Puerto Rico’s New Fiscal Plan: Certain Pain, Uncertain Gain

By Lara Merling and Jake Johnston*

June 2018

* Lara Merling and Jake Johnston are Research Associates at the Center for Economic and Policy Research (CEPR) in Washington, DC.
Acknowledgements

The authors thank Mark Weisbrot, Sergio M. Marxuach, Martin Guzman, and Alexander Main for helpful comments, and Dan Beeton and Rebecca Watts for editorial assistance.
Executive Summary

As Puerto Rico attempts to recover from the devastating impact of Hurricane Maria, this paper examines the prospects for the island’s economy under the oversight of a congressionally mandated financial oversight board. After more than a lost decade of economic growth, this paper finds that the Board-approved fiscal plan for Puerto Rico will do little to reverse that trend, and is more likely to exacerbate the problem.

The island is now due to receive a large influx of relief funds and external support to rebuild from the hurricane. This provides a real opportunity to bolster public investment and address the lack of efficient infrastructure that has contributed to the crisis. The Board’s plan, however, focuses on privatizing public institutions and putting funds aside for debt repayments, rather than using all available resources to help the island rebuild and recover.

The Board’s emphasis on labor supply, and the need to push more workers into the formal labor force, is based on a deeply flawed analysis of Puerto Rico’s labor market. As this paper shows, even with all mandated benefits accounted for, wages in Puerto Rico are still significantly lower than on the mainland, despite comparable living costs. The change to “at-will” employment mandated by the Board will surely erode labor rights in Puerto Rico. But it is unlikely that in the context of Puerto Rico’s depressed economy this approach will lead to an increase in employment.

Along with the erosion of labor rights, the Board is also requesting work requirements be added for welfare recipients, despite the high unemployment rate and weak labor market. The fiscal plan calls for further cuts to other government agencies, with education and health care seeing the sharpest budget cuts. Municipalities and local governments are also targeted for budget cuts, despite also being asked to play a larger role in providing essential services. Overall, the plan mandates expenditure cuts of $9.5 billion, or 2.2 percent of GNP, over the next six years.

The most likely impact of these steps is an increase in out-migration of workers seeking better wages and access to benefits on the mainland.1 Furthermore, the plan estimates that these cuts will have a minimal impact on growth that would be mitigated by the positive impact of the proposed structural reforms, which is not likely given the magnitude of the cuts and the negative fiscal multiplier associated with these types of measures. While the cuts will certainly hurt many of the island’s residents, the economic growth predictions that the fiscal plan is based upon are not likely to materialize.

---

1 For more information, and further discussion of migration projections, see Gluzmann, Guzman, and Stiglitz (2018).
Compared to the Board’s previous estimates from before Hurricane Maria, the current plan actually projects higher economic growth over the life of the plan. Additionally, the Board estimates the measures overall will actually stimulate growth, despite the size of the budget cuts increasing over time.

The Board does not have a mandate to address any of the structural problems that result from the island’s dysfunctional political status. As this paper notes, small changes in federal policy, such as scrapping the Medicaid reimbursement cap, would go a long way in improving Puerto Rico’s fiscal situation. If the federal government would treat its citizens residing in Puerto Rico fairly, the increased federal support would be larger than all of the cuts required by the plan. In terms of equal Medicaid funding alone, the result would be an extra $9.2 billion in federal funding over the period the plan covers.
Introduction

As part of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), the bankruptcy process created by the US Congress in 2016 to manage Puerto Rico’s unpayable debt, the Financial Oversight and Management Board for Puerto Rico (the Board) was appointed to oversee the island’s finances. The Board is assigned the responsibility of certifying a fiscal plan for Puerto Rico that includes all important policy and budget decisions for the island.

