

To: Bipartisan Congressional Task Force on Economic Growth in Puerto Rico

From: Working Group of the CNE Growth Commission *

Date: October 14th, 2016

Re: Developing a Medium to Long-Term Economic Strategy for Puerto Rico

We are writing in response to the request for “stakeholder input” issued by the Bipartisan Congressional Task Force on Economic Growth in Puerto Rico (the “Task Force”), which was established pursuant to Section 409 of the Puerto Rico Oversight, Management, and Economic Stability Act (“PROMESA”).¹

Devising economic development opportunities for Puerto Rico should be one of the most pressing goals for both U.S. and local policymakers, given Puerto Rico’s economic ties to the United States and the magnitude of the socioeconomic crisis faced by residents of the territory. Economic opportunities will not materialize spontaneously, even after significant debt restructuring. Rebuilding Puerto Rico’s economy is certainly in Congress’ best interest because reversing the island’s economic decline will ensure that further rounds of default and restructuring are not needed. This is often the case when restructuring and growth are not part of a common agenda. Achieving long-term economic growth is a complex endeavor that requires a new development strategy, and there are no quick fixes or silver bullets for it.

The CNE Growth Commission

As a first step in charting the road towards sustainable economic development, the Center for a New Economy - Puerto Rico’s only independent non-profit think tank - has undertaken the task of empaneling a Growth Commission (“GC”) to identify opportunities and strategies that can disrupt the pernicious pattern of economic decline and foster long-term growth. The GC’s primary objective is to perform the necessary analyses and provide recommendations to develop a diversified portfolio of high value-added activities, leverage existing capabilities, and develop new comparative advantages. The GC organizes its work via Working Groups composed of academics, policy makers, businesspersons, and civic leaders with expertise on particular focus areas.

* The views expressed in this document are those of the undersigned and do not necessarily represent those of the CNE Growth Commission, the Center for a New Economy (CNE), or its sponsors. The CNE Growth Commission is an advisory body of the CNE focused on defining a comprehensive development framework for Puerto Rico, one that can sustain a new phase of economic growth for the island.

¹ Public Law 114-187.

In a previous communication submitted to the Task Force, the Center for a New Economy (“CNE”) made a set of recommendations that could be implemented at the federal level to lay the foundation for strengthening innovation, research, and development capabilities in Puerto Rico, in addition to other strategies to address short-term economic growth.² We support the recommendations made by CNE to the Commission, and outline, in this memorandum, a preliminary vision for spurring growth: a way forward to address the deeper, structural constraints to economic advancement in Puerto Rico.

Our vision is based on the premise that long-term sustained economic growth is a result of a country’s capability to progressively move into higher value-added activities. This is achieved by improving the types and quality of the goods and services produced and by finding innovative and more efficient ways of producing them. This is especially true in the 21st century, which is characterized by ever-deeper inroads into a knowledge-based economy. Therefore, any new economic strategy for long-term growth ought to be focused on: (1) speeding up the process of structural change by advancing the economy’s insertion in high-value niches, investing in innovation, and adopting new knowledge and technologies; and (2) creating the institutional framework to promote this structural change.

Identifying Sectorial Opportunities

A first-order consideration to take into account is Puerto Rico’s prior development experience and assets. The territory combines a relatively low-cost, skilled labor force with wholesale integration into U.S. labor and product markets, procurement programs, as well as legal and monetary institutions. A new growth strategy should be designed to take advantage of these opportunities by exploiting high-value niches that are unavailable to rival locations. For illustrative purposes, following are several examples that could be swiftly implemented:

1. Domestic software development - Offshore software development is frequently portrayed as a handoff operation: end-users in Silicon Valley recruit programmers in India for a fraction of their domestic cost and simply wait for their applications to return bug-free. The reality is far more complex, and the benefits of offshoring are at times offset by unanticipated costs, including the near-constant back-and-forth of supervisors, project managers, and troubleshooters. While “near shore” locations like Mexico and Costa Rica offer proximity - or at least compatible time zones - they demand work visas and fluency in Spanish, and lack the U.S. courts, legal system, and currency that are taken for granted in Puerto Rico.

