

ADVANCING PUERTO RICO: DIALOGUING FOR CHANGE¹

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1.0 Introduction

The Department of Economic and Social Affairs of the United Nations has for long held the view that one of the basic prerequisites of good governance, growth and development is open and frank dialoguing among the three key players of a society – the government, the private sector and civil society organizations. There is a need for bonding. What is also needed is a framework of complementarities underpinned strongly by mutual appreciation of each others strengths as well as weaknesses. A public-private-civil society mix sensitive to the particular socio-economic needs and conditions of a society must provide the basis for all development.

Public-private-civil society mix or partnerships imply a common understanding of shared goals, a willingness to repartition responsibilities for their achievement, a continuing public-private-civil society dialogue on what needs to be done to promote their realization, and a supportive policy and institutional framework. Partnership goes beyond business concerns, and extends into all policy areas, including education, health, human rights, immigration and citizenship, science and technology, foreign relations, arts and culture. There is a widespread trend to broaden participation in governance by strengthening the interface between the state and non-state actors.⁴

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⁴ Public-Private Partnerships: The Enabling Environment for Development. United Nations Secretariat. 30 April 1997.

This paper begins with an emphasis on the aspect of partnerships to emphasize a couple of facts. Firstly, broad-based dialoguing is fundamental to sound policy development and sustained economic and social growth in any society let alone in Puerto Rico; secondly, such dialoguing must occur as a normative process and not merely on an ad hoc and/or on an opportunistic basis.

2.0 Challenges

It is important to stress that Puerto Rico (PR) with an average per capita income of USD 10,950 per annum is regarded by the World Bank as a rich country and not a developing nation. Furthermore, it is also important to remember that Puerto Rico's current challenge is not about how to make a poor country rich, but how to make a rich country even richer and most importantly (and this should be a key concern of all, especially that of the government), how to, in its journey to achieve greater economic prosperity for the island, distribute its wealth among all its citizens, equitably.

In view of the above, it appears that there are two challenges that confront Puerto Rico, currently – firstly, what can be done to make PR richer and better, and secondly, in doing so, what can be done to make everyone equitably well off. While achievement of the first objective may necessitate increasing opportunities and a better environment for investment and businesses in the Island, the second objective that relates to equity concern is equally important but more complex, and more importantly, prolonged neglect of the second objective has the risk of endangering the first one. Pertaining to the achievement of the first objective, the business community maintains the view that just as there are opportunities to expand businesses in Puerto Rico, there are also challenges that need to be overcome; the task of this paper is to focus on these challenges.

There is no doubt that creating hurdle-free opportunities for businesses should be an avowed goal of each and every government including PR's. But at the same time, it is also important to remember that these opportunities must be pursued within the framework of three important complementing principles that every state/government ought to follow, namely, economic growth, environmental sustainability and social equity.

The current challenges of Puerto Rico are described below.

1. The Economy and Recent Trends

With a GNI per capita of \$10,950, Puerto Rico stands head and shoulders above its Latin American counterparts. Indeed it is the only predominantly Spanish speaking entity in the Latin American region that is classified by the World Bank as a “high income” entity – the best of the rest, including Chile (\$4,910), Costa Rica (\$4,670), Mexico (\$6,770), Panama (\$4,450) and Venezuela (\$4020), are distant seconds with GNI per capita less than half of Puerto Rico’s for all but Mexico, and subsequently classified, at best, as “upper-middle income” countries. However, Puerto Rico’s current problem is not only to maintain its comparatively well-off status but how to do even better. In recent times, Puerto Rico’s economy seems to have slowed down significantly, causing concerns among all the key players – the government, the private sector and the civil society organizations.

