



Puerto Rico: A Development Roadmap

INTRODUCTION

Roadmap: “A high-level plan, defining an overarching strategic objective and capturing the major steps planned for achieving that objective. It is not backlog... a to-do list of the tasks required to complete a strategic initiative....”

The Fundación del Colegio de CPA de Puerto Rico has, over the years, been active in addressing policy issues and this report is a result of said interest. It is well aware that each of the six policy topics dealt with in it could be an extensive study by itself. It felt, however, that a roadmap that projected overall strategic directions was a particular need in the present situation of Puerto Rico's economy. The project resulted from the Fundación's concern for Puerto Rico's economic development and the absence of a clear path or roadmap towards a better economic future for the Island, once the initial reconstruction phase is completed.

In December, 2017 Estudios Técnicos, Inc. was charged with preparing this report.

The project entailed a detailed review of previous efforts with a similar objective in order to learn from these experiences. As a result, the Fundación decided to concentrate the Project on six issues and not on the whole gamut of factors that influence development. These are:

Strengthening the Industrial System

Defining the Role of Municipalities

Rethinking Promotional Strategies

Policies and Strategies to Stabilize Population

A Tax System that Stimulates Investment

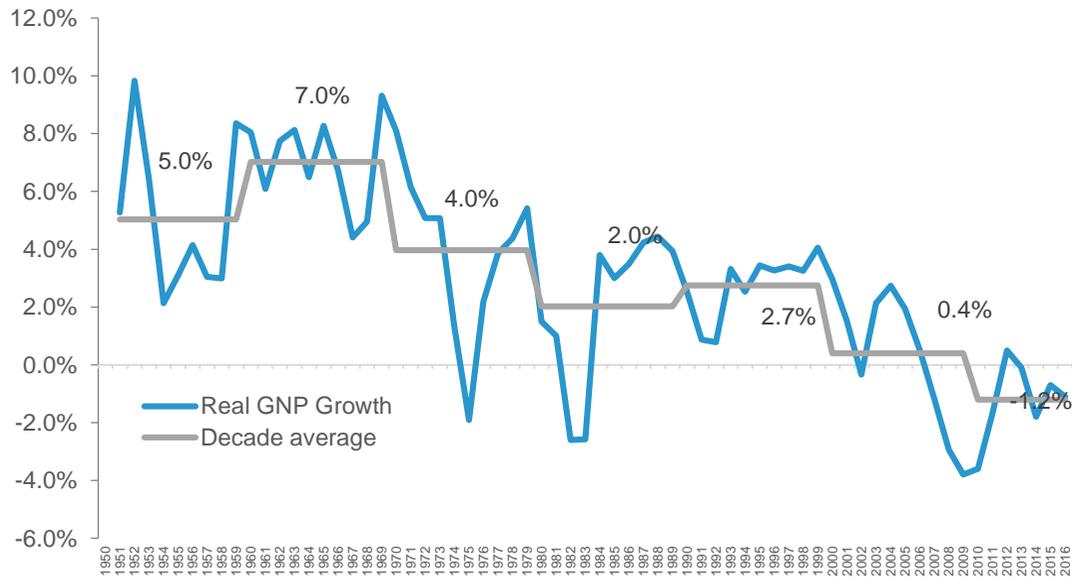
Optimizing the Management of Federal Programs and Funds

For each of the above, recommendations have been formulated with implementation as a primary concern. Thus, an assessment was made of why other similar initiatives had little impact and this effort tries to avoid the causes identified, among them recommending goals that exceeded the institutional capacity to achieve them.

The Fundación, its Directors and Estudios Técnicos, Inc. are cognizant of the importance of solving the energy problem. It was left out of the report because the issue has received ample attention in other venues.

PUERTO RICO REAL GNP

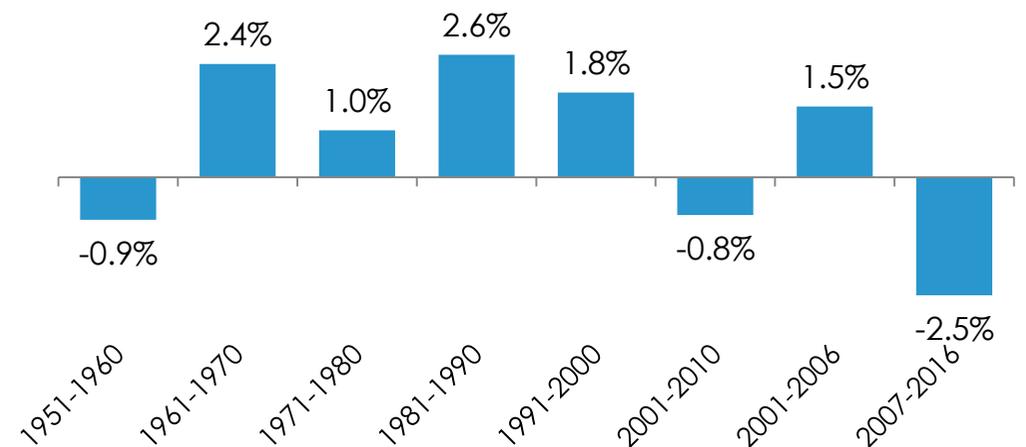
- Over the past five decades: a collapse of the capacity to generate growth occurred, and the recent experience is clearly the culmination of a long process of economic under-performance. The following graph shows a rapidly declining rate of growth over the last seven decades.
- Major structural transformations have resulted making useless the traditional economic tool kit for dealing with recessions.