As we noted at the time, the Board’s initial fiscal plan would not have led to an economic recovery in the foreseeable future; and following a decade of lost economic growth and prolonged recession, a more likely outcome from this plan appeared to be another lost decade.2

Puerto Rico’s circumstances changed significantly with the devastating impact of Hurricane Maria in September 2017. The storm claimed the lives of an estimated thousands of people,3 destroyed the island’s infrastructure, severely damaged over 472,000 homes, and completely shut down utilities. The Board estimates there to be at least $80 billion in damage from the storm, though a report from Puerto Rico’s governor estimated it would take $95 billion to rebuild.4

The island needed a new fiscal plan that took this new reality into account. After disagreeing on some proposed measures with the island’s government and rejecting various versions of a plan submitted by the governor, the oversight Board presented and certified its own version of a fiscal plan on April 19, 2018.5 After negotiations with the governor of Puerto Rico, the Board made some minor changes to the plan and certified an amended version on May 30, 2018.6

The Board expects Puerto Rico to receive about $62 billion in aid over the next six years, from both private insurance and the federal government, out of which $35 billion are federal public assistance funds, and $19 billion federal individual assistance funds.

This expectation of federal relief funds has led to a rally in the island’s debt. The Wall Street Journal reported in April that “the top performing bond investment of 2018” was Puerto Rican debt.7 With additional funding on the table, Puerto Rico’s creditors appear to believe they have a better chance

---

2 Merling et al. (2017).
3 Kishore et al. (2018).
4 Rossello (2017).
6 The Board (2018c).
7 Wirz (2018).
of repayment. The Board’s new plan aims to create a $6.1 billion surplus over the next six years that may be made available for debt repayment. However, federal support is clearly earmarked for relief efforts meant to aid Puerto Rico’s recovery after Hurricane Maria — not to direct funds towards fiscal surpluses that can be claimed by creditors.

This paper finds that the Board’s new fiscal plan, like the previous one, is based on overoptimistic macroeconomic assumptions, downplays the negative impacts of continued austerity, and fails to address many of the structural problems at the core of Puerto Rico’s lost decade, all while mandating a significant erosion of worker rights and reductions in public services.

Overall, the fiscal plan calls for almost $12 billion in savings over the next six fiscal years (in reality five, as FY 2018 ends in June of 2018). Of this, about $9.5 billion will come in the form of cuts to expenditures. Yet, despite the fact that this continued austerity is set to increase over the life of the plan, the Board estimates that its structural reform agenda will more than offset austerity’s drag on economic growth.

Though the Board puts the burden of these reforms largely on the Puerto Rican people, the plan does little to address Puerto Rico’s unfair treatment by the federal government, which has exacerbated the ongoing crisis — and without reform, will perpetuate it.

**Labor Market Reform**

At the core of the Board’s fiscal plan is a sweeping labor reform that aims to increase labor force participation and is seen as “the single most important reform.” The plan correctly highlights Puerto Rico’s low labor force participation, along with its high unemployment, but its proposed solution is based on a flawed analysis of the causes of these problems, and therefore has little chance of succeeding. At the same time, it erodes labor rights.

The labor force participation rate in Puerto Rico has been historically lower than in the US, but it has been steadily declining over the past 10 years — from 47 percent in 2007 to 41.6 today.\(^8\) Puerto Rico also has a much higher unemployment rate, currently at about 9.9 percent,\(^9\) two and a half times the

---

\(^8\) World Bank (2018).
rate for the US. As the economy has worsened and people have left the island, the overall size of the labor force\textsuperscript{10} dropped by about 20 percent, from 2007 to 2017.\textsuperscript{11}

The plan, along with a memo released by the Board, attributes these problems to labor market regulation and excessive benefits for workers.\textsuperscript{12} Unlike workers on the mainland, Puerto Rican workers benefit from mandated paid leave, and can qualify to receive a Christmas bonus at the end of the year. The plan claims these benefits can make it more expensive to employ workers, particularly low-wage ones, making Puerto Rico “less competitive in labor intensive sectors such as tourism.” The proposed measures and implementation timeline can be seen in Box 1.