Annual GDP Growth Rate of Puerto Rico: (1995-2004)⁵

YEAR	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
GNP (%) Growth '95 Prices	3.4	3.3	3.4	3.2	4.1	3.0	1.5	(0.3)	2.0	2.8

In recent times, the government took several initiatives to stimulate the economy including lowering the interest rate. However, despite these incentives, Puerto Rico’s economic growth has been moderate in recent years as evidenced by 2% and 2.8% growth in 2003 and 2004 respectively. Low job creation, especially in the private sector is indeed a source of major concern and a sign that the private sector is either stagnating or investing in activities that are not conducive to employment creation. Between 2003-4 private sector employment increased by only 5,000 jobs, while, over the same period, public sector employment increased by 30,000 jobs – a clear indication that job creation in the private sector has been rather slow, and at the same, the high job growth rate in the public sector is not necessarily a positive trend for the Puerto Rican economy.

⁵ *Puerto Rico in Figures 2004*, Government Development Bank for Puerto Rico.

Poverty and the growing income gap between the haves and have-nots is also a source of concern in Puerto Rico, with the Gini index for income inequality rising from 57.0 in 1990 to 61.0 in 2000;⁶ 44.6% of Puerto Rican families subsisted below the poverty line in 2000.⁷ When compared to fellow “high-income” economies or even regional neighbors, Puerto Rico looks dismally unequal. For example, the Gini indices for income inequality in Ireland, New Zealand and Singapore stand at 35.9, 36.2 and 42.5 respectively. These comparisons are important not only from the perspective of social justice, but for economic reasons as well - inequality, by itself, is a formidable constraint to development. Furthermore, the rising inequality also prompts two additional messages – that larger governmental participation in the economy is not a guarantee of increased social justice; and secondly, not all growth - irrespective of whether it is induced by the private or the public sector - is pro-poor.

Gini Index of Income Inequality – Latin America⁸

Country/ Territory	Chile	Costa Rica	Dominican Republic	Mexico	Panama	Puerto Rico	Uruguay	Venezuela
Gini Index	57.5	45.9	47.4	51.9	48.5	61.0	44.8	49.1

It is evident from the Latin American countries indicated in the table above that Puerto Rico has the most unequal economy given that it has the highest Gini Index (higher the value, greater the level of inequality). This is an ignominious achievement given that Latin America holds the mantle for the highest level of inequality in the world.

Among the various constraints, while the high price of crude oil (resulting from volatility in the energy market) may certainly have been a factor in accounting for Puerto Rico’s mediocre economic growth, draining valuable foreign exchange reserves from this energy dependent economy, there is also a need to critically analyze long-term internal structural problems that also impede growth; this includes the low employment elasticity of the island’s growth, an under-developed private sector and alleged government over-regulation including (alleged) patronage distribution etc. These factors do seem to work

⁶ Guerrero, Rafael Corrado. The Increasing Income Gap between Rich and Poor in Puerto Rico, 2004.

⁷ <http://factfinder.census.gov/>

⁸ http://hdr.undp.org/reports/global/2003/indicator/indic_126_1_1.html

as disincentives to the expansion of private investment and reduce the competitive edge of the island's economy.

In summary, what is evident is that the current woes of the Puerto Rican economy are difficult to attribute to a particular policy or an institution. Indeed, a recent study by the National Bureau of Economic Research (NBER) identifies a host of stumbling blocks that impede job creation and business development on the island; these include large government transfer payments, high minimum wage requirements, tax codes and regulatory entry barriers that benefit special business interests at the expense of general welfare, and most significantly, a cumbersome permitting process, that frustrates potential investors and inflates the cost of conducting business.

Furthermore, at the macro-economic level, the high incidence of poverty and a high Gini value indicate that minimum wages and transfer payments (contentiously, a policy promoted by the government to protect the poor) are not attaining their desired results. What is needed, perhaps, is a new policy regime that removes macro-economic constraints to growth and development and introduces a package of incentives and disincentives (both fiscal as well as non-fiscal) that encourages the private sector to invest more and create more jobs, thereby creating competition for labor and a resultant increase in wages. The private sector should also be encouraged to assume greater responsibility in meeting the social needs of their workers as well as the community.

2. Regulations, Controls and the Cost of doing Business

Among the institutional factors, that tend to slow or discourage growth in Puerto Rico, especially through private sector initiative is the aspect of complexities associated with doing business in the territory. The table below presents a comparative analysis of 'Ease of Doing Business'.