EMPLOYMENT

- After several decades of growth in employment, the period after 2000 is characterized by slow and negative growth, with employment falling from 1,232,000 in 2007 to 986,000 in 2016.

Average Growth of Total Employment per Period (NSA), 1951-2016



Source: Department of Labor and Human Resources, Employment and Unemployment, Household Survey. NSA = Not seasonally adjusted.

ECONOMIC CONTEXT

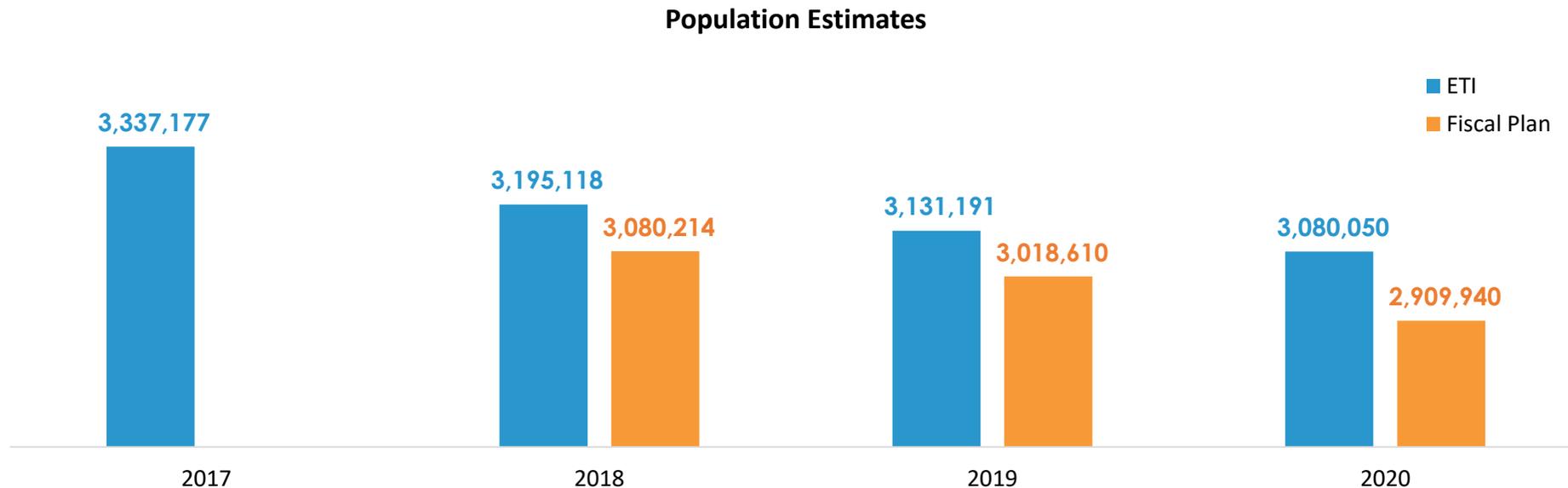
- Outmigration reached 93,000 persons in 2016.
- Average Net Migration in the past three years (2015-2017) surpassed 60,000.
- The young-adult population will continue to represent the majority of the out-migrants, although post María the age composition could change.
- Local conditions after the hurricane are causing a dramatic increase in migration. Net migration for fiscal 2018 should be close to 140,000.

Net Migration projections (Fiscal Years)	
2014	55,092
2015	65,089
2016	64,757
2017	68,278
2018	142,059
2019	63,927
2020	51,441
2021	40,943

Note: For 2017 through 2021 estimates by Estudios Técnicos, Inc.

FISCAL PLAN POPULATION ESTIMATES

- The fiscal Plan assumes a more severe contraction in population in fiscal 2018.
- Given the reversal of migratory flows observed in January it seems unlikely net migration in fiscal 2018 will surpass 200,000



Source: For 2016 and 2017, Annual Estimates of Resident Population Change, US Census Bureau. For 2018 through 2021 estimates by Estudios Técnicos, Inc. And the February 13, Fiscal Plan.

ETI'S ECONOMIC FORECAST POST-MARIA

Data is in fiscal years (July-June). Hurricane María occurred in fiscal 2018.

Estimated Economic Impact of Federal Relief Funds and Insurance Disbursements				
Fiscal Years 2018 - 2020				
Concept	Expected Growth (%)			
	2017	2018	2019	2020
Real GNP	-2.4%	2.1%	6.2%	-2.5%
Personal Consumption Expenditures	-0.1%	3.7%	0.3%	-2.4%
Government Construction Investment	-10.0%	29.2%	411.5%	-16.7%
Private Construction Investment	4.0%	29.7%	1.0%	-23.7%
Government Spending	-5.0%	7.2%	6.6%	-7.4%