2. Bilingual call centers - Bilingual call centers have at least two advantages over their monolingual rivals. First, they are able to shift their focus over the business cycle,

² Specifically, the CNE made proposals to (1) provide Puerto Rico with some fiscal space; (2) incentivize participation in the formal labor force; (3) stimulate new economic activity and the demand side of the labor market through increased lending by the private sector to small and medium enterprises and new public investment in infrastructure. See CNE Memorandum, submitted on August 22, 2016.

targeting English-speaking markets when demand is high in the Anglophone world, switching to Spanish-speaking markets when demands shifts, and vice versa. Second, they are able to adjust to the language of the recipient in heterogeneous markets, minimizing the need for advanced planning or ex-post facto adaptation. While Puerto Rico is by no means fully bilingual, it boasts English and Spanish as official languages and hosts a large bilingual population that could be trained and employed in the call center industry.

3. Defense and national security contracting - Federal law demands the domestic production or provision of a significant amount of defense and security-related goods and services, including not only military equipment but information technology that has national security implications and other similar products. Unlike their offshore rivals, Puerto Rican producers are eligible to compete for these contracts - which tend to involve high quality jobs - and can potentially do so to good effect given the island's low-cost, skilled labor force.

These are just a few examples of Puerto Rico's competitive opportunities. Others could be discovered and exploited as part of a thoroughgoing industrial policy-making exercise, one designed to identify and promote export and employment-generating activities on the island.

Revamping Institutions for Development Policy

In order to discover and take advantage of these opportunities, Puerto Rico will need to *revamp* the government institutions whose mission is to promote this structural transformation. Many of the crucial organizations - the Puerto Rico Planning Board, the Puerto Rico Industrial Development Company ("PRIDCO"), and the Government Development Bank ("GDB"), among others - have deteriorated in recent decades, experiencing a fragmentation of authority, loss of personnel, and a weakening of the *esprit de corps* that catalyzed the island's takeoff during the years of Operation Bootstrap.

Rebuilding these institutions will entail making selective investments, recruiting and retaining capable civil servants often tempted by the salaries and social status offered by private sector firms, and reviving the reputation and morale of the public sector more generally. It will also require organizational innovations to improve the coordination of financing, promotion, monitoring, and problem-solving efforts of government programs aimed at seeking and expanding private sector investments. This institutional makeover also requires reconfiguring agencies such as the GDB, the Puerto Rico Planning Board, and the agencies and instrumentalities under the Puerto Rico Department of Economic Development and Commerce (i.e. PRIDCO, the Puerto Rico Tourism Company, the Puerto Rico Trade Company, and the Office of Industrial Tax Exemption). Following the successful experience of competitor countries, Puerto Rico should spur institutional innovations to make, coordinate and monitor ambitious development plans and activities involving both public and private actors and among government entities. Undoubtedly, the process of institutional revamping and sectorial upgrading will require a broader set

of interventions and transformations, but the recommendations spelled here can serve as a starting point towards developing a comprehensive and sustained strategy for growth.

A Recommendation to the Task Force

While the creation of a Congressional Task Force on Economic Growth in Puerto Rico was a step in the right direction, its targeted mandate and limited lifespan limits its ability to address long-term development issues. The process of developing a new development strategy will require continuous interaction with Congress and the Executive Branch of the federal government well beyond December 31, 2016.

With this in mind, we propose that this Task Force include in its final report due by the end of this year the recommendation to create a **Congressional Commission on Economic Growth for Puerto Rico**. We recommend that this independent U.S. government body be composed of members of the United States Senate, the House of Representatives, relevant departments from the Executive Branch, and private experts.³

This Congressional Commission should help facilitate Puerto Rico's local development efforts and serve as a liaison between Puerto Rican stakeholders, Congress, and federal agencies on the multiple issues related to the territory's economic growth. It should be assigned sufficient resources and personnel to carry out this mandate.

Achieving economic growth and development in Puerto Rico will require a combination of programs, policies, and investments. We strongly believe the ongoing process of diagnosing, designing, and implementing feasible solutions that the CNE Growth Commission has undertaken should be bolstered and improved through interaction with a counterpart entity at the federal level. The complex task at hand requires the active involvement and firm commitment of policymakers and multiple stakeholders within and beyond the island.

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³ Analogous to the Commission on Security and Cooperation in Europe (the "Helsinki Commission").

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