Ease of Doing Business 9

Country/ Territory	Chile	Estonia	Lithuania	Malaysia	Mauritius	Puerto Rico	Thailand
Ease of doing business (rank)	25	16	15	21	23	22	20
GNI (per capita)	\$4,910	\$7,010	\$5,740	\$4,650	\$,4640	\$10,950	\$2,540

According to the World Bank's business climate indicators, the opportunity for conducting business in Puerto Rico is somewhat comparable to the average OECD country. However, with regard to the ease of doing business, Puerto Rico ranks only 22nd in the world, trailing or at par with countries like Lithuania, Estonia, Thailand, Malaysia, Mauritius and Chile where the GNI per capita for most of the countries is half of that of Puerto Rico's. However, the picture becomes somewhat dismal when PR is compared with High Income entities like the United States, New Zealand, Singapore and Australia - all of whom are well placed in the top six.

Ease of Dealing with Licenses¹⁰

Country	Kenya	Mongolia	Nepal	Puerto Rico	Vietnam	Yemen
Procedure (number)	11	18	7	20	14	13
Time (days)	170	96	21	137	143	131
Cost (% of income per capita)	40%	58.8%	69.6%	103.3%	64.1%	274.4%
GNI (per capita)	\$460	\$590	\$260	\$10,950	\$550	\$570

On a global basis, Puerto Rico's ranking drops dramatically to 51st when it comes to the ease of Dealing with Licenses, placing this high income country well below even low income countries like Nepal, Yemen, Mongolia, Vietnam and Kenya. For example, it takes 20 steps and 137 days to complete the process of complying with licensing and permit requirements for ongoing operations in Puerto Rico, and costs 103.3% of income per capita. In comparison, in Nepal, it takes only 7 steps and 21 days to complete the process, and costs 69.6% of income per capita. The time spent and effort incurred in traversing a multitude of procedures can be all the more daunting when concerned

9 World Bank, Doing Business 2005, www.doingbusiness.org

10 World Bank, Doing Business 2005, www.doingbusiness.org

licensing officials are corrupt and incompetent. The official cost incurred in traversing the bureaucratic red tape in many countries, is often an addition to the cost of hiring lawyers skilled in the licensing process, as well as “payoffs” to concerned officials for speeding up the process. Such delays and costs can act as a major disincentive to the expansion of new businesses on the island, particularly for small and medium scale enterprises that often cannot afford the high “fixed start-ups costs” associated with the licensing process.

Another related issue in ‘Ease of Doing Business’ is the ‘Ease of Registering Property’. Here also, PR’s ranking is not all that encouraging.

Ease of Registering Property¹¹

Country	Chile	Costa Rica	El Salvador	Guyana	Peru	Puerto Rico	United States
Procedures (number)	6	6	5	4	5	8	4
Time (days)	31	21	52	25	33	15	12
Cost (% of property value)	1.3%	3.6%	3.6%	2.5%	3.2%	1.6%	0.5%
Rank	30	38	45	25	32	46	12

As is evident from the table above, the island also ranks poorly (46th), placing below its regional neighbors including the United States, Guyana, Peru, Chile, Costa Rica and El Salvador. For example, it takes 8 steps and 15 days to register property in Puerto Rico, costing 1.6% of overall property value. In comparison, in the United States, it takes 4 steps and 12 days to register property and costs only 0.5% of overall property value. High cost of registering property and cumbersome procedures act as disincentives for Multi National Corporations from setting up shop on the island and increasing long-term investment prospects, particularly when compared to less “binding” commitments such as partnerships with local subsidiaries that eliminate or diminish property registration costs as well as other fixed cost for foreign investors, making it easier for them to pack up and leave when the investment climate becomes unfavorable.

¹¹ World Bank, Doing Business 2005, www.doingbusiness.org

The ease of ‘Hiring and Firing Workers’ is another important indicator (higher the value, more the complexities) that influences business decisions. Again, the table below paints a discouraging trend for Puerto Rico.