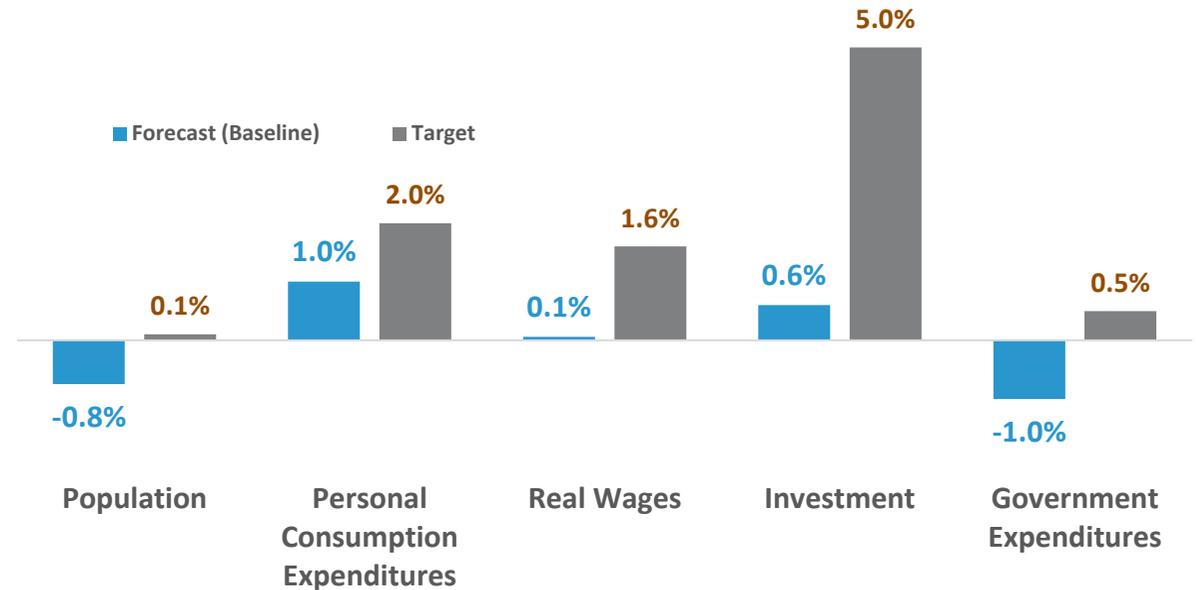
Source: Estimates by Estudios Técnicos, Inc. (2017)

PROPOSED TARGETS ARE IN LINE WITH RECENT HISTORICAL EXPERIENCE

- All of the proposed target growth rates are compatible with historical experience.
- Both, Investment and population, need a drastic reversal of trends if targets are to be met.
- Targets reflect key policy objectives:
 - Stability in population and consumption
 - Improved investment potential
 - Modest government increases in line with a more restrained spending policy
 - Improve productivity from innovation initiatives
- To achieve these targets the recommendations at the end of this report should be implemented.

Comparison of PR Forecasts and Growth Targets in Selected Indicators

Fiscal Years -- 2021 - 2025



Source: Estimates by Estudios Técnicos, Inc. (2018).

DEVELOPMENT OBJECTIVES

In addition to quantitative goals Puerto Rico should aspire to a society that is characterized by the following:

Flexibility – Refers to the need for an open economy to have the capacity and agility to adapt to rapidly changing external and internal context conditions. Many of our laws and regulations as well as the structure of the public sector have generated rigidity rather than flexibility.

Productivity – Without improved productivity a society cannot achieve higher standards of living for its population. Economic debate in Puerto Rico has emphasized Jobs, but productivity has been mostly absent.

Sustainability – This refers to environmental issues, increasingly recognized as key to long term development. In Puerto Rico this is particularly critical with respect to the coastal zone and availability of water.

Pluralism – Development as a process has to include access to social services and employment opportunities for all. In Puerto Rico it means taking steps to reduce the present high levels of inequality.

Constancy – Refers to the need to assure continuity in development efforts and avoiding the short term perspective that has characterized many of these efforts in Puerto Rico.

Innovation – An innovative society is one that is recognized as a “path developer” along many dimensions. Puerto Rico in the forties and fifties was a hub of innovation in public administration, social programs, health services and economic policies.

THE GLOBAL CONTEXT

- Puerto Rico, although a regional economy of the US is not immune to impacts from changes in the global economy.
- The changed center of gravity in the global economy as a result of the ascendancy of China and India explains the creation of the Pacific Alliance by various Latin American countries.
- It also explains the growth of Chinese investments in the region that now surpass those of the U.S.A. in various countries Latin American and Caribbean countries.
- Technology trends include the increased control by various major firms, increased interconnectivity and thus, vulnerability to external shocks. The next major technology benchmark is the “blockchain” technology used by Bitcoin and similar activities.
- The new tax environment in the United States, a result of moving to a territorial tax system poses major challenges for Puerto Rico looking forward. The recent U.S. tax reform removes Puerto Rico’s tax based competitive advantage.
- Increased volatility in commodity markets and the shift to trade in intangible have implications for Puerto Rico’s economic policy.
- Uncertainty in the economic context, as stated previously makes risk management an essential component of economic policy-making.

