

October 10, 2016

Hon. Orrin Hatch  
Hon. Marco Rubio  
Hon. Bill Nelson  
Hon. Robert Menendez  
Hon. Sean Duffy  
Tom MacArthur  
Hon. Nydia Velázquez  
Hon. Pedro Pierluisi  
Congressional Task Force on Economic Growth in Puerto Rico

Dear members:

I write to you as members of the Congressional Task Force on Economic Growth for Puerto Rico created under the Puerto Rico Oversight, Management and Economic Stability Act ("PROMESA") (the "Task Force").

As a candidate for Senator in the Puerto Rico State Legislature, I hope to work constructively with the Task Force to enact bipartisan legislation in Puerto Rico and to encourage legislation and executive actions at the federal level that can return Puerto Rico to fiscal solvency, economic prosperity and political sovereignty. Below are the issues I would encourage the Task Force to consider as it develops its December report.

**Infrastructure Investment**

The federal government can do a great deal to encourage infrastructure development on the Island, which is an important driver of economic development.

Puerto Rico Aqueduct and Sewer Authority ("PRASA") has had to suspend an important capital improvement program for lack of access to debt markets at the same time the Island has been experiencing a drought and facing expensive environmental mandates. Federal loan programs like the Rural Utilities Service administered by the U.S. Department of Agriculture and the state revolving funds ("SRF") for wastewater and clean drinking water administered by the U.S. Environmental Protection Agency have been important sources of funding for water and sewer infrastructure in Puerto Rico. These agencies have worked within their statutory authority to assist the Island, but the Task Force and PRASA should identify legislative changes that recognize some of the unique aspects of Puerto Rico's circumstances. For example, the revolving loan program for states under the SRF program makes sense where there are multiple borrowers, but PRASA is virtually the only user of federal SRF monies in Puerto Rico. Therefore, legislation to provide PRASA more immediate access to the federal funds in that program should be considered.

The Federal Highway Administration, the Federal Transit Administration and the Federal Aviation Administration, under the U.S. Department of Transportation, are also important sources of infrastructure funding for all Americans. The Task Force should work with Puerto Rico's transportation agencies to determine if there are legislative, regulatory or administrative changes that would facilitate greater investment in transportation infrastructure in Puerto Rico.

These are just two examples of where the federal government can accelerate infrastructure development on the Island. Better coordination with federal infrastructure financing programs combined with better access to low cost capital discussed in the previous section is a powerful combination that can be used to accelerate economic growth.

### **Access to Low Cost Capital**

PROMESA did not go far enough in providing a funding mechanism to give Puerto Rico access to low cost capital. The federal government can assist Puerto Rico by working with the PROMESA board to develop structures that achieve investment grade credit ratings. The Puerto Rico government's ability to borrow at low interest rates can also accelerate infrastructure investment, which as described in the next section is vital to reviving the local economy.

### **Streamlining Federal Regulations to Encourage Development**

Puerto Rico can and should do more to streamline its regulatory processes to ensure we don't "get in the way" of economic development. Overlapping approval processes and excessive bureaucracy impose burdensome headwinds on economic growth. As Puerto Rico reforms its regulatory processes, I would encourage the Task Force to look to the federal regulatory bodies responsible for approving projects in Puerto Rico to expedite their approval processes. In many cases, this will not require legislation, just a greater focus on timely responses by regulators to private and public sector applicants for environmental and other approvals from agencies such as the U.S. Army Corps of Engineers.

### **Property Exchange Initiative**

Puerto Rico is engaged in an effort to draft new pathways to attract investors to our market. At the same time it is palpable the amount of commercial property that is abandoned or in need of restoration. In Puerto Rico when a traditional transaction of sale of property takes place, the seller is required to pay capital gains local taxes on any gain realized in the sale. The creation of a local property exchange system similar to the one described in 26 U.S. Code § 1031 (Exchange of property held for productive use or investment) would create a favorable environment for the local and foreign investment in the Island's real estate market.

The exchange program would serve as an innovative economic strategy by providing for a deferred payment in local taxes when selling qualified property, and then proceeding with an acquisition of another qualified property within a specific time frame. The transaction would be treated as an exchange and not as a simple sale creating a local system where an investor can change the form of the investment without cashing out or recognizing a capital gain. This initiative will allow the investment to continue to grow tax deferred while an investor would be able to roll over the gain from one piece of investment real estate to another and another, until actually sells for cash. At the same time the investor, in order to comply and swap the property, would have to engage in efforts of restoration and/or renovation (“fix and flip”) that would reflect a positive change in our commercial landscape.

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The exchange rules in order to create a continuous system would have to take under consideration some requirements such as: (a) property not for personal use; (b) exchange of like-kind properties; (c) same seller taxpayer is the taxpayer who buys; (d) new property identification within a term of no less than 45 calendar days from closing of the first property; (e) replacement property purchase within six months; (f) price of replacement property must be equal to or greater than the old or relinquished property; (g) hold time and (h) related party transaction regulations. Also, the properties exchanged must be held for productive use in a trade or business, or for investment.