Ease of Hiring and Firing Workers¹²

Country	Marshall Islands	Micronesia	Palau	Puerto Rico	United States
Difficulty of Hiring Index	22	33	0	56	0
Rigidity of Hours Index	0	0	0	20	0
Difficulty of Firing Index	0	0	0	30	10
Rigidity of Employment Index	7	11	0	35	3
Hiring cost (% of salary)	10.5%	6.0%	6.0%	16.2%	8.5%

While certain labor regulations are necessary to protect workers from exploitation and arbitrary layoffs, it is also vital for employers to have the flexibility to hire and fire workers based on performance. Unnecessarily inflated hiring and firing costs promotes mediocrity in the workplace as high firing costs deter employers from doing away with workers with falling productivity, while high hiring costs deter the infusion of fresh talent into the workforce, resulting in a decline in competitiveness. In this regard, Puerto Rico once again ranks poorly (44th), with hiring and firing costs higher than the United States as well as its (past and present) protectorates/territories including the likes of Palau, Micronesia and the Marshall Islands.

Access to credit also acts as an important indicator of business incentive. The following table presents a comparative analysis for PR. It would appear that though PR is not too far behind in certain aspects, in others there are serious pitfalls.

¹² According to the World Bank (www.doingbusiness.org) “Each index assigns values between 0 and 100, with higher values representing more rigid regulations. The Rigidity of Employment Index is an average of the three indices.”

Ease of Access to Credit Information¹³

Country	Botswana	Bosnia Herzegovina	Malaysia	Kenya	Puerto Rico	Panama
Legal Rights Index	9	8	8	8	6	6
Credit Information Index	5	5	6	5	5	6
Public registry coverage (% adults)	0%	0%	33.7%	0%	0%	0%
Private bureau coverage (% adults)	30.8%	19.3%	N.A.	0.1%	63.6%	40.2%
GNI per capita	\$4340	\$2040	\$4650	\$460	\$10,950	\$4450

With regards to the ease of accessing credit, “the Legal Rights Index ranges from 0-10, with higher scores indicating that those laws are better designed to expand access to credit.” Additionally, the “Credit Information Index measures the scope, access and quality of credit information available through public registries or private bureaus. It ranges from 0-6, with higher values indicating that more credit information is available from a public registry or private bureau.”¹⁴

Ready access to credit information allows potential investors and financiers to determine local Puerto Rican partners with credible track records, significantly reducing the risk of investment. In the absence of such information, potential investors are logically deterred from partnering with entrepreneurs with no official track records. The unavailability of a credit history impacts most upon budding entrepreneurs in the informal sector whose achievements are not credited and the government must take steps to ease their passage into the mainstream economy. Once again, Puerto Rico ranks only 27th in the field, placing well behind weaker low and middle income economies like Kenya, Malaysia, Botswana, Bosnia and Herzegovina and Panama.

¹³ World Bank, Doing Business 2005, www.doingbusiness.org

¹⁴ www.doingbusiness.org/ExploreEconomies/

Presented below is another important indicator of ‘Ease of Doing Business’.

Ease of Enforcing Commercial Contracts¹⁵

Country	Brazil	Chile	El Salvador	Jamaica	Nicaragua	Puerto Rico	United States
Procedures (number)	24	28	41	18	20	43	17
Time (days)	546	305	275	202	155	270	250
Cost (% of debt)	15.5%	10.4%	12.5%	27.8%	16.3%	21%	7.5%

Puerto Rico’s performs dismally with regards to the ease of enforcing contracts, falling to 77th in the world, placed well behind regional neighbors like the United States (10th), Nicaragua (22nd), Jamaica (40th), Chile (41st), El Salvador (53rd) and Brazil (70th). For example, it takes 43 steps and 270 days to enforce contracts in Puerto Rico, with the cost of enforcing contracts at 21% of debt. In comparison, in Nicaragua, it takes only 20 steps and 155 days to enforce contracts and costs 16.3% of debt.¹⁶ The exorbitant cost of enforcing contracts at nearly 3 times the rate of the United States will undoubtedly go a long in pushing potential investors away to others markets with a similar economy and skills base but with significantly lower enforcement costs.

