block grant provides federal grants to the states and territories for a wide range of benefits, services, and activities, including helping states and territories pay for cash welfare for needy families with children. TANF generally applies to Puerto Rico and the other territories in the same manner as it applies to the states and DC, in terms of its purpose, flexibility to use federal grants, program requirements, and the computation of the TANF basic block grant (which, in Puerto Rico, is set at $71.6 million). TANF's application to Puerto Rico and the other territories differs in that they are ineligible for certain TANF grants—supplemental grants (not currently applicable), contingency funds, and mandatory child care funds—that certain qualifying states may receive. On the other hand, Puerto Rico and the other territories may receive special matching funds for TANF, child care, and Title IV-E foster care and permanency programs under Section 1108(b) of the Social Security Act. NOTE REGARDING SOCIAL SERVICES FUNDING CAP: Puerto Rico is subject to an overall annual federal funding cap of $107,255,000 set forth in Section 1108 of the Social Security Act. The four federal programs subject to the Section 1108 cap are (1) the AABD program, (2) *the Temporary Assistance for Needy Families (TANF) program*, (3) various child welfare funding streams under Title IV-E of the Social Security Act, and (4) the Matching Grants to the territories under Section 1108(b) of the Social Security Act.
Temporary Assistance for Needy Families (TANF) Contingency Fund (Title IV-A of the Social Security Act)	U.S. Department of Health and Human Services (HHS), Administration for Children and Families (ACF)	House Committee on Ways and Means Senate Committee on Finance	Only the 50 states and DC are eligible to receive funding under the TANF Contingency Fund; Puerto Rico and the other territories are not eligible. See 42 U.S.C. 603(b)(7). States qualify based on high unemployment, Supplemental Nutrition Assistance Program (SNAP) caseloads, and state expenditures above what was spent in Fiscal Year 1994.
Child Care Mandatory and Matching Funds of the Child Care and Development Fund (Title IV-A of the Social Security Act)	U.S. Department of Health and Human Services (HHS), Administration for Children and Families (ACF)	House Committee on Ways and Means Senate Committee on Finance	Only the 50 states and DC are eligible to receive funding under the Child Care Mandatory and Matching Funds program; Puerto Rico and the other territories are not eligible. See 42 U.S.C. 618(d). There are two different mandatory child care funding streams: (1) "guaranteed" mandatory funds, and (2) mandatory matching funds. Guaranteed mandatory funds are allocated to states based on the amount each state received for certain welfare-related child care programs in Fiscal Year 1994 or Fiscal Year 1995, or the average of Fiscal Year 1992-Fiscal Year 1994, whichever is greater. Mandatory matching funds are distributed to states based on their relative share of children under age 13. To receive their full share of mandatory matching funds, states must meet maintenance-of-effort and matching requirements.
Title IV-E Foster Care, Adoption Assistance, Guardianship Assistance Program (Title IV-E of the Social Security Act)	U.S. Department of Health and Human Services (HHS), Administration for Children and Families (ACF)	House Committee on Ways and Means Senate Committee on Finance	Title IV-E of the Social Security Act entitles states and territories with an approved Title IV-E plan to reimbursement of part of their costs of providing foster care, adoption assistance, and kinship guardianship assistance on behalf of eligible children. Puerto Rico is the only territory with an approved Title IV-E plan. Federal Title IV-E support is offered on an open-ended basis to states, but is subject to the social services spending cap in Puerto Rico. The share of federal Title IV-E support provided is 50 percent for program administration costs; 75 percent for program training

			costs; and the state or territory's Federal Medical Assistance Percentage (FMAP) for foster care maintenance, adoption assistance, and guardianship assistance payments. State FMAPs are recalculated annually and may vary from 50 percent to 83 percent; states with the highest per capita income relative to the nation receive lower federal support and vice versa. Puerto Rico's FMAP (as applied to Title IV-E) is fixed at 55 percent. For Fiscal Year 2015, Puerto Rico submitted federal Title IV-E foster care and adoption assistance claims of about $5.4 million, primarily for foster care, and received federal reimbursement of $2.8 million. Puerto Rico has not opted to provide Title IV-E guardianship assistance. Federal eligibility rules for Title IV-E foster care include state/territory-specific income limits, tied to program rules in the now-defunct Aid to Families with Dependent Children (AFDC) program, as they existed in July 1996. A federal review of Puerto Rico's Title IV-E claims in 2003 indicated that the territory did not have procedures to properly limit Title IV-E claims to children meeting these IV-E foster care eligibility criteria. Puerto Rico's Title IV-E claims subsequently dropped to nearly zero. While Puerto Rico made corrections to its claiming system, for Fiscal Year 2015 it indicated that IV-E foster care maintenance payments were provided to just 252 children on an average monthly basis. NOTE REGARDING SOCIAL SERVICES FUNDING CAP: Puerto Rico is subject to an overall annual federal funding cap of $107,255,000 set forth in Section 1108 of the Social Security Act. The four federal programs subject to the Section 1108 cap are (1) the AABD program, (2) the Temporary Assistance for Needy Families (TANF) program, (3) *various child welfare funding streams under Title IV-E of the Social Security Act,* and (4) the Matching Grants to the territories under Section 1108(b) of the Social Security Act.
Chafee Foster Care Independence Program, including Educational and Training Vouchers (Section 477 of the Social Security Act)	U.S. Department of Health and Human Services (HHS), Administration for Children and Families (ACF)	House Committee on Ways and Means Senate Committee on Finance	The John H. Chafee Foster Care Independence Program (CFCIP) authorizes funding for states and territories to provide services to help youth make a successful transition from foster care to adulthood. Funding for this program is authorized as a capped entitlement to states and territories provided they have an approved Title IV-E foster care and adoption assistance plan. Annual mandatory funding is authorized at $140 million and is distributed by formula; the federal share of program costs is 80 percent. Funding for Chafee Educational and Training Vouchers (ETVs) is available to states and territories receiving Chafee grants and may be used to provide vouchers (valued at up to $5,000 per year) to support post-secondary education and training for youth who have aged out (or are expected to age out) of foster care. Annual funding is authorized on a discretionary basis and is distributed by formula to each state or territory that receives CFCIP funds; the federal share of program costs is 80 percent. For Fiscal Year 2015, Congress provided just over $43 million for the ETV program. Puerto Rico is the only territory with a Title IV-E plan and thus the only one receiving CFCIP and ETV funds. For Fiscal Year 2015, Puerto Rico's CFCIP allotment was $1,376,075 and its ETV allotment was $444,652.

			NOTE REGARDING SOCIAL SERVICES FUNDING CAP: Puerto Rico is subject to an overall annual federal funding cap of $107,255,000 set forth in Section 1108 of the Social Security Act. The four federal programs subject to the Section 1108 cap are (1) the AABD program, (2) the Temporary Assistance for Needy Families (TANF) program, (3) *various child welfare funding streams under Title IV-E of the Social Security Act*, and (4) the Matching Grants to the territories under Section 1108(b) of the Social Security Act.
Adoption and Legal Guardianship Incentive Payments (Section 473A of the Social Security Act)	U.S. Department of Health and Human Services (HHS), Administration for Children and Families (ACF)	House Committee on Ways and Means Senate Committee on Finance	Adoption and Legal Guardianship Incentive Payments are awarded to states and territories (with a Title IV-E plan) that increase the rate at which children who cannot return home leave foster care to permanent adoptive families or legal guardians. Funding for incentive payments is authorized on a discretionary basis and awarded to states and territories based on their performance. For Fiscal Year 2016, Congress provided $38 million for these incentive payments. Puerto Rico is the only territory with a Title IV-E plan and thus the only one eligible for these incentive payments. For adoptions and legal guardianships finalized in Fiscal Year 2014, the most recent data publicly available, Puerto Rico received an incentive payment of $5,000. NOTE REGARDING SOCIAL SERVICES FUNDING CAP: Puerto Rico is subject to an overall annual federal funding cap of $107,255,000 set forth in Section 1108 of the Social Security Act. The four federal programs subject to the Section 1108 cap are (1) the AABD program, (2) the Temporary Assistance for Needy Families (TANF) program, (3) *various child welfare funding streams under Title IV-E of the Social Security Act*, and (4) the Matching Grants to the territories under Section 1108(b) of the Social Security Act.
Section 1108(b) Matching Grants to the Territories (Section 1108(b) of the Social Security Act)	U.S. Department of Health and Human Services (HHS), Administration for Children and Families (ACF)	House Committee on Ways and Means Senate Committee on Finance	Puerto Rico and the other territories qualify for Section 1108(b) Matching Grants based on having territorial government expenditures in excess of what the territory in question spent in Fiscal Year 1995. Section 1108(b) Matching Grants may be used for TANF, including child care, or Title IV-E foster care and permanency programs. Section 1108(b) Matching Grants include a 25 percent territory government matching requirement. NOTE REGARDING SOCIAL SERVICES FUNDING CAP: Puerto Rico is subject to an overall annual federal funding cap of $107,255,000 set forth in Section 1108 of the Social Security Act. The four federal programs subject to the Section 1108 cap are (1) the AABD program, (2) the Temporary Assistance for Needy Families (TANF) program, (3) various child welfare funding streams under Title IV-E of the Social Security Act, and (4) *the Matching Grants to the territories under Section 1108(b) of the Social Security Act*.