THE NATURE OF A REGIONAL ECONOMY

- The prevalence of risk in a regional very open economy such as ours is greater than in a closed, larger economy. Puerto Rico's economy behaves as a regional, not a national economy.
- The lack of control over labor and capital flows conditions domestic policy. (i.e. no barriers to trade, no monetary policy, free movement of labor and capital and significant leakages).
- The absence of economies of scale presents a major obstacle in a number of areas, including import substitution for consumer goods, R&D and production for the internal market. Network creation should be a core concern for small economies as a means of overcoming the absence of scale economies. Denmark provides an excellent example of optimizing network creation and management.
- The limited diversification of the productive sector while having a consumption sector that is much more diversified makes imports unavoidable for a wide range of products.
- Imposed complexity is the result of importing technology developed for larger, more developed economies. It makes the regulatory apparatus less able to manage the consequences.
- Outward orientation is an essential need for these economies but in the present global context it involves more than simply stimulating exports. Insertion in the global context is a much more complex multi-dimensional process.

AN INTEGRATED SYSTEMS APPROACH

“A List of ingredients is not enough to make a dish”

Robert Solow, quoted in the World Bank Growth Report

- Development is a complex process in which interactions among its many components is a paramount concern that fragmented or sectorial approaches do not capture
- It entails the integration of social, environmental and economic factors and a recognition of the need for a small, open economy to balance risks
- As technology advances the level of complexity increases and the challenges to technology importing economies assume a greater importance
- Based on the above, a new manner of dealing with traditional government services and policy approaches is required
- The following table provides a schematic illustration of what is entailed in an integrated approach

THE DEVELOPMENT INFRASTRUCTURES & SOCIAL OBJECTIVES

- One can define development as the concerted activities related to six basic infrastructures in order to achieve specified social objectives.

- These six infrastructures are the following:

Physical	Social
Environmental	Institutional
Cultural	Knowledge

- Social objectives expressed as conditions that should characterized a developed economy are those below:

Flexibility	Productivity
Sustainability	Pluralism
Constancy	Innovation

- These are merely illustrative of what could be social objectives for a particular society.
- The following table integrates infrastructures and social objectives. Columns reflect how each infrastructure can support the objective of that particular column. The last column reflects the need for an innovation policy that covers all the infrastructures.
- Rows suggest how each infrastructure supports all of the objectives.

THE DEVELOPMENT INFRASTRUCTURES & SOCIAL OBJECTIVES

INFRASTRUCTURES	OBJECTIVES					
	Flexibility	Productivity	Sustainability	Pluralism	Constancy	Innovation
Physical	Integrated planning and decentralization	Emphasis on connectivity	Focus on renewable energy and decentralized initiatives Iniciativas locales	Stimulate local initiatives (acueductos comunitarios)	Long range planning	Needed a public policy on innovation that covers all infrastructure areas
Social	Decentralization of social programs	STEM programs in education	Training programs that integrate social and environmental concerns	Integrated housing and social service programs	Improve efficiency and decentralized delivery	Needed a public policy on innovation that covers all infrastructure areas
Environmental	Improve regulations	New energy sources and better land use planning	Include the environment in the Fiscal Plan	Better and more accessible information	Create non government environmental policy entity	Needed a public policy on innovation that covers all infrastructure areas
Institutional	Consolidate processes, deregulate and re-regulate	An investment focused tax system	Adequate and balanced laws and regulations	Consider social infrastructure as a development tool	Minimize political intervention in government activities	Needed a public policy on innovation that covers all infrastructure areas
Cultural	Stimulate institutional learning	Culture as an economic sector	A change of vision: Culture as consumption Culture as investment	Strengthen support for community initiatives	Increase intervention in cultural policy by non government entities	Needed a public policy on innovation that covers all infrastructure areas
Knowledge	Reduce market entry obstacles	Improve technology transfer capacities (Fundación Chile)	Work towards an autonomous innovation system	Improve access by SMEs to new technologies	Strengthen K-12 educational system and R&D infrastructure	Needed a public policy on innovation that covers all infrastructure areas

THE SIX ROADMAP COMPONENTS

The CPA Foundation and Estudios Técnicos, Inc. have identified six areas considered essential in any Roadmap for Puerto Rico's economy. The six are:

1

Promoting a robust industrial system

2

Rethinking promotional strategies

3

Taxes and Economic Development

4

Defining the role of municipalities

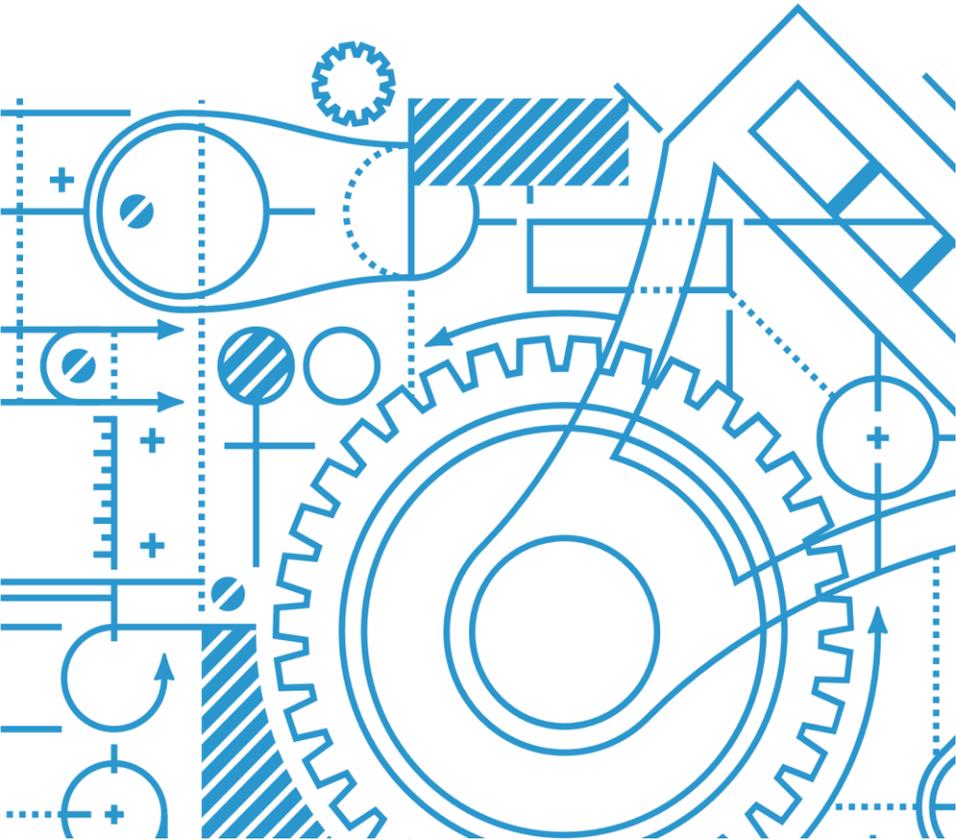
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Policies and strategies to stabilize population

6

Optimizing the management of federal programs and funds

THE FUTURE OF MANUFACTURING



- In a recent Puerto Rico Manufacturers Association document, manufacturing is seen as the major economic sector for the future but it will be a very different sector with increased intangible production and an important service component.
- Innovation should be given a front seat in economic policy. Much of the traditional approach to innovation saw it as being embedded in inflows of capital investment in the manufacturing sector.
- The trends in the advanced services sector clearly point out to promising growth sectors with respect, not only to employment growth, but also supporting innovation expansion in manufacturing and other sectors.
- Decentralized manufacturing and a smaller scale with strong design components and collaborative experiences will be characteristic of the sector.

EVOLUTION OF MANUFACTURING SUBSIDIES

- Business activity in Puerto Rico has been subsidized by the U.S. government through several tax provisions for over eighty years: US Revenue Act of 1921 (Section 931); Tax Reform Act of 1976 (Section 936); Section 30A (Substituting in 1996 for Section 936 until 2005); through the US CFSC (Section 901 which replaced Section 936).
- Over the past several years there has been an increasing discussion in the US about how effective these incentives are in achieving goals such as increased employment, when compared to their cost:
 - T. J. Bartik (2017). *A New Panel Database on Business Incentives for Economic Development Offered by State and Local Governments in the United States*: “**existing research on incentives [show] that in some cases they can affect business location decisions, but that in many cases they are excessively costly and may not have the promised effects.**”
 - PEW Charitable Trust (2017). *How States Are Improving Tax Incentives for Job Growth*: “**While these tax credits, exemptions, and property tax abatements are popular tools to create jobs, attract new businesses and strengthen the local economy, they also constitute high-risk investments that can squander billions in tax dollars without always paying off.**”
- In addition to the above, the recently approved Federal Tax Reform makes it inevitable that new approaches to investment promotion in Puerto Rico be adopted and that advanced services be part of these efforts. Thus, growth must be based on local factor endowments and sectors with endogenous growth potential.

ADVANCED SERVICE EXPORTS

- Under the new global economic structure, services will play an increasingly important role. Service exports are key to increasing Puerto Rico's long term competitiveness.
- Greater presence in Puerto Rico – approximately 790 new players in service exports as of 2016, mainly due to Act 20 of 2012.
- Growing global market – the share of services in global trade increased from 9% in 1970 to 20% in 2014 (IMF, 2017).
- Relatively high resiliency with respect to exports of goods (ibid).
- Relevant policy framework in place for attracting new investment (Acts 20 and 22). These policy tools create networks that facilitate inter- industry collaboration.
- Allows for a transition of manufacturing as independent silos, into a new productive and collaborative organization of production based on the cluster concept as opposed to the sectorial approach.

RECOMMENDED MEASURES

- Puerto Rico needs a well conceived innovation policy that will make innovation a cross cutting condition for economic development, not just in manufacturing, but throughout the economy. The models exist of such policies in jurisdictions such as Chile, Finland, Singapore and others. Fundación Chile is a model of an explicit initiative to integrate the economy in the global context through technology transfers.
- Another key component of our recommendation is for a concerted effort to strengthen the internal linkages in the economy through the completion of value chains in the Island. This entails a very different approach in industrial policy, that must include a cluster based approach in order to localize supply-chains.
- Thirdly, the merging of advanced services and manufacturing production is increasingly evident in many productive activities and this has brought with it the elimination of hard and fast distinctions between economic activities. Puerto Rico must have in place initiatives that recognize this as an essential component of its economic policy and, in particular, in its promotional strategies.
- Implementing the recommendations above should be the responsibility of an independent entity, a permanent economic development board with its major responsibility initiating and monitoring development programs. One objective of this recommendation is to assure continuity beyond four year cycles. The Administration has already initiated two projects that are congruous with this recommendation, the DMO and “Invest Puerto Rico”.