<table>
<thead>
<tr>
<th><strong>Box 1</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Labor Reform Measures and Implementation Dates</strong></td>
</tr>
<tr>
<td>• Institution of at-will employment (effective by January 1, 2019)</td>
</tr>
<tr>
<td>• Earned Income Tax Credit (starting July 1, 2018)</td>
</tr>
<tr>
<td>• Welfare work requirement and work bonus (effective by January 1, 2019)</td>
</tr>
</tbody>
</table>

However, the Board’s claim that it is too costly to employ Puerto Rican workers does not appear accurate. Despite the federal minimum wage of $7.25 applying to Puerto Rico, mean wages on the island, even in low-wage sectors, are much lower than on the mainland. And even if we were to assume that mainland workers receive no benefits at all, and that workers in Puerto Rico receive the maximum amount of benefits, mainland workers earn vastly more than their counterparts in Puerto Rico, as can be seen in Figure 1.\textsuperscript{13}

\textsuperscript{10} The decrease in the labor force can be attributed partially to the overall decline in the working-age population, as well as to people dropping out of the labor force.

\textsuperscript{11} BLS (2018).

\textsuperscript{12} The Board (2018a).

\textsuperscript{13} Despite there being no federal mandate for paid leave, or a bonus, some states do mandate some benefits, and some employers offer them voluntarily. These annual wages for the US do not account for any of those benefits. For Puerto Rico, we use the cost of the maximum available vacation days and highest possible Christmas bonus for these calculations — something only a worker employed for over 15 years, in a large and profitable company, would qualify for.
Puerto Rico’s New Fiscal Plan: Certain Pain, Uncertain Gain

Figure 1 shows overall average wages in Puerto Rico, and in two tourism-related occupations specifically, including mandated benefits. When looking at all occupations, average annual wages in the US are $50,620, and in Puerto Rico are just $28,930. With the cost of the upper bound for mandated paid leave and the Christmas bonus, the mean wage in Puerto Rico goes up to $32,535, which is still significantly lower than in the US overall. Even if we make the same comparison for specific lower wage tourism-related occupations, average annual wages in Puerto Rico are still lower, at $21,220, compared to $24,250 in the US for hotel, motel, and resort clerk desks, and $21,298, compared to $24,710 for food preparation and serving-related occupations. (Again, this is a comparison with the maximum possible benefits added to Puerto Rican wages, and not including any benefits for US workers.) It is important to note that despite lower wages, living costs in Puerto Rico are comparable to the mainland.\textsuperscript{14}

Thus, it would appear misguided to blame high labor costs for the lack of jobs, when it is overall already much cheaper to hire Puerto Rican workers, despite mandated benefits. As the Government Accountability Office has noted, lowering the minimum wage for Puerto Rico, or reducing benefits, may mean that even more workers will choose to leave Puerto Rico.\textsuperscript{15}

\textsuperscript{14} Instituto de Estadísticas de Puerto Rico (2016).
After pushback from the governor of Puerto Rico, the Board agreed to remove from the amended fiscal plan both the cuts to the Christmas bonuses and the reduction in sick leave.\textsuperscript{16} However, much of the core labor reforms remained unchanged in the new version.

The plan mandates the introduction of “at-will” employment, meaning employees could be fired without “just cause.” This would serve to erode job security amid what is already an incredibly weak labor market, likely increasing unemployment in the short term. This would further contribute to the increased out-migration of workers, who can relocate and work on the mainland as they wish.

The plan also includes “compensation-related” measures that are comprised of government-wide reductions in benefits, agency-specific layoffs and benefit cuts, and an across-the-board cut in pensions.\textsuperscript{17} The cuts aim to reduce costs by a total of $4.5 billion over the entire period. The cuts gradually increase every year, and by 2023 amount to $1.3 billion, or 1.7 percent of projected GNP, per year.\textsuperscript{18} These are savings that are coming directly out of the pockets of current public sector workers.\textsuperscript{19}

Paired with reduced labor protections, and in the context of a very weak labor market, the plan also calls for introducing work requirements for welfare recipients, the current lack of which is described by the Board as partially responsible for the low labor force participation rate. Despite recognizing the “limitations on the data available” to assess whether welfare discourages formal labor market participation, the plan calls for the introduction of work requirements. This creates additional hurdles for welfare recipients, since the burden of proof for fulfilling the newly introduced requirements will be on them.