Low-Income Home Energy Assistance Program (LIHEAP)	U.S. Department of Health and Human Services (HHS), Administration for Children and Families (ACF)	House Committee on Energy and Commerce; House Committee on Education and the Workforce Senate Committee on Health, Education, Labor and Pensions	Under LIHEAP, the federal government makes annual grants to states and territories to operate home energy assistance programs for low-income households. The LIHEAP statute authorizes two types of funds: regular funds, which are allocated to all states using a statutory formula, and emergency contingency funds, which are allocated to one or more states at the discretion of the executive branch in cases of emergency. States and territories may use LIHEAP funds to help low-income households pay for heating and cooling costs, for crisis assistance, weatherization assistance, and services (such as counseling) to reduce the need for energy assistance. The LIHEAP statute provides that at least 0.10 percent (one-tenth of 1.0 percent) but not more than 0.50 percent (one-half of 1.0 percent) of the total regular fund appropriation must be set aside for energy assistance in the five territories. Within that range, HHS sets the exact percentage of funds that goes to the territories. From the inception of the program in the early 1980s through Fiscal Year 2013, HHS established the set-aside at approximately 0.134 percent of regular funds. This percentage was based on the amount of funding that the territories received under LIEAP, the predecessor program to LIHEAP. In FY2014, HHS set aside 0.5 percent of funding for the territories, the first time that funding had reached the maximum allowed by the statute. This set-aside has continued in appropriations since Fiscal Year 2014. HHS apportions funds among the five territories based on population, with Puerto Rico receiving approximately 90 percent of funds. In Fiscal Year 2016, Puerto Rico received $15.1 million in LIHEAP funds.
Medical Assistance Program (Medicaid)	U.S. Department of Health and Human Services (HHS), Centers for Medicare and Medicaid Services (CMS)	House Committee on Energy and Commerce Senate Committee on Finance	Medicaid is a joint federal-state program that finances the delivery of medical services for low-income individuals. The territories operate Medicaid programs under federal rules that differ from those applicable to the states and DC. For example, most of the eligibility and benefit requirements for the states and DC apply to the territories, but none of the territories cover all the mandatory eligibility groups and benefits. The federal matching rate (FMAP) in the states varies according to a state's per capita income and can range from 50 percent to 83 percent, while DC's FMAP is set by statute at 70 percent. The FMAP for the territories is generally set by statute at 55 percent. Federal Medicaid funding to the states and DC is open-ended, while the Medicaid programs in the territories are subject to federal spending caps (i.e., allotments) pursuant to Section 1108 of the Social Security Act (48 U.S.C. 1308), which are adjusted annually for inflation. Puerto Rico's Section 1108 cap was $335,300,000 in Fiscal Year 2016. The Patient Protection and Affordable Care Act (ACA; P.L. 111-148, as amended) provided $7.3 billion in additional Medicaid federal funding to the territories, available between July 1, 2011, and September 30, 2019, of which Puerto Rico received approximately $6.4 billion. In Fiscal Year 2016, Puerto Rico drew down approximately $1.63 billion in combined ACA funds ($1.3 billion) and Section 1108 funds ($335.3 million), not including federal funding for the Children's Health Insurance Program (CHIP), funding provided through Section 1935(e) of the Social Security Act, sometimes referred to as the enhanced allotment program

			(EAP), or funding for health information and technology.
State Medicaid Fraud Control Units (MFCU)	U.S. Department of Health and Human Services (HHS), Centers for Medicare and Medicaid Services (CMS)	House Committee on Energy and Commerce Senate Committee on Finance	Section 1902(a)(61) of the Social Security Act requires each state and territory to operate an MFCU to investigate and prosecute Medicaid provider fraud and patient abuse or neglect under state law, unless the state or territory demonstrates to the satisfaction of the HHS Secretary that the operation of an MFCU would not be cost-effective,. Currently, all states (except North Dakota) and the District of Columbia have MFCUs. Provided that a state MCFU is certified (and recertified annually) by the Department of Health and Human Services Office of Inspector General, federal law provides for an enhanced federal medical assistance percentage (FMAP) for MFCUs. None of the five territories operates an MFCU, which is likely a result (at least in part) of the annual federal Medicaid funding cap that applies to the territories. None of the territories has sought or received a waiver from the Secretary.
State Health Insurance Assistance Program (SHIP)	U.S. Department of Health and Human Services (HHS), Administration for Community Living (ACL)	House Committee on Energy and Commerce Senate Committee on Finance	In the Omnibus Budget Reconciliation Act of 1990 (OBRA 90; P.L. 101-508) Congress authorized and appropriated funding from the Medicare trust funds for a "beneficiary assistance program" to help Medicare beneficiaries receive Medicare, Medicaid, and other health-insurance services. The beneficiary assistance program was later renamed the State Health Insurance Assistance Program (SHIP) and administration of the SHIP program was officially transferred from CMS to the Administration for Community Living (ACL) in 2014. SHIP funding is allocated to states through grants that are required to consider the percentage of Medicare beneficiaries in the state, the rural population, and state administration capacity. Section 119 of the Medicare Improvements for Patients and Providers Act of 2008 (MIPPA, P.L. 110-275) authorized additional appropriations for SHIPs and other outreach assistance programs under the Administration on Aging, a precursor to ACL. The additional MIPPA appropriation, $13 million annually in Fiscal Year 2016 and Fiscal Year 2017, are allocated based on a statutory formula that relies in part on the percentage of Medicare beneficiaries who are eligible, but do not receive, a low-income subsidy (LIS) through Medicaid. Under Medicaid law, LIS subsidy programs are optional for the territories and none of the territories offer LIS. Thus, territories are not eligible for the additional MIPPA SHIP funding.

Medicare Part A	U.S. Department of Health and Human Services (HHS), Centers for Medicare and Medicaid Services (CMS)	House Committee on Ways and Means Senate Committee on Finance	Medicare Part A provides coverage for inpatient hospital, skilled nursing facility, home health, and hospice benefits. Eligible hospitals, including hospitals in Puerto Rico, that treat a certain share of low-income patients and are reimbursed under the Medicare Inpatient Prospective Payment System (IPPS) can receive additional payments—Medicare Disproportionate Share Hospital (DSH) payments—to offset the financial effects of treating such patients. Prior to the Patient Protection and Affordable Care Act (ACA; P.L. 111-148, as amended), DSH payments were provided by a single statutory formula that increased the IPPS reimbursement amount based on the disproportionate patient percentage (DPP). The DPP was based on a hospital's share of low-income patients, defined as the share of Medicare inpatient days for individuals entitled to federal Supplemental Security Income (SSI) benefits out of a hospital's total Medicare inpatient days (Medicare/SSI) plus the share of Medicaid inpatient days out of the hospital's total inpatient days. The ACA modified DSH funding for Fiscal Year 2014 and thereafter, splitting DSH into two payments with separate methodologies: (1) empirically justified DSH payments, which continue to be based on the traditional DPP but are reduced to 25 percent of the DSH payments that otherwise would have been provided in the absence of the ACA modification, and (2) uncompensated care payments, which are based on the most appropriate data available and, in the aggregate, are equal to the remaining 75 percent of the pre-ACA DSH amount. Currently, Medicare/SSI is a factor in calculating both payments. Residents of Puerto Rico are ineligible for SSI because the program is not available in the territory. The HHS Secretary, using administrative authority, modified the uncompensated care payment formula for Fiscal Year 2017 to use 14 percent of a Puerto Rico hospital's Medicaid days as a proxy for Medicare/SSI days, resulting in an estimated $12.9 million increase rather than an estimated $3.4 million decrease in total uncompensated care payments to hospitals in Puerto Rico in Fiscal Year 2017 in the absence of the new proxy. The Secretary did not use a proxy for Medicare/SSI in the empirically justified DSH payment formula, citing that the DPP is prescribed in statute for empirically justified DSH. See Social Security Act 1886(d)(5)(F)(vi).
Medicare Part B	U.S. Department of Health and Human Services (HHS), Centers for Medicare and Medicaid Services (CMS)	House Committee on Energy and Commerce; House Committee on Ways and Means Senate Committee on Finance	Medicare Part B provides coverage for physicians' services, outpatient hospital services, durable medical equipment, outpatient dialysis, and other medical services. Residents of every state and territory other than Puerto Rico who are receiving Social Security benefits are automatically enrolled in both Part A and Part B, and coverage begins the first day of the month they turn 65. Because beneficiaries must pay a premium for Part B coverage, they have the option of turning this coverage down. Disabled individuals who have received cash payments for 24 months under the Social Security disability programs are also automatically enrolled in Part B unless they decline such coverage. Those individuals who are not automatically enrolled in Medicare—e.g., because they have not filed for Social Security benefits—must file an application for Medicare Part A and Part B with the Social Security Administration during their seven-month initial enrollment period (IEP), which begins three months before the month in which they