PROMOTIONAL STRATEGIES

- Traditionally, Puerto Rico has depended on tax incentives as the key component of its promotional strategies. This promotional strategy was weakened considerably because all of our competitors in effect offered similar incentives.
- Promoting technology intensive, mid level and emerging firms requires very different approaches than promoting large mature manufacturing establishments. The focus should be placed on the former.
- Manufacturing is not a homogeneous category since it includes emerging technology firms, mature manufacturing establishments, and in the case of Puerto Rico local and externally owned establishments. Each has its own needs so a “one size fits all” approach will not work.
- The merging of manufacturing and services (or the “servicification” of manufacturing as the World Bank calls it) requires a very different set of instruments and knowledge from promotional agencies than has traditionally been the case. Sector knowledge becomes an even more important component of promotional activities.
- PRIDCO has not had sector specialists in its promotional staff. If for example, bio-pharma is a key sector the agency should have a specialist in that area, likewise with other sectors deemed priority promotional targets.

POLICY RECOMMENDATIONS

- Promotional efforts should incorporate Asian economies, including the new East Asian tigers (in particular, Malaysia, Philippines and Indonesia).
- An integrated rather than a fragmented approach to promotional efforts – strengthen brand recognition. Currently, PR Tourism Company, PRIDCO, and PR Export Company each has a separate promotional strategy. There is no clear Puerto Rico brand, as was the case in the fifties, when Puerto Rico's brand was based on projecting “quality” across a broad range of activities: cultural, economic and social(see examples of Puerto Rico's promotions in the next slide).
- Create a dedicated program for value chain completion through improving capacity of local firms to become part of multi-national firms' supply chains. A key component of a new promotional strategy is the need to identify gaps in the value chains of different industries and tailor incentives accordingly.
- Promotional strategies should adopt a flexible approach to permit more agile adaptation to changing market conditions.
- Constant monitoring of competing destinations is essential, recognizing that competitors include counties, cities and states in the mainland and not just Singapore, Ireland and other national economies. The new Federal Tax Law reinforces this need.
- Adopt a “retain, attract and grow” format for promotional policies, recognizing that each component requires very different promotional tools. Likewise, emerging tech and mature industrial firms have different requirements as to incentives. “One size fits all” incentives will not be effective.
- A strong policy on the Puerto Rican diasporas as instruments of economic promotion and growth is recommended. For decades the Puerto Rican population in the mainland has been of minor interest to Puerto Rican policy makers in the Island. Promotional strategies should leverage the Puerto Rican diaspora not only in terms of potential consumption opportunities but also strategic alliances for productive activity. Measuring and monitoring these groups is essential for future investment, capital flows and integration mechanisms.

THE ROLE OF TAXES IN ECONOMIC DEVELOPMENT

- The OECD has done extensive work on the subject. A recent report analyzes the structure of taxes and its role in economic growth and reaches the following conclusion:
- “A revenue neutral growth-oriented tax reform would be to shift part of the revenue base from income taxes to less distortive taxes. Taxes on residential property are likely to be best for growth...In practical policy terms, a greater revenue shift could probably be achieved into consumption taxes”.
- In sum, the OECD concludes that a development friendly tax system should emphasize property and consumption based taxes.

SOME GLOBAL TRENDS

- The move towards consumption taxes, specifically VAT is evident in the literature.
- The variants that are prevalent are those that
 - have few exemptions,
 - are uniform among sectors and products,
 - are easily implemented and monitored
 - were carefully implemented
- Specific investment related measures such as
 - Expensing investment (U.S.)
 - R&D incentives (Ireland)
 - Service exports (Finland)
 - Capital Gains (opportunity zones)

RECOMMENDATIONS

Emphasize consumption and residential property taxes

Assess the VAT as a mid and long term option

Expensing investment in productive activities

Incentives in support of an innovation system

Eliminate Capital Gains Taxes in specific areas

Integrate tax reform and new incentives code

The potential disruption of a change to a VAT could be understood as an opportunity to make structural changes in the tax system as a whole. For instance, a change in the tax incentive code and a separate tax reform are both market disruptions that could be better integrated in a comprehensive change to the tax system. Introducing the VAT requires a careful and extended planning and educational process. This is why we do not recommend implementing the VAT as a short term solution.

CONSOLIDATION DOESN'T GENERATE SIGNIFICANT SAVINGS BY ITSELF

- Mayors and their respective municipal assemblies cost local tax payers an average of \$1.6 million. In the extreme case of all the mayors and municipal assemblies being eliminated, the move would save tax payers a maximum of \$122.6 million.
- **Therefore, average savings generated by consolidating municipalities without some level of regionalization would be almost negligible.**

Cost of Political Structure		
Municipality	Mayor & Municipal Assembly	% of Total Expenses
Aguadilla	\$1,501,931	2.3%
Arecibo	\$2,693,460	3.9%
Arroyo	\$1,902,651	12.5%
Culebra	\$531,952	7.7%
Fajardo	\$2,549,172	5.4%
Humacao	\$3,592,524	5.2%
Jayuya	\$1,140,910	5.4%
Maunabo	\$136,986	0.7%
Naguabo	\$651,261	3.9%
Orocovis	\$903,994	3.4%
Sabana Grande	\$2,669,897	10.3%
San Lorenzo	\$1,476,190	5.6%
Vieques	\$683,177	4.9%
Average	\$1,571,854	5.5%