Though the Board argues that these welfare benefits act as a disincentive to joining the formal labor market, the main impediment to jump-starting employment is likely to be one of inadequate aggregate demand — not excessive benefits (as will be discussed below).

To directly address the lack of formal employment, the Board proposes implementing an Earned Income Tax Credit (EITC) program, similar to that utilized on the mainland. Though this would appear to be a commonsense reform, it is unlikely to seriously address the problem if implemented at its proposed level. Projected to cost $200 million per year, the proposed EITC program would boost earnings for a single mother with two children earning the minimum wage by $1,500 a year (under the

\textsuperscript{16}The Board (2018b).
\textsuperscript{17}The Board (2018c).
\textsuperscript{18}Authors’ calculations based on the Board (2018c).
\textsuperscript{19}These measures are inspired by reforms imposed by the IMF in Europe — where they have a poor track record of increasing employment. See Weisbrot et al. (2017) and Rosnick and Weisbrot (2013) for examples and more information.
mainland EITC program, that same single mother would receive more than $5,700).20 Again, it is important to note that while wages and the payouts from the EITC program are below those on the mainland, overall living costs are comparable.21

In addition, the Board is mandating a 10 percent cut in pensions for retired government workers, reducing incomes of Puerto Ricans even further, and placing even more downward pressure on demand.

Overall, the Board’s Labor Reform Agenda is expected to generate savings of about $320 million over the next six years. However, this income would be taken away from Puerto Rican workers and welfare beneficiaries — placing an extra burden on the island’s most vulnerable residents — in order to create a surplus that may go to private creditors. Restricting access to welfare and reducing compensation for workers is most likely going to worsen poverty and increase out-migration, as well as reduce overall economic growth. It may also discourage residents who left the island from returning. Meanwhile, given past experience, the assumption that these measures will stimulate employment and attract more investment appears overly optimistic.22

To partially offset these significant cuts, the Board proposes using some of the savings for reinvestment in health care and education. As will be discussed later, these sectors would see large cuts over the next five years under the plan, and the reinvestment does not begin to cover those losses. Even after accounting for reinvestment in education and health care, both sectors would still see across-the-board cuts of $1.54 billion and $486 million, respectively. (A more detailed accounting of the expenditure cuts is provided in the following section.)

Though the reinvestment of savings is a positive development, there is no guarantee it will materialize. If the Puerto Rican government does not implement “at-will” employment by June 27, 2018, then there will be no funds made available for reinvestment.23 While the cuts are guaranteed, the reinvestment is not. It is worth noting that the Puerto Rican government has proposed a budget that does not include pension cuts.24 It remains to be seen how the Board will handle this.

20 Internal Revenue Service (2018).
21 Instituto de Estadísticas de Puerto Rico (2016).
22 See Weisbrot and Jorgensen (2013).
23 The Board (2018c).
**Accounting of Austerity Measures and Their Impact on the Economy**

Overall, the austerity measures mandated by the Board are projected to reach nearly 3 percent of yearly GNP by 2020 and to continue increasing from there. In total, the Board’s fiscal plan projects “savings” of $11.8 billion through 2023, of which $9.5 billion is from cuts to expenditure. As Puerto Rico remains locked out of credit markets, some cuts will be inevitable, yet the Board’s plan targets areas that are more likely to have a negative impact on the island’s residents.