			turn 65. Beneficiaries who do not sign up for Part B during their IEP, or who drop it and sign up again later, may have to pay a late-enrollment penalty for as long as they are enrolled in Part B. Monthly premiums for Part B may go up 10 percent for each full 12-month period that one could have had Part B but did not sign up for it. Certain low-income beneficiaries may qualify for premium assistance from Medicaid through a Medicare Savings Program (MSP). Beneficiaries in an MSP are not subject to late- enrollment penalties regardless of when they signed up for Medicare. Under federal statute, residents of Puerto Rico who receive Social Security benefits are automatically enrolled in Part A, but not Part B, when they turn 65. Rather, they need to sign up for Part B during their IEP or be subject to a penalty. The lack of an automatic Part B enrollment process in Puerto Rico has resulted in a disproportionate number of Puerto Rican Medicare beneficiaries paying the late-enrollment penalties. Because Puerto Rico does not have an MSP program, low-income beneficiaries subject to this penalty may be responsible for paying the full penalty amount in addition to their premiums.
Medicare Part D	U.S. Department of Health and Human Services (HHS), Centers for Medicare and Medicaid Services (CMS)	House Committee on Energy and Commerce; House Committee on Ways and Means Senate Committee on Finance	Medicare Part D provides an outpatient prescription drug benefit, either through private prescription drug plans that offer only drug coverage or through Medicare Advantage prescription drug plans that offer coverage as part of broader, managed-care plans. In the states and DC, individuals with incomes up to 150 percent of the federal poverty level and assets below set limits are eligible for assistance with their Part D premiums and cost sharing, which is known as the Part D low-income subsidy (LIS). The states and DC make annual payments, known as clawback payments, to help cover the cost of LIS. Pursuant to federal statute, residents of the territories are not eligible for LIS. In lieu of LIS, federal law provides Medicaid funding to the territories to provide Medicaid coverage of prescription drugs for low-income Medicare beneficiaries. This funding, provided through Section 1935(e) of the Social Security Act, is sometimes referred to as the enhanced allotment program (EAP). Each territory government is required to match the Section 1935(e) funding at its regular Medicaid FMAP rate of 55 percent. This means for every dollar a territory spends on providing Medicaid coverage for prescription drugs to low-income Medicare beneficiaries, the territory draws down $0.55 from its allotted Section 1935(e) funding, up to annual limit. In Fiscal Year 2015, Puerto Rico received a Section 1935(e) allotment (i.e., the maximum amount of federal funds available for this purpose) of $44 million, but Puerto Rico used only $9 million of these funds as a result of the matching requirement.
Health Insurance Exchange Marketplace	U.S. Department of Health and Human Services (HHS), Centers for Medicare and Medicaid Services (CMS)	House Committee on Energy and Commerce; House Committee on Ways and Means Senate Committee on Finance	The Patient Protection and Affordable Care Act (ACA; P.L. 111-148, as amended) requires health insurance exchanges to be established in every state and DC where individuals and small businesses purchase private health insurance coverage. States must have two types of exchanges: an individual exchange and a small business health options program exchange. Exchanges may be established either by the state itself as a state-based exchange or by the HHS Secretary as a federally-facilitated exchange. Persons who obtain coverage through the individual exchange may be eligible for financial assistance—premium tax credits and cost-

			sharing subsidies—from the federal government, and small businesses that use the small business exchange may be eligible for tax credits to assist businesses with the cost of providing health insurance coverage to employees. Section 1323 of the ACA authorized each territory to elect to establish an exchange, but did not require a territory to do so. A territory that did elect to establish an exchange could receive limited federal funding for the purpose of providing premium and cost-sharing assistance for individuals who enrolled in the exchange. Section 1323 provided $1 billion to be available for this purpose beginning in 2014 and ending in 2019, with $925 million allocated to Puerto Rico and $75 million allocated among the four other territories. If a territory did not establish an exchange, Section 1323 provides that the territory is entitled to an increase in Medicaid funds by the equivalent amount of its Section 1323 funding (in the case of Puerto Rico, $925 million). No territory elected to establish an exchange and each instead received an increase in its Medicaid funding.
Family-to-Family Health Information Center Grant Program	U.S. Department of Health and Human Services (HHS), Health Resources and Services Administration (HRSA)	House Committee on Energy and Commerce Senate Committee on Finance	The F2F program was established as part of the Family Opportunity Act, which was included in the Deficit Reduction Act of 2005 (P.L. 109-171). Under the program, HRSA makes competitive grants to support Family-to-Family Health Information Centers. Centers are primarily non-profit organizations run by families with children and youth with special health care needs, and they provide education, training, peer support, and expertise in navigating health care systems for other families of children and youth with special health care needs. The law establishing the program makes grants available to support a single center in each of the 50 states and in DC, but not in the U.S. territories. See 42 U.S.C. 701(c)(5). The program is directly funded (not subject to the annual appropriations process) and the current annual appropriation is $5 million. Funding is distributed equally among centers in each state and DC, with each center receiving about $95,000 per year, regardless of the state's population.
Federal Home Visiting Program Also known as Maternal, Infant, and Early Childhood Home Visiting Program (MIECHV)	U.S. Department of Health and Human Services (HHS), Health Resources and Services Administration (HRSA)	House Committee on Ways and Means Senate Committee on Finance	The Federal Home Visiting Program supports home visiting services for families with young children who reside in communities that have concentrations of poor child health and other risk indicators. Home visits are conducted by nurses, mental health clinicians, social workers, or others with specialized training. The law does not specify how state and territory grant funds are to be allocated to eligible entities. In practice, HRSA distributes Federal Home Visiting Program funds by both formula and competitive awards and, on its face, the funding formula treats states and territories the same. Between Fiscal Year 2010 and Fiscal Year 2015, funding was distributed according to the relative share of children under age five in families at or below 100 percent of the federal poverty line in each state. The poverty data are derived from the U.S. Census Bureau's Small Area Income Poverty Estimates (SAIPE), which are not available for the territories. There was a $1 million funding minimum for both state and territory grantees, and HRSA allocated the minimum level of funding to each of the territories from Fiscal Year 2011 through Fiscal Year 2015.