Source: Single Audits, 2013&2014

REGIONALIZATION IS KEY

- On the other hand, regionalization of certain services can generate meaningful improvements in service quality and costs, by:
 - Eliminating Redundancy
 - Cost sharing arrangements
 - Reducing Administrative Costs
 - Achieving Economies of Scale
- As the FOMB recommended, the Commonwealth should retain at least 20% of current subsidies municipalities to change their operating model and avoid further fiscal imbalance. Municipal receipts should be tied to meaningful structural reforms.
- The services that should be regionalized include, but are not limited to:
 - Solid waste disposal
 - Management of Federal Funds
 - Security (municipal police)
 - General administrative services



POLICY RECOMMENDATIONS

- Create an inter-agency commission with the goal of executing a coordinated plan towards improving municipal efficiency and organizational structure and also avoid the dangers of fragmenting development policy.
- Improve guidelines on administrative processes, work plans, and operational procedures.
- Standardize, harmonize and improve the reporting of financial, budget and Project information, adopting the Chart of Accounts already in place under the Municipal Administrative Regulation.
- Develop quality metrics to measure the effectiveness of municipalities in each designated programme area.

Source: Estudios Técnicos, Inc. (2017). *Estudio Para Evaluar la Estructura Municipal de Puerto Rico*.

POLICY RECOMMENDATIONS

- Implement a shared services approach, in which efficiencies are obtained by consolidation of functions and process reengineering (see PR Fiscal Agency and Financial Advisory Authority, Fiscal Plan, 2018, p. 73).
- Foster the usage of inter-municipal agreements and regional structures to promote efficiencies of scale (ibid.).
- Create oversight and fiscal control mechanisms, preferably through a designated commission.
 - Establish reductions in state transfers
 - Enact fiscal plans and enforcement procedures
 - Create savings reserves for financially fragile municipalities
 - Directly supervise the planning and budget processes, and the compliance of cash flows to the budget guidelines

THE CONTEXT IN PUERTO RICO



- Poverty, inequality and the lack of opportunities for social mobility in Puerto Rico exacerbates the probability of migrating.
- Thus, any strategy developed for stabilizing the population :
 - **Must be** designed based on a framework that addresses poverty
 - **Should** emphasize on improving employment opportunities
 - **Has to** focus on the provision and strengthening of complementary services and social infrastructures
 - **Requires paying** attention to the particular needs of our vulnerable populations

5

Roadmap for Puerto Rico's economy: POLICIES AND STRATEGIES TO STABILIZE POPULATION

A focus on providing opportunities and a better quality of life to vulnerable populations: some examples



YOUTH

- Development of programs to improve the opportunities and facilitate the transition from school to college
- Promotion of volunteerism and other “school to work” programs to increase youth employability opportunities
- Education and capacity building opportunities
- Implementation of prevention and after school programs
- Complementary services for young parents (day care, housing incentives, among others)
- Incentives to promote entrepreneurship



WOMEN WITH CHILDREN

- Provision of complimentary services (day care, after school programs)
- Expansion of early intervention services (for children 0-5)
- Training and capacity building opportunities
- Equal opportunity policies
- Labor flexibilities (for example paternity leave)
- Incentives to promote entrepreneurship
- Housing incentives



AGING POPULATION

- Complementary services for the aging population through municipalities and NPOs (housekeepers, day care, assisted living, among others)
- Incentives to care givers
- workforce re-training opportunities
- Volunteerism and community service programs
- Promote community-based health initiatives

STRATEGIES FOR DEALING WITH POPULATION LOSS

- Part of Puerto Rico's measures to stabilize population include (as previously mentioned) **a strong policy for dealing with the Puerto Rican diaspora.**
- This policy must incorporate the capacity to access Puerto Rican human capital in the mainland, including professionals that have left Puerto Rico.
 - Attracting these professionals on a non-permanent basis could resolve some of the shortages experienced in specific niches (e.g. medical specialists).
- *A broad overhaul of the current measurement system in the island is needed.*
 - Outdated metrics need to be updated
 - Additional metrics need to be developed
 - Consistency and uniformity

FEDERAL FUNDS AND ECONOMIC DEVELOPMENT

Develop a matrix of funding sources

- Main objectives
 - Funding sources with broader eligible uses must be prioritized for strategic public interventions. Less flexible options could have a higher outsourcing component.
 - Create safeguard that limit the use of federal funds to finance recurrent expenditures
- Short-term priorities:
 - Prioritize use and government interventions
 - Prioritize innovative and autonomous program design
 - Determine optimal combination of funding sources
 - Determine rules defining eligible uses and match unmet needs
- Actions
 - CRRO and federal funds office could develop regulation to imbed the above objectives within federal programs.