Ease of closing a business is also another important consideration in investment decision-making.

Ease of Closing a Business¹⁷

Country	Canada	Colombia	Jamaica	Mexico	Puerto Rico	United States
Time (years)	0.8	3.0	1.1	1.1	3.8	2.0
Cost (% of estate)	4%	1%	18%	18%	8%	7
Recovery rate (cents on \$)	90.1	55.2	64	64.1	61.5	76.3

Puerto Rico (26th) falls well behind NAFTA giants – the United States (17th), Canada (4th) and Mexico (22nd) and is more at par with middle income neighboring countries like

¹⁵ World Bank, Doing Business 2005, www.doingbusiness.org

¹⁶ World Bank, Doing Business 2005, www.doingbusiness.org

¹⁷ World Bank, Doing Business 2005, www.doingbusiness.org

Jamaica (24th) and Colombia (27th). In Canada, it takes 0.8 years to resolve bankruptcies and costs 4% of the estate value. In comparison, in Puerto Rico, the time period is almost five times longer to resolve bankruptcies (3.8 years) and costs twice as much (8% of estate value). The recovery rate, expressed in terms of how many cents on the dollar claimants recover from the insolvent firm, is 90.11 cents in Canada compared to only 61.5 cents in Puerto Rico. Given Puerto Rico's heavy reliance upon U.S. investment, the burgeoning closing costs pose the risk of losing out on future U.S. investment, particularly if preferential U.S. trade agreements – once reserved exclusively for Puerto Rico and a handful of others – is extended to the entire region, as the Free Trade Area of the Americas (FTAA) increasingly takes greater shape.

The aforementioned indicators that reveal discouraging trends for PR substantially hinder investment in the territory. The constraints of the regulatory process, in particular, the labyrinth of procedures that need to be traversed and the time and cost involved in obtaining permits, registering property and enforcing contracts etc, attributable mainly to the lethargy of the government, continue to stifle businesses in PR, especially in the construction sector. The complex regulatory processes currently pursued by the government, seemed to have been causing unnecessarily high costs of doing business, deterioration of the business and regulatory climate, weighing down of economic development, and undercutting the drive for future investment.¹⁸ Additionally there has been a trend for resolutions made by past governments to be left on the wayside by incumbent authorities as indicated by a February 17, 2006 memorandum by the Puerto Rican Chamber of Commerce where it claims to have consistently reminded the government of this problem for the past twenty years, with little or no effect.

In order to improve Puerto Rico's ranking to be at par with countries that place in the top ten among business friendly entities, there is an urgent need to clarify labor regulations, modify legislations to improve access to credit, and most importantly, streamline and consolidate the permitting process in each and every agency in a simultaneous fashion.

¹⁸ Steven J. Davis & Luis Rivera-Batiz, *The Climate for Business Development and Employment Growth in Puerto Rico*, NBER Working Paper No. 11679, September 2005, pg 30.

Processes must be realized with an integrated vision of the objectives of the regulation. Additionally, the government must provide an adequate budget to compensate technical and management personnel and equip regulatory agencies and their reviewing units with the necessary tools, equipments and skills. Indeed, the result of the 2005 survey conducted by the National Bureau of Economic Research goes so far as to recommend a comprehensive dismantling of the existing system and the creation of an innovatory and efficient set of rules and procedures.¹⁹ In this regard, it may be useful to look at examples from fellow high income countries such as Ireland, Singapore and New Zealand; through a system of checks and balances, they have maintained strict environmental and social standards pertaining to private sector investment, without wasting an undue amount of time in processing applications.

The Planning Board, the apex decision-making body of the government, must play a greater role in coordinating and facilitating the approval process. Legal mechanisms must be in place to ensure that changes in government do not lead to the arbitrary cancellation of projects that received approval from previous administrations. Furthermore, it is important to ensure that all projects are examined through a comparable and pre-determined technical, financial and scientific criterion; they should not be subjected to ad-hoc and arbitrary approval processes. Transparency and accountability mechanisms must also be promoted at all levels of governance to ensure that the approval of new business activities is free from corruption and political influence.