			For Fiscal Year 2016, HRSA redesigned the funding allocation for formula grants. About one-third of funding is allocated based on the share of children under age five in families at or below 100 percent of the federal poverty line in each state, again using 2013 SAIPE data that are not available for the territories. About two- thirds of funding is allocated based on the amount of competitive awards a state or territory received under the Federal Home Visiting Program between Fiscal Year 2013 and Fiscal Year 2015. There continues to be a $1 million funding minimum for both state and territory grantees, and the territories each received the base allocation of $1 million in Fiscal Year 2016.
Community Mental Health Services Block Grant (MHBG)	U.S. Department of Health and Human Services (HHS), Substance Abuse and Mental Health Services Administration (SAMHSA)	House Committee on Ways and Means Senate Committee on Finance	The MHBG is a block grant program that distributes funds to states and territories according to a formula to support community mental health services for adults with serious mental illness and children with serious emotional disturbance. For states and DC, the MHBG allotment formula is based on the population at risk (weighted), the cost of providing services, and taxable resources. The minimum allotment is the amount that the state received in Fiscal Year 1998. Territories are funded pursuant to a different formula. Of MHBG funds appropriated annually, the law requires the HHS Secretary to reserve 1.5 percent for distribution to the territories. Funds are distributed among the territories in amounts proportional to their populations. The minimum allotment for the territories is $50,000. In Fiscal Year 2016, Puerto Rico received $6.5 million. See PHS Act 1918; 42 U.S.C. 300x-7.
Substance Abuse Prevention and Treatment Block Grants (SABG)	U.S. Department of Health and Human Services (HHS), Substance Abuse and Mental Health Services Administration (SAMHSA)	House Committee on Ways and Means Senate Committee on Finance	The SABG is a block grant program that distributes funds to states and territories according to a formula for the purpose of supporting substance abuse prevention and treatment services. State and territories, in turn, may distribute funds to local government entities and non-profit organizations. For the states and DC, the SABG allotment formula is based on the MHBG formula and takes into account the population at risk (unweighted), the cost of services, and taxable resources. The minimum allocation is 0.375 percent of the SABG appropriation. Territories are funded pursuant to a different formula. Of SABG funds appropriated annually, the law requires the HHS Secretary to reserve 1.5 percent for distribution to the territories. Funds are distributed among the territories in amounts proportional to their populations. The minimum allotment for the territories is $50,000. In Fiscal Year 2016, Puerto Rico received $22.8 million. See PHS Act 1933; 42 U.S.C. 300x-33.

National Housing Trust Fund (HTF)	U.S. Department of Housing and Urban Development (HUD)	House Committee on Financial Services Senate Committee on Banking, Housing, and Urban Affairs	The HTF was established by the Housing and Economic Recovery Act of 2008 (P.L. 110-289) to provide formula-based grants to states and territories to use for certain affordable housing activities, with a focus on producing rental housing for extremely low-income households. The HTF is funded through contributions from two government-sponsored enterprises, Fannie Mae and Freddie Mac, rather than through appropriations. The statute establishes a formula that takes into account certain factors related to rental housing for extremely low-income and very low-income households. The statute also specifies a minimum allocation for the 50 states and DC of $3.0 million, but the minimum allocation does not apply to Puerto Rico and the other territories. HUD announced the first state allocations from the HTF in May 2016, made from funds that were set aside by Fannie Mae and Freddie Mac during calendar year 2015. Fifteen states received an amount greater than the minimum allocation of $3.0 million (and, of those 15, five have allocations above $4.0 million), while 35 states and DC received the minimum allocation of $3.0 million. Puerto Rico received $326,000.
Pittman-Robertson Fund/Federal Aid in Wildlife Restoration (Wildlife Restoration, Basic Hunter Education, Enhanced Hunter Education)	U.S. Department of the Interior (DOI), Fish and Wildlife Service (FWS)	House Committee on Natural Resources Senate Committee on Environment and Public Works	The Pittman-Robertson Wildlife Restoration Act (WRA) uses the proceeds from a federal excise tax (on pistols, revolvers, shells, cartridges, archery equipment) to fund matching grants to states and territories for projects to benefit wildlife resources and conduct hunter education programs, with revenues going into an account called the Wildlife Restoration Fund administered by FWS. The appropriation of these funds is mandatory, indefinite spending. Distribution of funding is by formula. First, $8 million is set aside for Enhanced Hunter Education to construct or maintain public target ranges. No more than one-sixth of 1.0 percent may be provided to each territory, while allocations to states are based on population. In Fiscal Year 2016, Puerto Rico and the other territories each received $13,400. Next, one-half of the excise tax on pistols, revolvers, bows, and arrows (but not firearms) is set aside for Basic Hunter Education. As before, no more than one-sixth of 1 percent may be provided to each territory, while allocations to states are based on population. In Fiscal Year 2016, Puerto Rico and the other territories each received $204,230. The remaining amount forms the bulk of the program for Wildlife Restoration. No more than one-half of 1 percent may be provided to Puerto Rico (or one-sixth of 1 percent in the case of the other territories), while allocations to states are based on a formula involving numbers of licensed hunters and state acreage. In Fiscal Year 2016, Puerto Rico received $2,881,535.
State Wildlife Grants (SWG)	U.S. Department of the Interior (DOI), Fish and Wildlife Service (FWS)	House Committee on Appropriations Senate Committee on Appropriations	The SWG program provides matching funds to state and territory fish and wildlife agencies to develop and implement programs that benefit wildlife and their habitats. Funding may be used to address a variety of conservation needs—such as research, fish and wildlife surveys, species restoration, habitat management, and monitoring—that are identified in a state or territory's Wildlife Action Plan. A portion of the funds appropriated is for formula grants and the other portion is for competitive grants. The program was created in P.L. 106-291 and further detailed in subsequent Interior appropriations laws; it has no separate

			authorizing statute and is a program that was originally created by the Appropriations Committees. With respect to the funds appropriated for formula grants, appropriations law provides that the allocation formula is based two-thirds on the population of each state and one-third on the land area of each state. No state may receive less than 1.0 percent or more than 5.0 percent of the amount allocated. Neither Puerto Rico nor DC may receive more than one-half of 1.0 percent, and the other territories may not receive more than one-fourth of 1.0 percent. In Fiscal Year 2016, Puerto Rico received $241,087 in SWG formula funding and $7,545 in competitive grants.
Dingell-Johnson Sport Fish Restoration Grants	U.S. Department of the Interior (DOI), Fish and Wildlife Service (FWS)	House Committee on Natural Resources Senate Committee on Environment and Public Works	Excise taxes on fishing equipment, motorboat and small engine fuels, import duties, and interest are collected and appropriated from the Sport Fish Restoration and Boating Trust Fund. The Fund has a mandatory, permanent appropriation. The matching funds are made available to states and territories through grants, with funding allocated pursuant to a formula. Under Section 4 of the Dingell-Johnson Sportfish Restoration Act, no state may receive less than 1.0 percent or more than 5.0 percent of the amount allocated. Under Section 12 of the Act, neither Puerto Rico nor DC may receive more than 1.0 percent, and the other territories may not receive more than one-third of 1.0 percent. In Fiscal Year 2016, Puerto Rico received $3,555,272 in Sport Fish Restoration grants. (Eleven states also received the same allocation of one percent.) Five other subprograms are also included in this Fund; allocation is through competitive grants. In Fiscal Year 2016, Puerto Rico did not receive any of these grants.
Land and Water Conservation Fund, State Assistance Program	U.S. Department of the Interior (DOI), National Park Service (NPS)	House Committee on Natural Resources Senate Committee on Energy and Natural Resources	The Land and Water Conservation Fund (LWCF) Act of 1965—enacted to help preserve, develop, and ensure access to outdoor recreation resources—created the Land and Water Conservation Fund. The Fund is currently authorized through September 30, 2018, to accrue revenues of $900 million annually from three specific sources: revenues from oil and gas leases on the Outer Continental Shelf (OCS), the federal motorboat fuel tax, and surplus property sales. A portion of the LWCF, administered by the NPS, provides matching grants to states, DC and the territories for recreation planning, acquisition of lands and waters, and facility development. To be eligible for a grant, a state or territory must prepare and update a statewide outdoor recreation plan. Under the statutory formula, a portion of the State Assistance appropriation is divided equally among 51 jurisdictions—(1) each of the 50 states and (2) the five territories and DC, which together are considered one state. This "state" share is divided among the five territories and DC in accordance with population. The remaining State Assistance appropriation is apportioned based on need, as determined by the Secretary of the Interior, taking into consideration factors in law, among others. For this purpose, the five territories and DC are each treated as separate states. In Fiscal Year 2016, Puerto Rico received a total of $1.3 million in LWCF funding under the state grant program.
Federal Aid-Highway Program (FAHP)	U.S. Department of Transportation (DOT), Federal Highway Administration (FHWA)	House: Committee on Transportation and Infrastructure; House Committee on Ways and Means (for tax	FAHP is an umbrella term for the separate highway programs administered by the FHWA. Under the 2015 surface transportation reauthorization act—FAST Act (P.L. 114-94)— most FAHP funding is distributed through the following formula- based programs: (1) National Highway Performance Program, (2) Surface Transportation Block Grant Program, (3) Highway Safety