**Table 1**

<table>
<thead>
<tr>
<th>Accounting of Austerity Measures (in millions)</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>Total</th>
<th>Total (Percent of Cumulative GNP)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Spending Cuts — Total</strong></td>
<td>149</td>
<td>294</td>
<td>1476</td>
<td>2226</td>
<td>2552</td>
<td>2775</td>
<td>9472</td>
<td>2.26%</td>
</tr>
<tr>
<td>Compensation-Related Measures</td>
<td>0</td>
<td>56</td>
<td>128</td>
<td>196</td>
<td>265</td>
<td>333</td>
<td>978</td>
<td>0.23%</td>
</tr>
<tr>
<td>Payroll Freeze</td>
<td>0</td>
<td>0</td>
<td>72</td>
<td>140</td>
<td>208</td>
<td>277</td>
<td>696</td>
<td>0.17%</td>
</tr>
<tr>
<td>Uniform Health Care</td>
<td>0</td>
<td>56</td>
<td>56</td>
<td>56</td>
<td>56</td>
<td>56</td>
<td>282</td>
<td>0.07%</td>
</tr>
<tr>
<td>Agency Efficiency Measures</td>
<td>0</td>
<td>302</td>
<td>693</td>
<td>992</td>
<td>1122</td>
<td>1182</td>
<td>4292</td>
<td>1.02%</td>
</tr>
<tr>
<td>Corrections</td>
<td>0</td>
<td>22</td>
<td>60</td>
<td>89</td>
<td>112</td>
<td>112</td>
<td>395</td>
<td>0.09%</td>
</tr>
<tr>
<td>Education</td>
<td>0</td>
<td>60</td>
<td>234</td>
<td>347</td>
<td>433</td>
<td>466</td>
<td>1539</td>
<td>0.37%</td>
</tr>
<tr>
<td>Health Care</td>
<td>0</td>
<td>61</td>
<td>85</td>
<td>105</td>
<td>114</td>
<td>121</td>
<td>486</td>
<td>0.12%</td>
</tr>
<tr>
<td>Public Safety</td>
<td>0</td>
<td>26</td>
<td>57</td>
<td>69</td>
<td>71</td>
<td>71</td>
<td>294</td>
<td>0.07%</td>
</tr>
<tr>
<td>All Other</td>
<td>0</td>
<td>134</td>
<td>257</td>
<td>382</td>
<td>392</td>
<td>413</td>
<td>1577</td>
<td>0.38%</td>
</tr>
<tr>
<td>Health Care Reform</td>
<td>49</td>
<td>154</td>
<td>500</td>
<td>750</td>
<td>795</td>
<td>840</td>
<td>3088</td>
<td>0.74%</td>
</tr>
<tr>
<td>Cuts in Subsidies to Municipalities/UPR</td>
<td>23</td>
<td>40</td>
<td>170</td>
<td>285</td>
<td>352</td>
<td>376</td>
<td>1246</td>
<td>0.30%</td>
</tr>
<tr>
<td>Pension Reform</td>
<td>0</td>
<td>0</td>
<td>185</td>
<td>182</td>
<td>179</td>
<td>185</td>
<td>731</td>
<td>0.17%</td>
</tr>
<tr>
<td>Office of the CFO</td>
<td>76</td>
<td>68</td>
<td>69</td>
<td>70</td>
<td>71</td>
<td>72</td>
<td>426</td>
<td>0.10%</td>
</tr>
<tr>
<td>PREPA</td>
<td>0</td>
<td>0</td>
<td>13</td>
<td>18</td>
<td>19</td>
<td>24</td>
<td>74</td>
<td>0.02%</td>
</tr>
<tr>
<td>EITC Implementation</td>
<td>0</td>
<td>-204</td>
<td>-204</td>
<td>-204</td>
<td>-204</td>
<td>-204</td>
<td>-1020</td>
<td>-0.24%</td>
</tr>
<tr>
<td>Economic Development Investment</td>
<td>0</td>
<td>-123</td>
<td>-78</td>
<td>-64</td>
<td>-48</td>
<td>-34</td>
<td>-345</td>
<td>-0.08%</td>
</tr>
<tr>
<td><strong>Revenue Increases — Total</strong></td>
<td>45</td>
<td>322</td>
<td>422</td>
<td>435</td>
<td>518</td>
<td>545</td>
<td>2287</td>
<td>0.55%</td>
</tr>
<tr>
<td><strong>Total Measures</strong></td>
<td>194</td>
<td>616</td>
<td>1898</td>
<td>2661</td>
<td>3070</td>
<td>3320</td>
<td>11759</td>
<td>2.80%</td>
</tr>
</tbody>
</table>