3. Inter-Agency Coordination

Coordination between and among various government agencies is a continuing problem and must be improved as dozens of agencies can potentially be involved in the approval of a project and each agency has the authority to suspend the entire process. This adds to the high cost of doing business on the island. Absence of a centralized oversight mechanism that possesses the necessary political clout to troubleshoot - contributes to

¹⁹ Steven J. Davis & Luis Rivera-Batiz, *The Climate for Business Development and Employment Growth in Puerto Rico*, NBER Working Paper No. 11679, September 2005, pg 32.

frequent breakdowns in the decision-making chain; lack of trained manpower is also seen as another problem.²⁰

The essential question and concern pertaining to the role of the state is not one of whether it should support the deregulation process or not, but rather a careful evaluation of what sort of deregulation should it be supporting and where and how it should be stepping in more. Not all deregulations (or regulations) work in favor of the citizenry. A brief analysis of the health care system in the United States may be quite instructive. While the US government does not provide universal health care to its citizenry, leaving 15% of its population or in excess of 45 million people uninsured and millions of others with inadequate insurance, it spends more per capita on health care than total per capita spending by Canada on its federal health care. Out of control medical spending resulting from double digit cost increases decimate the earnings of the citizenry and threatens to bankrupt corporations and the government.²¹ The health care system is the classic case of an industry where deregulations do not necessarily favor the citizenry – neither cost-wise nor in terms of service delivery.

4. Large Public Sector, Low Output

In comparison to its GDP contribution, Puerto Rico seems to have a large public sector. For example, in comparison to fellow high income countries like New Zealand, Ireland and Singapore, Puerto Rico's public sector is much larger and its economic growth rate lower. In 2004, the public sector's share of the workforce was only 20% in Ireland²², and 20.5% in New Zealand compared to 29.6% in Puerto Rico. Additionally Puerto Rico has a double digit difference in public sector employment with its regional neighbors, including the United States (16.4%), Uruguay (17.7%), Mexico (15.1%) and Costa Rica (14.1%).²³ However despite accounting for a substantially higher percentage of the workforce, the public sector's contribution to the Puerto Rican GDP was only 11.9% in

20 Steven J. Davis & Luis Rivera-Batiz, *The Climate for Business Development and Employment Growth in Puerto Rico*, NBER Working Paper No. 11679, September 2005, pg 36

21 <http://www.globalpolicy.org/globaliz/econ/2006/0202yale.htm>

22 1997 figures <http://laborsta.ilo.org/>

23 2004 figures <http://laborsta.ilo.org/>

200324, compared to 15.8% in Ireland, 17.6% in New Zealand, and 11.8% in Singapore. The difference between total public sector contribution as a % of the GDP and total public sector employment as a % of the total workforce among its regional neighbors was only 0.4% in Costa Rica, -2.7% in Mexico, -0.8% in the United States and -6.3% in Uruguay – relatively moderate shortfalls when compared to the massive gap of -17.7% in Puerto Rico. During the last two decades or so, Ireland, Singapore and New Zealand also maintained higher growth rates than Puerto Rico.

In summary, two inferences can be drawn from the above analysis: (i) In comparison to countries that are similar in economic outlay, Puerto Rico lags behind in economic growth, job creation and poverty reduction; and (ii) Puerto Rico's large public sector is proving to be quite costly, if not counter-productive in stimulating economic growth and reducing poverty. It is also alleged that apart from being oversized, the public sector is also highly compartmentalized and run on a silo mentality – consequently leading to problems in inter-agency coordination.

5. Low Job Creation/ Low Skills Base: A Double-Edged Sword

At the heart of Puerto Rico's economic challenges lies its low job creation capacity. Employment rate in 2004 stood at only 41%, compared to 69% in the US and an average of 66% in OECD countries. Even in Turkey, the country with the lowest employment rate among OECD members, the employment rate is far higher at 49%.²⁵ While a part of the island's low official employment rate may be accounted for by a certain percentage being engaged in the informal economy, the lack of a concrete survey prevents one from knowing exactly how much. However, the informal sector is unlikely to account for the entire shortfall, given that some participants in the formal economy counted in national surveys also partake in the informal economy to augment their income.