		issues) Senate Committee on Environment and Public Works; Senate Committee on Finance (for tax issues)	Improvement Program, (4) Congestion Mitigation and Air Quality Improvement Program, (5) National Highway Freight Program, and (6) Metropolitan Planning Program. The FAST Act provides for a single gross apportionment to each state and DC, which is then divided up among the various programs. For purposes of apportioning federal-aid highway funds, Puerto Rico is not considered a state. Instead, funds are authorized for a stand-alone program called the Puerto Rico Highway Program. Under Section 1115 of the FAST Act, funding for the Puerto Rico Highway Program is authorized at $158 million annually from Fiscal Year 2016 through Fiscal Year 2020. However, because Puerto Rico is subject to penalties under 23 U.S.C. Section 154 (Open Container Requirements), Section 158 (National Minimum Drinking Age), and Section 164 (Repeat Offenders driving while Intoxicated or driving under the influence), the $158 million is reduced (for Fiscal Year 2016, the reduction was approximately $15.7 million or about 10 percent). Current law directs Puerto Rico Highway Program funding to be used as follows: 50 percent for purposes eligible under the National Highway Performance Program (essentially, on National Highway System roads in Puerto Rico), 25 percent for purposes eligible under the Highway Safety Improvement Program (for safety infrastructure), and 25 percent for any purpose allowable under the Highway title of the U.S. Code (Title 23). The FAHP, as well as the Puerto Rico Highway Program, rely upon revenues from the Highway Account of the Highway Trust Fund, which is financed from a federal excise tax on motor fuels, as well as a federal tax on tires, truck and trailer sales, and heavy-vehicle use. Federal law does not impose the excise tax on motor fuel, or the other federal taxes, in Puerto Rico.
Motor Carrier Safety Assistance Program (MCSAP)	U.S. Department of Transportation (DOT), Federal Motor Carrier Safety Administration (FMCSA)	House Committee on Transportation and Infrastructure Senate Committee on Commerce, Science, and Transportation	The Motor Carrier Safety Assistance Program (MCSAP) is a formula grant program that provides financial assistance to states and territories to reduce the number and severity of accidents and hazardous materials incidents involving commercial motor vehicles. MCSAP grants are provided annually to the state's MCSAP lead agency, which is designated by the governor as the state motor vehicle safety agency responsible for administering the Commercial Vehicle Safety Plan within the state. There are two categories of MCSAP grants: Basic grants and Incentive grants. Basic grants are distributed pursuant to a formula that involves highway miles, vehicle miles traveled, population, and special fuel consumption. All states, DC, and the territories are eligible for Basic grants. There is a 20 percent match requirement on the part of the state lead MCSAP agency, but the state lead MCSAP agency in the four territories other than Puerto Rico are exempt from this match requirement. In addition, a state lead MCSAP agency may qualify for Incentive grants if it can demonstrate that its commercial vehicle safety program has shown improvement in certain areas. Puerto Rico and the other territories are not currently eligible for Incentive grants, evidently because the safety performance and data quality factors on which the Incentive grants are based are not available for the territories. In Fiscal Year 2016, Puerto Rico received an MCSAP Basic Grant of $1,146,134.

Growing States and High Density States Program	U.S. Department of Transportation (DOT), Federal Transit Administration (FTA)	House Committee on Transportation and Infrastructure Senate Committee on Banking, Housing, and Urban Affairs	Under 49 U.S.C. 5340, funds are authorized from the Mass Transit Account of the Highway Trust Fund for two programs: the Growing State Formula Program (Section 5340(c)) and the High Density State Formula Program (Section 5340(d)). Funding from these two programs can be used by recipients for a wide variety of purposes, including capital projects, planning and, in certain circumstances, operating costs. The programs are authorized through Fiscal Year 2020. In Fiscal Year 2016, the Growing States Formula Program was authorized at $272.3 million and the High Density States Formula Program at $264.0 million. Funding for the Growing States Formula Program is apportioned among states based on the projected population of each state 15 years beyond the most recent decennial census. Funding is distributed to urbanized areas and rural areas within a state based on projections of the distribution of population. Funding for the High Density State Formula Program is apportioned to states with a population density greater than 370 persons per square mile. Currently, seven states qualify: Massachusetts, Rhode Island, Connecticut, New York, New Jersey, Delaware, and Maryland. Funds are distributed within states to urbanized areas only. Puerto Rico, the other territories and DC are not included within the definition of "state" in 49 U.S.C. 5340(a) and are therefore ineligible for funding under both the Growing State Formula Program and the High Density State Formula Program. According to the 2010 decennial census, Puerto Rico has a population density of 478 persons per square mile, trailing only New Jersey (and DC).

Appendix 3: Treatment of Puerto Rico Under Major U.S. Census Bureau Statistical Programs

Table of Major U.S. Census Bureau Statistical Programs					
Name of Program	**Other Federal Agency Involved?**	**Description of Program**	**Does program collect and publish state-by-state information?**	**If yes, is Puerto Rico included?**	**If no, is PR data collected and published as part of the national or regional totals?**
Census of Governments (six associated annual surveys directly below)	No	The Census of Governments, which is conducted every five years, identifies the scope and nature of the nation's state and local government sector; provides benchmark figures of public finance and public employment; classifies local government organizations, powers, and activities; and measures federal, state, and local fiscal relationships. The Census of Governments is comprised of the following six surveys on this list: Annual Survey of State Government Finance, Annual Survey of Local Government Finance, Annual Survey of Public Employment and Payroll, Annual Survey of Public Pensions, Annual Survey of School System Finances, Annual Survey of State Government Tax Collections. The years ending in “2” and “7” for these annual surveys are considered the Census of Governments years, and data are collected from all governments units as compared with a sample of government units in the other years.	Yes	**No**	N/A
Annual Survey of State Government Tax Collections (STC)	No	Provides a summary of taxes collected by state for 5 broad tax categories and up to 25 tax subcategories. These tables and data files present the details on tax collections by type of tax imposed and collected by state governments.	Yes	**No**	N/A
Annual Survey of State Government Finances	No	Provides statistics on revenue, expenditure, debt, and assets (cash and security holdings) for state governments. There are statistics for the 50 states and DC, as well as a national summary.	Yes	**No**	N/A
Annual Survey of Local Government Finances	No	Provides statistics on revenue, expenditure, debt, and assets (cash and security holdings) for local governments. There are statistics for the 50 state areas and the District of Columbia, as well as a national summary.	Yes	**No**	N/A
Annual Survey of Public Employment & Payroll (APES)	No	Provides state and local government data on full-time and part-time employment, part-time hours worked, full-time equivalent employment, and payroll statistics.	Yes	**No**	N/A

Annual Survey of Public Pensions	No	Provides revenues, expenditures, financial assets, and membership information for the defined benefit public pensions. Data are shown for individual pension funds and systems as well as at the national, state, and local level. There were 299 state-administered funds and 6,000 locally-administered defined benefit public pension systems, all of which are represented here.	Yes	**No**	N/A
Annual Survey of School System Finances	National Center for Education Statistics (NCES)	Provides statistics about the finances of elementary and secondary public school systems. Education finance data include revenues, expenditures, debt, and assets of elementary and secondary public school systems. Statistics cover school systems in all states and DC. This survey is co-funded by the National Center for Education Statistics, which has a stake in the survey content and data products.	Yes	**No**	N/A
Decennial Census of Population and Housing	No	The Decennial U.S. Census counts every resident in the United States. It is mandated by Article I, Section 2 of the Constitution and takes place every 10 years.	Yes	Yes	N/A
Economic Census	No	The Economic Census is the U.S. Government's official five-year measure of American business and the economy for planning and key economic reports, and economic development and business decisions. The last Economic Census was conducted during the year ending December 2012. In October through December 2012, nearly 4 million businesses in America received an economic census form, including most businesses with paid employees.	Yes	**No**, but PR is included in the Economic Census of Islands Areas	No
Advance Monthly Retail Trade and Food Services Survey (MARTS)	No	Census conducts MARTS to provide an early estimate of monthly sales by kind of business for retail and food service firms located in the United States. Each month, questionnaires are mailed to approximately 4,700 employer firms selected from the larger Monthly Retail Trade Survey (MRTS). No questionnaires are mailed to firms in PR.	No	N/A	No
American Community Survey	No	Premier source for information about America's changing population, housing and workforce.	Yes	Yes, via equivalent Puerto Rico Community Survey	N/A
American Housing Survey (AHS)	Department of Housing and Urban Development (HUD)	AHS is sponsored by HUD and conducted by Census. The survey is the most comprehensive national housing survey in the United States. The AHS is conducted biennially between May and September in odd-numbered years.	No, AHS produces national and regional statistics; statistics for the 15 largest metropolitan areas; and statistics for other selected metropolitan	**No**, HUD has never chosen San Juan as one of the selected metro areas.	No, PR is not included in the sample design.