The system must be dynamic and agile in order to allow the continuous flow of property exchanges. A control system must be created for the recording of the transactions. As such, the exchange process should be handled by a designated and qualified intermediary in order to facilitate and supervise the transactions.

### **Crime Prevention**

Crime, in general, deters economic development, not only by discouraging new investment, but also by increasing the cost of doing business on the Island. High crime is especially detrimental to tourism. Coordination between local law enforcement and the FBI has had a measurable impact on reducing crime in Puerto Rico. This effort needs to be redoubled until Puerto Rico is able to boast the lowest crime rate in the Caribbean.

### **Focus on Eliminating Government Corruption**

A paper from February 2007 entitled “The Ethics of Tax Evasion: Two Empirical Studies of Puerto Rican Opinion” (Barry McGee and Silvia López-Palau), contains the following ranking of arguments justifying tax evasion (from strongest to weakest) based on a survey of University of Puerto Rico students.

**Table 3: Statements Ranked from Strongest to Weakest Arguments Support Tax Evasion**

Rank	#	Statement	Score
1	11	Tax evasion is ethical if a significant portion of the money collected winds up in the pockets of corrupt politicians or their families and friends.	4.29
2	4	Tax evasion is ethical if a large portion of the money collected is wasted.	4.62
3	3	Tax evasion is ethical if the tax system is unfair.	4.84
4	16	Tax evasion would be ethical if I were a Jew living in Nazi Germany in 1940.	4.90
5	18	Tax evasion is ethical if the government imprisons people for their political opinions.	5.09
6	13	Tax evasion is ethical if some of the proceeds go to support a war that I consider to be unjust.	5.19
7	14	Tax evasion is ethical if I can't afford to pay.	5.20
8	1	Tax evasion is ethical if tax rates are too high.	5.64
9	6	Tax evasion is ethical if a large portion of the money collected is spent on projects that I morally disapprove of.	5.66
9	17	Tax evasion is ethical if the government discriminates against me because of my religion, race or ethnic background.	5.66
10	8	Tax evasion is ethical if a large portion of the money collected is spent on projects that do not benefit me.	6.04
11	12	Tax evasion is ethical if the probability of getting caught is low.	6.15
12	15	Tax evasion is ethical even if it means that if I pay less, others will have to pay more.	6.17
13	7	Tax evasion is ethical even if a large portion of the money collected is spent on worthy projects.	6.19
13	10	Tax evasion is ethical if everyone is doing it.	6.19

Perceptions of government corruption and waste and inequity in the tax system rank above all other factors, including affordability of the tax. Perception of public corruption also deters foreign direct investment. The FBI, the U.S. Attorney and other federal agencies on the Island should continue to focus on public corruption in Puerto Rico.



### **Political Sovereignty-Statehood**

One of the most important issues the Task Force must address is Puerto Rico's political status as an unincorporated territory of the United States. Uncertainty over Puerto Rico's political status is a significant head wind to the Island's economy.

According to Time Magazine "How Statehood Changed Hawaii's Economy" (<http://time.com/3994194/hawaii-statehood-economic-effects/>) (August 21, 2015):

*"While the U.S. annexed Hawaii as a territory in 1898 under somewhat shady circumstances — and over the objections of many Hawaiians — by the 1950s most Hawaiians were in favor of being admitted as a state. When the state reached that milestone, on this day, Aug. 21, in 1959, just seven months after Alaska had joined the Union, Hawaii underwent immediate and radical change, largely in the form of unprecedented economic growth."*

Statehood will boost confidence in the local economy, increase tourism and encourage external and internal direct investment, more than fully off-setting the loss of formerly applicable federal tax incentives, such as Section 936.


Statehood would also address many of the inequities that disadvantage Puerto Rico's economy relative to that of U.S. states, including Medicaid and Medicare reimbursements and access to the federal earned income tax credit.

Full enfranchisement of the U.S. citizens of Puerto Rico under statehood is, indeed, a matter of civil rights. But it is also an economic issue. It is critical that the Task Force keep the status issue in mind as it formulates recommendations to revamp Puerto Rico's economy. Ignoring this issue and recommending policies that perpetuate Puerto Rico's isolation as a jurisdiction that is neither an independent nation nor a sovereign U.S. state will, at best, be a return to the same failed, unsustainable policies of the past that have proven not to work and, at worst, exacerbate the economic downturn we have experiencing for the past several decades and the outright economic stagnation we have suffered in the last 10 years.

Statehood goes hand in hand with fiscal reform and rationalization of Puerto Rico's debt. One major reason Puerto Rico has been able to borrow a greater share of its economy than U.S. states is the fact that it collects the equivalent of the federal income tax. Under statehood, the federal government would collect the majority of those income tax revenues.

As shown by the graph to the right, Puerto Rico's total public sector debt, including unfunded retirement obligations (UPL and OPEB), is lower as a percentage of its economic output than the equivalent for the mainland U.S. Progress toward statehood will entail addressing these fiscal issues in conjunction with current inequities in Puerto Rico's access to federal programs.

Respectfully submitted,

  
Miguel A. Romero-Lugo