*Source: The Board (2018c).*

Table 1 shows the overall austerity measures included in the certified fiscal plan, in millions of dollars, and breaks down those measures by category and year. It is important to note that these numbers actually downplay the true level of austerity. As can be seen, very few cuts come in FY 2018. That is
because it is already too late to implement these measures in the current fiscal year (Puerto Rico’s fiscal year runs from July to June). However, the Board held budget projections constant from FY 2018 to FY 2019 without taking into account inflation or other potential increases. This indicates that in real terms, the cuts are actually larger than the Board projects.

As can be seen in Table 1, the largest component of spending cuts comes from agency efficiency measures — $4.29 billion, or 1.02 percent of cumulative GNP over the planning period. Within that, the largest cuts are in health and education. The Board mandates the consolidation of dozens of government agencies as well as significant cuts in personnel expenses (as was discussed previously).

In addition to the cuts to the health care budget overall, reform of the Mi Salud program accounts for an additional $3.09 billion in savings. This “new health care model” is expected to generate these savings by addressing waste, fraud, and abuse; lowering drug prices; implementing enrollment verification; and other reforms. However, should the expected savings not materialize, more significant cuts are on the table, including reducing coverage of certain benefits, and increasing co-pays.

Some $1.25 billion in savings comes from reducing subsidies to municipalities and to the University of Puerto Rico (UPR). This figure accounts for the reinvestment of some savings into a scholarship program for low-income students at UPR. The cuts in transfers to municipalities puts an additional burden on these communities’ attempts to recover from hurricanes Irma and Maria.

It should also be noted that Puerto Rico will continue to pay hundreds of millions of dollars in Title III expenses and in funding for the Board itself. Though expenses for the Board are reduced in the current plan, this reduction is smaller than the cuts to other agencies’ budgets. In total, over the next six years, it is estimated that Puerto Rico will spend $1.5 billion on professional fees and Board funding, or about one-eighth of the targeted budget tightening over the period. This is quite a large administrative cost by any international comparison.

The new plan also predicts a higher budget surplus for the government, as compared to the previous one: $6.1 billion over the next six years, compared to $4.8 billion in the pre-storm estimates. This is despite much higher predictions for population loss; the new plan expects an 11 percent decline over the next six years, while the old plan estimated that at less than 1 percent.

---

25 The section of PROMESA that establishes the process for legal bankruptcy proceedings.
26 Total GNP over the period is estimated by the Board to be about $420 billion.
27 A smaller population means both a smaller tax base, and a smaller labor force.
The plan’s goal is to reduce spending and increase revenue in order to achieve about $12 billion in savings — about 3 percent of predicted cumulative GNP — over the six-year period. However, the Board projects that the negative impact from the cuts will be offset by the positive impact of the structural reforms within three years. Despite the sharp cuts, the Board expects an overall boost in growth over the six-year period of about 1 percent. This is despite the fact that the largest reductions in spending would actually materialize over the last three years of the plan’s timeline, as can be seen in Table 2.