			areas (usually 10-15 each survey cycle).		
American Time Use Survey (ATUS)	Department of Labor, Bureau of Labor Statistics (BLS)	ATUS measures the amount of time people spend doing various activities, such as paid work, childcare, volunteering, and socializing. ATUS data are collected via telephone interviews. Households that have completed their final (8th) month of the Current Population Survey (CPS) are eligible for the ATUS.	No	N/A	No, because PR households do not participate in the CPS.
Annual Capital Expenditures Survey (ACES)	No	ACES provides data on capital spending for new and used structures and equipment by U.S. nonfarm businesses.	No	N/A	No, businesses in PR and the other territories are excluded.
Annual Retail Trade Survey (ARTS)	No	Provides estimates on sales, e-commerce sales, end-of-year inventories, methods of inventory valuation, purchases, and operating expenses.	No	N/A	No
Annual Survey of Entrepreneurs (ASE)	Department of Commerce, Minority Business Development Agency (MBDA)	Provides estimates of number of firms, sales/receipts, annual payroll, and employment by gender, ethnicity, race, and veteran status. The ASE is a supplement to the Survey of Business Owners (SBO), which is conducted every five years as part of the Economic Census. ASE collection is electronic only. The estimate of the sample is approximately 290,000 employer businesses in operation during the survey year. Those selected for the survey receive an initial letter informing the respondents of their requirement to complete the survey.	No	N/A	No
Annual Survey of Manufactures (ASM)	No	Provides estimates on manufacturing activity, products, and location for the public and private sectors.	Yes	**No**	N/A
Annual Wholesale Trade Survey (AWTS)	No	Provides estimates on sales, e-commerce sales, end-of-year inventories, methods of inventory valuation, purchases, and operating expenses. The Monthly Wholesale Trade Survey (MWTS) and the AWTS work together to produce the most comprehensive data available on wholesale economic activity in the United States.	No	N/A	No
Boundary and Annexation Survey (BAS)	No	Census conducts the BAS annually to collect information about selected legally defined geographic areas. The BAS is used to update information about the legal boundaries and names of all governmental units in the United States.	Yes	Yes	N/A

Building Permits Survey (BPS)	No	Provides national, state, and local statistics on new privately-owned residential construction. Building permits data are collected from individual permit offices, most of which are municipalities. Data are also collected for PR and other U.S. territories, although these areas are excluded from the national statistics.	Yes	Yes, but data for states is published monthly an data for PR is published annually.	No
Business Dynamics Statistics (BDS)	No	Provides annual measures of business dynamics (such as job creation and destruction, establishment births and deaths, and firm startups and shutdowns) for the economy and aggregated by establishment and firm characteristics.	Yes	**No**	N/A
Business R&D and Innovation Survey (BRDIS)	National Science Foundation (NSF)	Provides data on R&D activities of companies operating in the United States, as well as statistics on the R&D workforce, intellectual property, technology transfer activities and innovation, which is useful to decision makers in both the public and private sectors. A mail-out/mail-back sample survey of approximately 40,000 companies with 5 or more employees. Large companies with known R&D above $3 million from the previous survey cycle are selected each year from the Business Register.	Yes	**No**, PR companies are not included in the sample.	No
Commodity Flow Survey (CFS)	Bureau of Transportation Statistics (BTS)	The CFS, undertaken through a partnership between the Census Bureau and BTS, is conducted every 5 years (years ending in “2” and “7”) as part of the Economic Census. The CFS produces data on the movement of goods in the United States, providing information on commodities shipped, their value, weight, and mode of transportation, as well as the origin and destination of shipments of commodities from manufacturing, mining, wholesale, and selected retail and services establishments. Beginning with the 2007 CFS, a sample of 100,000 establishments from the mining, manufacturing, wholesale, and selected retail industries is selected based on geographic location and industry.	Yes	**No**	N/A
Construction Progress Reporting Survey (CPRS)	No	Provides monthly estimates on the total dollar value of construction work done in the U.S. Composite estimates are based on mail-out/mail-back and interview surveys of selected construction projects and building owners, and estimates developed or compiled from other sources. These four surveys currently cover about 6,500 private nonresidential, 10,500 state and local, 1,500 multi-family, and 700 federal projects each month.	Yes. Statistics are available at the U.S. level monthly, and by division, region, and state annually for selected categories.	**No**, PR is excluded from state, regional and national totals.	N/A

Consumer Expenditure Survey (CE)	BLS	The CE program consists of the Quarterly Interview Survey and the Diary Survey, which provide information on the buying habits of American consumers, including data on their expenditures, income, and consumer unit (families and single consumers) characteristics. The survey data are collected for BLS by the Census Bureau.	Expenditures at the state level are not calculated or published, but geographic-specific data is published.	N/A	No
County Business Patterns	No	CBP is an annual series that provides subnational economic data by industry. This series includes the number of establishments, employment during the week of March 12, first quarter payroll, and annual payroll. This is not a survey, but rather a data product that relies on administrative records, the Company Organization Survey, and the Economic Census as inputs. PR is included in the CBP, although its data is published with the other territories in a separate file.	Yes	Yes	N/A
Current Population Survey (CPS)	BLS	The CPS is a monthly survey sponsored by BLS and conducted by the U.S. Census Bureau. It is the primary source of labor force statistics for the population of the United States.	Yes	**No**	N/A
Economic Census of Islands Area (IA)	No	The Economic Census of Island Areas is the U.S. Government's official five-year measure of businesses and the economy used for planning, economic development, and business decisions. The last Economic Census was conducted for the year ending in December 2012. The Census Bureau mailed a questionnaire to all employer firms in PR that were classified as in-scope for the Economic Census. The Census Bureau covered roughly 38,000 establishments in PR. Respondents were instructed to reply either by mail or on-line. A telephone follow-up was conducted to obtain information from selected firms that failed to report. The Economic Census of Island Areas covers the five US territories. Data collected include total sales, receipts or revenue, kind of business, legal form of organization, employment, annual and first quarter payroll, and class of customer. Hotels, and other lodging places report additional data on sources of receipts and number of accommodations.	Yes, separate statistics are published for PR and each of the other territories	Yes	N/A
Enterprise Statistics Program (ESP)	No	The Enterprise Statistics Program (ESP) collects enterprise level data from the Report of Organization Survey (also known as the Company Organization Survey, or COS). The COS is an annual survey whose purpose is to obtain current organization and operating information on large multi-establishment enterprises in order to maintain the Business Register (BR). The BR is a multi-relational database that contains a record for each	No	N/A	No

		establishment that is located in the U.S. or Puerto Rico and has employees.			
Export Statistics	Bureau of Economic Analysis (BEA); U.S. Customs and Border Protection (CBP)	Provides detailed statistics on goods and services shipped to and from the U.S. and foreign countries. The United States Code, Title 13, requires this program. Participation is mandatory. This is covered under the International Trade Statistics Program.	Yes	Yes	N/A
Federal Audit Clearinghouse	Office of Management and Budget (OMB)	FAC operates on behalf of the Office of Management and Budget (OMB). Its primary purposes are to: distribute single audit reporting packages to federal agencies; support OMB oversight and assessment of federal award audit requirements; and maintain a public database of completed audits. Data is collected from entities in PR that expend federal awards, but data is not used in national and/or regional totals.	No	N/A	No
Government Units Survey	No	Identifies local governments for the Census of Governments, from which PR is excluded, and provides selected data on local governments. Previously known as "Directory Survey of Local Governments."	Yes	**No**	N/A
Housing Vacancy Survey (HVS)	No	The HVS is a Census Bureau-sponsored section within the Current Population Survey questionnaire that is conducted to inform on vacant housing units. It is not a stand-alone survey. Provides current information on rental and homeowner vacancy rates, and characteristics of units available for occupancy. These data are used by public and private sector organizations to evaluate the need for new housing programs and initiatives. In addition, the rental vacancy rate is a component of the index of leading economic indicators and is thereby used by the Federal Government and economic forecasters to gauge the current economic climate. Rental and homeowner vacancy rates and homeownership rates are available for the U.S., regions, states, and for the 75 largest Metropolitan Statistical Areas (MSAs).	Yes	**No**	No