FEDERAL FUNDS AND ECONOMIC DEVELOPMENT

Create reconstruction programs beyond traditional housing reconstruction activity

- Main objectives
 - Incentivize rehabilitation efforts within urban areas or higher density locations within municipalities.
 - The high number of vacant units in urban areas creates an opportunity to capitalize on existing infrastructure. Moreover, a substantial portion of current housing stock is considered informal housing and not compliant with building codes. Due to fiscal constraints, municipalities were not able to enforce local ordinances and many abandoned properties remain within urban areas.
- Short-term priorities:
 - Buyout programs combined with demolition activities. Fund local *estorbos públicos* programs via federal slum and blight demolition activities. The strategy must recognize that abandoned or empty properties could be transformed into assets that promote urban renewal (i.e. green parks on empty lots).
 - Also, municipalities could try to induce concentration of disperse population via housing grants and stronger infrastructure investments on strategic areas.
 - Federal funds can be combined to formalize informal housing via subsidized loans from SBA and joint venture with local banking institutions.
- Actions:
 - Develop a targeted code enforcement program which address vacant and blighted properties.
 - Limit efforts which try to fund small investments via scattered efforts. No changes in legislation are required.
 - Tax policy on property could be used to deter reconstruction on areas with less density.

FEDERAL FUNDS AND ECONOMIC DEVELOPMENT

Anchor investments via local institutions

- Main objectives
 - Academic institutions and NGOs must play a central role in rehabilitation efforts
 - Importance to address critical projects targeted to local needs but are also congruous with regional/central priorities.
- Short-term priorities:
 - Increase spectrum of government action and provide greater assurances for long-term survival of economic development initiatives.
 - Municipal governments are key to immediate relief efforts, however, a regional or central agency must be responsible for a comprehensive approach.
- Actions
 - Capitalize on robust relationships with key local development actors via regional federal fund offices and the creation of disaster-development zones.

FEDERAL FUNDS & MUNICIPALITIES

SUMMARY

- Deployment of a new policy targeting decentralization and regionalization through federal funds
 - Create regional structure of shared services for federal funds management
 - Pilot program with recovery funds
 - Consolidate federal funds offices between municipalities
 - Increase local government capacity to manage and use federal funds
 - Action plans for federal funds disbursements must be regional rather than place-bound
 - Natural disasters effects are regional, not municipal

- The recommendations made are mostly designed to avoid major conflicts with stakeholders and thus facilitate execution.
- They are incremental and can be put in place without major structural disruptions. The execution strategy is illustrated by the following quote:

“Cross the river by feeling for the stones” [Deng Xiao Ping, cited in the Growth Report](#)

- The government and the private sectors in Puerto Rico have very scarce resources to undertake a number of major initiatives simultaneously. Thus it is essential to define priorities and a carefully laid out Action Plan.
- Designing a system of metrics to gauge progress is essential. There is an old adage in planning that states that “you get what you measure”.
- Assuring continuity is essential. This is achieved by creating an institutional framework that makes it possible. Thus, the recommendation of creating a private sector entity to manage economic development policies and actions is essential. This recommendation, with some differences, has been made on a number of occasions.

Although the Foundation recognizes the importance and urgency of the reconstruction efforts, this report is oriented towards longer term sustainable development. The recommendations in this report are the following:

1. **Strengthen the Island's capacity for successful integration** into the global economy, recognizing that this requires a major overhaul of the economic policy making entities in the government and that the process incorporates dimensions beyond export promotion and investment attraction.
 - **Promote Puerto Rico as a service exporter** in key advanced services sectors and make the necessary institutional changes to improve effectiveness, recognizing that service exports require a very different approach and support mechanisms, as well as very different skill levels in the promotional entities. Law 20 of 2011 provides a major stimulus for service exports from Puerto Rico.
 - **Adopt an innovation policy** with the objective of introducing innovation in every sector and, of course, the government and municipalities. The result would be to make innovation and institutional learning a key competitive strategy.
2. **Puerto Rico must adopt an economic promotion strategy** that is not tax driven and relies on tax advantages to induce external investment.
 - **With respect to manufacturing, adopting a “retain, attract and grow” strategy** is key. Incentives will vary with the needs of particular firms and the stage at which they find themselves. PRIDCO, or the responsible entity, must have sector specialists in its staff, which has not been the case.
 - **Incentives cannot be one size fits all**, since emerging and mature firms have different needs and retention, attraction, and growing of industries also requires different approaches.

3. **Puerto Rico must develop and adopt a coherent and consistent policy for dealing with the diaspora**, not only for support in dealings with Congress, but also as support for the Island's development strategies, mobilizing the resources of the Puerto Rican community in the mainland. This will require changes in the present public sector approach to the diasporas.
4. **Stabilizing population and stemming outward migration** can be achieved through a combined effort aimed not only at job creation but improving social infrastructure, in particular education, health and labor reforms.
5. **The tax system is a core component of any development strategy**. Puerto Rico's must be simple, consumption based and with low compliance and monitoring costs. Specific tax measures for priority policy areas are a key component of any tax system.
6. **Municipalities must play a more important role in development** than heretofore, but in order to do so, changes in the way in which they are currently organized must be made. The creation of counties or autonomous regions in which cost sharing is possible and that can generate scale economies, is seen as essential.
7. **The management of federal programs and funds requires that a central agency be created** to handle what is perhaps the most critical element in future development prospects. As of today such programs are handled in a fragmented manner that has cost the Island billions of dollars in such funds.