**TABLE 2**
Projections from 2018 Amended Certified Plan

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GNP Growth Post-Measures</td>
<td>-13.3</td>
<td>6.3</td>
<td>1.1</td>
<td>1.5</td>
<td>1.9</td>
<td>1.8</td>
</tr>
<tr>
<td>Impact of Measures on GNP Growth</td>
<td>-0.3</td>
<td>-0.8</td>
<td>-1.6</td>
<td>0.3</td>
<td>1.4</td>
<td>1.9</td>
</tr>
<tr>
<td>Savings from Measures as percent of GNP</td>
<td>0.31%</td>
<td>0.91%</td>
<td>2.75%</td>
<td>3.74%</td>
<td>4.17%</td>
<td>4.37%</td>
</tr>
<tr>
<td>Spending Cuts Total as percent of GNP</td>
<td>0.24%</td>
<td>0.44%</td>
<td>2.14%</td>
<td>3.13%</td>
<td>3.47%</td>
<td>3.66%</td>
</tr>
</tbody>
</table>

**Source:** The Board (2017b and 2018c) and authors’ calculation.

Table 2 illustrates the fiscal plan’s growth predictions — the Board’s estimate for the impact that its proposed structural measures will have on growth — along with the proposed cuts. The cuts make up an increasingly larger share of predicted GNP, and as shown, a large fragment of the savings are simply direct cuts to spending. Moreover, roughly half of those cuts comes from measures that will directly target the incomes of residents, which will directly impact demand in the economy.²⁸

The cuts to incomes, as well as to social services, will worsen the living standards of many Puerto Ricans. Before the storm, when the last estimates were made, the island already had an alarmingly high poverty rate of 46 percent, and a child poverty rate of 58 percent.²⁹

Furthermore, given these large cuts, it seems very unlikely that there would not be a much larger negative impact on the economy. As was the case with the pre-hurricane plan, the fiscal multiplier used by the Board is overly optimistic and does not really account for the deep recession the economy has been in. The estimates also fail to account for any endogenous negative feedback, thus understating the negative impact the cuts will have on the economy overall.³⁰

The negative impact on the economy, as well as reduction in income, will most likely exacerbate out-migration. This would then provoke further economic decline, and prolong the crisis.

²⁸ Authors’ calculations based on the Board (2018c).
²⁹ US Census Bureau (2016).
³⁰ For a complete explanation on the flaws in the Board’s calculations, see Gluzmann, Guzman, and Stiglitz (2018).
It immediately stands out that according to the new plan, Puerto Rico’s economy seems to be much better off than in the pre-storm scenario. Before, real GNP was expected to shrink by about 12 percent over the next six years, but the current plan estimates only a 1 percent decline.

**FIGURE 2**  
Real GNP Projections Based on 2017 and 2018 Certified Fiscal Plans

Still, as can be seen in Figure 2, even under this optimistic scenario, Puerto Rico would not reach its pre-hurricane level of GDP until FY 2024 at the earliest. Alternative projections are far less optimistic. The International Monetary Fund (IMF), for example, projects negative GDP growth in each year through 2023 (the last year for which projections are available). According to the IMF, Puerto Rico’s economy, in real terms, would be smaller in 2023 than it was in 1997.

Even taking into account the large decline in population by using GDP per capita, the IMF projects Puerto Ricans to be no better off in 2023 than they were in 2003 — two lost decades.32

Of course, the IMF has not taken the Board’s proposed reforms into account in their projections; however, even if we were to use the Board’s “premeasure” estimates, the analysis remains the same: the Board’s projections are more optimistic than the IMF’s.

---

31 The IMF projects GDP, and the Board GNP, but historically both indicators have had almost identical growth rates.
**Addressing Puerto Rico’s Structural Problems**

The Board points out that Puerto Rico has “long-standing and structural” problems that predate the storm — mainly poor infrastructure, a “difficult” business climate, an oversized public sector, and low labor force participation.\(^{33}\)

However, the Board fails to recognize the role that Puerto Rico’s dysfunctional political status has played in its economic decline, which started over a decade ago. As an unincorporated territory, Puerto Rico did not have the tools to respond to changes in the global economy, with the US government having control over important trade, tax, and monetary policy, as well as other economic decision-making. Since Puerto Rico is not a state, it has historically not been eligible for many of the federal benefits that states enjoyed.\(^{34}\) The most glaring example of this disparate treatment is the funding received by Puerto Rico for Medicaid, which is capped at a much lower level than for states — thus requiring the Puerto Rican government to cover expenses for a benefit that all US citizens should have equal access to.\(^{35}\)

In 2018, Congress approved some $4.9 billion in supplemental funding\(^{36}\) for Puerto Rico’s Medicaid program, thereby averting the impending “Medicaid cliff.” However, this money will only fully fund the program for two years. Beginning in 2020, the Board projects Puerto Rico filling in for the reduced federal funding, significantly increasing the government’s estimated expenditures. It is this second “Medicaid cliff” that leads the Board to mandate such significant cuts elsewhere — especially in later years covered by the plan.