Import Statistics	BEA; CBP	Provides detailed statistics on goods and estimates of services entering the U.S. from foreign countries. This is covered under the International Trade Statistics Program.	Yes	Yes	Yes
Longitudinal Employer-Household Dynamics (LEHD)		Under the Local Employment Dynamics (LED) Partnership, states agree to share Unemployment Insurance earnings data and Quarterly Census of Employment and Wages (QCEW) data with the Census Bureau. The LEHD program combines these administrative data, additional administrative data and data from censuses and surveys creating statistics on employment, earnings, and job flows at detailed levels of geography and industry and for different demographic groups. The LEHD program uses these data to create partially synthetic data on workers' residential patterns. Data products released by LEHD include the Quarterly Workforce Indicators (QWI), the LEHD Origin Destination Employment Statistics (LODES), and Job-to-Job Flows (J2J). QWI is the most likely product to be available for PR in the short term. 49 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands have joined the LED Partnership, although the LEHD program is not yet producing public-use statistics for PR or the USVI. Data have been collected from Puerto Rico but have not been published because of quality issues with the input files. Census is currently working with its partners in Puerto Rico to address these issues with input files.	Yes	**Not in practice**.	N/A
Manufactured Housing Survey	HUD	MHS is sponsored by HUD and collected by the Census Bureau, and provides data on shipments, prices and characteristics of new manufactured housing. Key statistics include “Shipments by State.” Estimates of Average Sales Price of Manufactured Homes Sold or Intended for Sale for Residential Use are available at national, region, division, and state level annually and region level monthly. Estimates of Manufactured Home Shipments are available at the national and state level monthly. Estimates of shipped homes by status are available at the national level monthly. Estimates of selected characteristics of sold/placed homes are available by region.	Yes	**No**	No
Manufacturers’ Shipments, Inventories, and Orders Survey (M3)	No	Provides monthly estimates on current economic conditions and indications of future production commitments in the manufacturing sector.	No	N/A	No

Manufacturers' Unfilled Orders Survey (M3UFO)	No	Collects data used to benchmark the new and unfilled orders information published in the monthly M3.	No	N/A	No
Manufacturing Energy Consumption Survey (MECS)	Department of Energy, Energy Information Administration (EIA)	Provides estimates on energy consumption in the manufacturing sector.	No	N/A	No
Medical Expenditure Panel Survey (MEPS)	Department of Health and Human Services, Agency for Healthcare Research and Quality (AHRQ)	MEPS is a set of large-scale surveys of families and individuals, their medical providers (doctors, hospitals, pharmacies, etc.), and employers across the United States. MEPS collects data on the specific health services that Americans use, how frequently they use them, the cost of these services, and how they are paid for, as well as data on the cost, scope, and breadth of health insurance held by and available to U.S. workers.	Yes	**No**	No
Monthly Retail Trade Survey (MRTS)	No	Provides monthly estimates on sales at retail and food services stores and inventories held by retail stores.	No	N/A	No
Monthly Wholesale Trade Survey (MWTS)	No	Provides monthly estimates of sales and inventories of wholesale trade industries.	No	N/A	No
National Ambulatory Medical Care Survey	CDC, National Center for Health Statistics (NCHS)	NAMCS is a national survey designed to meet the need for objective, reliable information about the provision and use of ambulatory medical care services in the United States. Findings are based on a sample of visits to non-federal employed office-based physicians who are primarily engaged in direct patient care.	No	N/A	No
National Health Interview Survey (NHIS)	NCHS	NHIS data are collected through personal household interviews. For over 50 years, the U.S. Census Bureau has been the data collection agent for the National Health Interview Survey. Survey results have been instrumental in providing data to track health status, health care access, and progress toward achieving national health objectives. An estimated 35,000 completed sample adult interviews and 12,000 completed sample child interviews are expected to be available annually for analysis in the redesigned NHIS. There are numerous data reports linked to—based on—NHIS. In the geographic classification of the U.S. population, states are grouped into the four regions used by the U.S. Census Bureau; PR is not included in any region. NCHS collects Vital Statistics (birth and death certificate data) for Puerto Rico through the National Vital Statistics System. But no information is collected in PR for other NCHS surveys. NCHS surveys target the resident civilian non-institutionalized population using the Census definition of this population which is defined as the 50 states and DC. The target population does not include persons residing	In general no, although there is state-by-state information for estimates of health insurance coverage and variation in health care service utilization. There is no PR-specific data.	**No**	No

		outside the 50 states and DC.			
National Hospital Ambulatory Medical Care Survey (NHAMCS)	NCHS	The National Hospital Ambulatory Medical Care Survey (NHAMCS) is designed to collect data on the utilization and provision of ambulatory care services in hospital emergency and outpatient departments. Findings are based on a national sample of visits to the emergency departments and outpatient departments of non-institutional general and short-stay hospitals.	No, national and regional only.	N/A	No
National Sample Survey of Registered Nurses	Department of Health and Human Services (HHS)	Conducted every four years since 1977. The data from these periodic surveys provide the basis for evaluating trends and projection of the future supply of nursing resources. Sponsored by the Department of Health and Human Services' Health Resources and Services Administration (DHHS/HRSA), the NSSRN was last conducted by an organization other than Census in 2008. HRSA recently approached Census for the purposes of redesigning the survey, and it is anticipated that we will field the new version of the survey for the first time in January, 2018.	Yes	**No**	N/A
National Survey of Children's Health (NSCH)	HHS	Examines the physical and emotional health of children ages 0-17 years of age.	Yes	**No**	No
National Survey of College Graduates (NSCG)	National Science Foundation (NSF)	Biennial survey of college graduates residing in the United States. Sponsored by the National Science Foundation and conducted by the Census Bureau. The survey provides data on the number and characteristics of individuals with a bachelor's or higher degree, with a special focus on individuals with education and/or employment in science or engineering. NSF uses the information to prepare congressionally mandated biennial reports such as Women, Minorities and Persons with Disabilities in Science and Engineering and Science and Engineering Indicators.	In general, no. Although some state information was collected, the state-by-state estimates were not as reliable and were never published.	N/A	Yes. PR is included in the national total, but four other territories are not.
National Survey of Fishing, Hunting, and Wildlife-Associated Recreation	US Fish and Wildlife Service (FWS)	Partnership effort with the States and national conservation organizations, and has become one of the most important sources of information on fish and wildlife recreation in the United States. Quantifies the economic impact of wildlife-based recreation. Federal, State, and private organizations use this detailed information to manage wildlife, market products, and look for trends. The 2011 Survey is the twelfth in a series of surveys conducted about every 5 years since 1955.	Yes	**No**	No

Nonemployer Statistics	No	An annual series that provides subnational economic data for businesses that have no paid employees and are subject to federal income tax. The data consist of the number of businesses and total receipts by industry. Most nonemployers are self-employed individuals operating unincorporated businesses (known as sole proprietorships). This is not a survey, but rather a data product that primarily relies on administrative records as input.	Yes	**No**	N/A
Population Estimates	No	Produces estimates of the population for the United States, its states, counties, cities, and towns, as well as for Puerto Rico.	Yes	Yes	N/A
Population Projections	No	Population projections are typically based on an estimated population consistent with the most recent decennial census and are produced using the cohort-component method. The Census Bureau does not have a current set of state population projections and currently has no plans to produce them. PR residents are not included in the 2014 National Population Projection. However, PR projections have been done in the past in a separate program and may be done again in future.	Yes, but the data is old.	**No**, although PR is included in the projections prepared by Census as part of its International Database Program.	No, PR was not included in 2014 national population projection.
Puerto Rico Community Survey (PRCS)	No	Part of the Census Bureau's annual American Community Survey (ACS), customized for Puerto Rico.	Yes, PR only	Yes	Yes
Quarterly Financial Report (QFR)	No	Provides quarterly aggregate statistics on the financial results and position of U.S. corporations.	No	N/A	No
Quarterly Services Survey (QSS)	No	The only data source providing timely estimates of revenue and expenses for selected service industries.	No	N/A	No
Quarterly Summary of State and Local Government Tax Revenue (QTAX)	No	Provides quarterly estimates of state and local government tax revenue at a national level, as well as detailed tax revenue data for individual states.	Yes	**No**	N/A
Quarterly Survey of Plant Capacity Utilization (QPC)	Federal Reserve Board, Defense Logistics Agency (DLA)	Collects statistics on establishment operational status, value of actual production, estimated production attainable at full and emergency conditions, and reasons for operating at less than full production capacity.	No	N/A	No
Quarterly Survey of Public Pensions	No	Quarterly survey that provides national summary data on the revenues, expenditures, and composition of assets of the largest defined benefit public employee pension systems for state and local governments. This survey currently consists of a panel of 100 pension systems, which comprise 88.4 percent of financial activity among such entities, based on the 2012 Census of Governments.	No	N/A	No