But, as noted earlier, if the federal government simply reimbursed Puerto Rico like it does states, it would result in an additional $9.2 billion in federal funding through 2023. That is almost the same amount as all of the budget cuts mandated by the Board. In other words, if Puerto Rico were simply treated fairly by the federal government, the entirety of the budget cuts would be unnecessary in terms of meeting the Board’s mandated fiscal targets.

Thus, there is a substantial case to be made for more federal support for Puerto Rico. In addition to relief and reconstruction funding, the federal government could address these structural inequities that have plagued Puerto Rico for decades.

---

\(^{33}\) The Board (2018c).
\(^{34}\) For a more detailed discussion of these issues, see Merling et al. (2017).
\(^{35}\) Merling and Johnston (2017).
\(^{36}\) US Senate Committee on Appropriations (2018).
It is due to the long-term economic decline that some of the problems pointed out by the Board have developed, and the measures proposed do not address any of the causes of this decline, but rather appear to exacerbate some of them.

The fiscal plan notes Puerto Rico’s lack of modern infrastructure as a problem. Especially when it comes to reliable electricity, the Board claims “public corporations … have consistently created a drain on the economy by delivering lower quality services at high costs while crowding out private investment.” Their proposed solution is to privatize these entities. However, given Puerto Rico’s own past experience, privatizing public services offers no guarantee of increased investment, or better-quality services, particularly when it comes to utility monopolies.

The plan offers little in terms of increasing public investment in infrastructure projects, which has dropped significantly over the last decade. However, utilizing the influx of federal funds to increase public investment and modernize infrastructure could actually help attract more private investment to the island and increase the competitiveness of businesses operating there. The lack of reliable infrastructure, and the high cost of energy are probably much larger deterrents to investment than the added costs from extra benefits for workers, for example.

The damage caused by the hurricane does provide Puerto Rico with an opportunity to use the relief funds it receives to rebuild its infrastructure. However, the current plan prioritizes putting funds aside to achieve a fiscal surplus that can be used for debt repayments, as well as forcing significant cuts that will have a negative feedback effect on the economy, rather than using all available resources to help the island rebuild and recover.

**Conclusion**

As Hurricane Maria damaged most of Puerto Rico’s infrastructure, the island is now due to receive a large influx of relief funds and external support to rebuild. Despite clear instructions from members of Congress that none of the support received can be used for debt repayment, the Board certified a fiscal plan that makes steep cuts to public services in the pursuit of a budget surplus that can be used to pay off creditors.

---

37 The Board (2018c), 6.
38 Merling (2018).
39 Investment peaked at 20.7 percent of GDP in 1999 and fell to just 8.25 percent in 2016, according to government data. See Merling et al. (2017).
40 Velázquez et al. (2018).
Immediately after the storms, the Board released a set of “core principles” that the fiscal plan would follow. However, the actual certified plan diverges from these principles, instead prioritizing cuts in the health and education sectors; a labor reform agenda that will erode worker rights and likely exacerbate out-migration; and the privatization of public entities, rather than bolstering public investment and addressing the lack of efficient infrastructure.

A number of prominent economists warned the Board that a return to austerity “would provoke further out-migration and accelerated economic decline and prolong the current humanitarian crisis.” But this is exactly the path the Board has chosen to take.

41 The Board (2017a).
42 Acemoglu et al. (2018).
References


Puerto Rico’s New Fiscal Plan: Certain Pain, Uncertain Gain