Quarterly Workforce Indicators (QWI)	No	The QWI are a set of economic indicators including employment, job creation, earnings, and other measures of employment flows. The QWI are reported based on detailed firm characteristics (geography, industry, age, size) and worker demographics information (sex, age, education, race, ethnicity) and are available tabulated to national, state, metropolitan/micropolitan areas, county, and Workforce Investment Board (WIB) areas.	Yes	**No**	No
Rental Housing Finance Survey (RHFS)	HUD	Provides current and continuous measure of financial, mortgage and property characteristics of multifamily rental housing properties in the United States.	No, only national or regional statistics.	N/A	No
School Crime Supplement to the National Crime Victimization Survey (SCS/NCVS)	NCES; Bureau of Justice Statistics (BJS)	Created as a supplement to the National Crime Victimization Survey (NCVS), the SCS collects information about victimization, crime, and safety at school. The SCS is a national survey of approximately 6,500 students ages 12 through 18 in U.S. public and private elementary, middle, and high schools. None of the 6,500 students are from PR.	No	N/A	No
School Survey on Crime and Safety (SSOCS)	NCES	The primary source of school-level data on crime and safety for NCES. Over 3,000 public school principals are selected to receive the SSOCS questionnaire. None of the 3,000 public school principals selected to receive the SSOCS questionnaire are from PR.	No	N/A	No
Service Annual Survey (SAS)	No	Collects data from companies whose primary business is to provide services to individuals, businesses, and governments. Includes most personal, business, automotive, amusement and recreation, social welfare, health care, and other professional services. This is a survey of approximately 72,000 selected service businesses with paid employees. To be eligible for the list sample, service businesses must be in the Business Register List (BR), which contains all Employer Identification Numbers (EINs) for listed businesses and all locations of multi- establishment companies.	No	N/A	No
Small Area Health Insurance Estimates (SAHIE)	No	The SAHIE produces single-year estimates of health insurance coverage for all counties and states by detailed demographic and income groups. SAHIE data can be used to analyze geographic variation in health insurance coverage, as well as disparities in coverage by race/ethnicity, sex, age and income levels that reflect thresholds for state and federal assistance programs.	Yes	**No**	N/A

Small Area Income and Poverty Estimates (SAIPE)	No	SAIPE are produced for school districts, counties, and states. The main objective of this program is to provide updated estimates of income and poverty statistics for the administration of federal programs and the allocation of federal funds to local jurisdictions. Estimates for 2014 were released in December 2015. These estimates combine data from administrative records, post- censal population estimates, and the decennial census with direct estimates from the American Community Survey to provide consistent and reliable single-year estimates. These model-based single-year estimates are more reflective of current conditions than multi-year survey estimates.	Yes	**No**	N/A
Small Business Lending Survey	Federal Deposit Insurance Corporation (FDIC)	The survey will provide insight into many aspects of small business lending, including important (heretofore unavailable) nationally representative information on the general characteristics of small business borrowers to which the banks lend, the types of credit offered to small businesses (such as closed-end loans, lines-of- credit, and credit cards), and the relative importance of commercial lending activity for banks of different sizes and business models and banks with different levels of urban or rural presence.	No	N/A	No
State Government R&D Survey (SGRD)	NSF	The only source for comprehensive, uniform statistics regarding the extent of R&D activity performed and funded by departments and agencies in each of the nation's 50 state governments, the government of DC, and the government of Puerto Rico.	Yes	Yes	N/A
Statistics of U.S. Businesses (SUSB)	Small Business Administration (SBA)	Annual series that provides national and subnational data on the distribution of economic data by enterprise size and industry. SUSB covers most of the country's economic activity. Data are presented by geographic area, industry detail, and enterprise size. Annual data consist of number of firms, number of establishments, annual payroll, and employment during the week of March 12. In addition, estimated receipts data are included for years ending in 2 and 7. A compilation of data is extracted from the Business Register (BR).	Yes	**No**. All SUSB data are produced as cost-reimbursabl e special tabulations. There is no appropriated funding.	N/A

Survey of Business Owners and Self-Employed Persons (SBO)	No	The SBO provides the only comprehensive, regularly collected source of information on selected economic and demographic characteristics for businesses and business owners by gender, ethnicity, race, and veteran status. Estimates include the number of employer and nonemployer firms, sales and receipts, annual payroll, and employment. Data aggregates are presented by states, metropolitan and micropolitan statistical areas, counties, places, and employment and receipts size. Businesses were eligible to be selected for this survey if they reported any business activity on any one of the following Internal Revenue Service tax forms: 1040 (Schedule C), 1065, (U.S. Return of Partnership Income), any one of the 1120 corporation tax forms, 941, (Employer's Quarterly Federal Tax Return), and 944, (Employer's Annual Federal Tax Return)	Yes	**No**	No
Survey of Construction (SOC)	HUD	Provides current national and regional statistics on starts, completions, and characteristics of new, privately-owned single-family and multifamily housing units and on sales of new single-family houses. HUD partially funds this survey. BEA uses the estimates in development of the national income and product accounts. The Federal Reserve Board and Council of Economic Advisers use the estimates to determine the condition of the economy. HUD uses the estimates to develop and evaluate housing programs. Manufacturers use estimates to plan production schedules and establish market shares. Insurance companies use estimates to adjust rates and establish replacement costs. Financial institutions use data to estimate mortgage demand.	No, only national or regional statistics.	N/A	No

Survey of Income and Program Participation (SIPP)	No	SIPP collects data and measures change for many topics including: economic well-being, family dynamics, education, assets, health insurance, childcare, and food security. SIPP is a household-based survey designed as a continuous series of national panels. Each panel features a nationally representative sample interviewed over a multi-year period lasting approximately four years. SIPP is a source of data for a variety of topics and provides for the integration of information for separate topics to form a single, unified database. This allows for the examination of the interaction between tax, transfer, and other government and private policies. Government policy formulators depend heavily upon SIPP for information on the distribution of income and the success of government assistance programs. SIPP data provide the most extensive information available on how the nation's economic well-being changes over time. The 2014 SIPP Panel began in February 2014 with a sample of approximately 53,000 households based on the 2010 decennial census. Each household is interviewed four times.	Yes, although SIPP is primarily a national product, since the sample is usually too small for most states.	**No**	No
Survey of Market Absorption of New Multifamily Units (SOMA)	HUD	SOMA, sponsored by HUD, uses the Census Bureau's Survey of Construction (SOC) as its sampling base. Each month, a sample of residential buildings containing five or more units is selected for SOMA. Data are collected each month by the 12 Regional Offices of the Census Bureau. Interviews are conducted with the building manager, rental/sales agent, owner or builder.	No, only national or regional statistics.	N/A	No
Survey of Program Dynamics (SPD)	No	The Survey of Program Dynamics is a longitudinal, demographic survey designed to collect data on the economic, household, and social characteristics of a nationally representative sample of the U.S. population over time.	No	N/A	No
Telephone Point of Purchase Survey (TPOPS)	BLS	Collects data on where Americans are spending their money. The results of the TPOPS are used in the calculation of the Consumer Price Index (CPI). Participation in the TPOPS is based on random sampling. PR is not considered as part of the CPI calculation.	No	N/A	No
Value of Construction Put in Place Survey (VIP)	No	Provides monthly estimates of the total dollar value of construction work done in the United States (the 50 states and DC). Covers construction work done each month on new structures or improvements to existing structures for private and public sectors (in the 50 states and DC).	Yes	**No**	N/A