Persistently poor job creation rates lead to Puerto Rican residents lacking work experience, marketing skills and opportunities for acquiring on the job skills.

²⁴ <http://stats.unctad.org/Handbook/TableViewer/tableView.aspx?ReportId=149>

²⁵ Steven J. Davis & Luis Rivera-Batiz, *The Climate for Business Development and Employment Growth in Puerto Rico*, NBER Working Paper No. 11679, September 2005, pg 2.

Additionally, even for employed workers, there exists a major lag in terms of average work hours on the island and the mainland. For example, for employed men, U.S. work time exceeds Puerto Rican work time by 220-270 hours per year. Low job creation rates are most evident in the private sector which accounts for only 28% of Puerto Rican adults as compared to 58% of U.S. adults.²⁶

Additionally, the average educational attainment of private sector workers tends to lag behind their US counterparts. The rate of post-secondary degree holders employed in the private sector in the United States is double that of Puerto Rico.²⁷ While it is certainly encouraging that nearly one-third of undergraduate degrees in 2002 were awarded in the field of Business Administration in Puerto Rico, more attention should also be given to science and technology. Currently, the island seems to be producing more managers than technocrats and/technologists.

Similarly, in the public sector, the evolution of a progressive and technically competent civil service is stymied somewhat by the existing recruitment system which is alleged to be fraught with a host of difficulties. Vague kinship ties and political connections rather than merit-based recruitment continue to weaken the technical competencies required of the public sector. As societies become more complex, governments must govern cleverly and do more with less; meritocracy, rather than mediocrity, should be the rule rather than the exception in the public sector recruitment process.

There are also limited opportunities to diversify skills in the private sector. This is due to the fact that a large part of private sector employment is concentrated in industries that do not operate under normal free market conditions, be it the pharmaceuticals industry that owes its mushrooming to special tax subsidies granted by the US treasury, or the construction industry, whose operations are greatly restricted by cumbersome and costly bureaucratic obstacles. Furthermore, given their nature to shy away from the unrestricted

²⁶ Steven J. Davis & Luis Rivera-Batiz, *The Climate for Business Development and Employment Growth in Puerto Rico*, NBER Working Paper No. 11679, September 2005, pg 5

²⁷ Steven J. Davis & Luis Rivera-Batiz, *The Climate for Business Development and Employment Growth in Puerto Rico*, NBER Working Paper No. 11679, September 2005, pg 10

competition of the global marketplace, public and regulated private sector jobs lack the cutting edge, skills & drive to succeed under competitive circumstances; consequently they are not the ideal breeding grounds for entrepreneurial skills.

Additionally, given that overcoming challenges posed by regulation, taxation and other constraints are part and parcel of conducting business on the island, inter-establishment connections supercede technical know-how as the major private sector recruitment criterion. Consequently, limited work experience in the private sector leads to a limited level of understanding of its operational needs, and as a result, individuals are more restrained in supporting market oriented economic reforms. This leads to a vicious cycle where a sheltered environment breeds lethargy and mediocrity – the longer firms remain in this environment, the less likely they are able to capitalize on competitive market forces, and consequently, for survival purposes, the more vehemently they oppose any attempts at reform, thereby maintaining the status quo.

Given the current status of human resources, one can infer that sheltered policies, combined with a narrow competency base for private and public sector jobs, place society in a no-win situation. On the one hand, a narrow competency base is incompatible with investment diversification; on the other hand, a narrow job market – the outcome of faulty policies, provides little or no incentive for skills diversification. Furthermore, in the public sector, patronage-based recruitment procedures in the public sector do little to attract competent civil servants.

6. Challenges of Accessing Information

As explained earlier, accessing information concerning government requirements in processing and approving business operations is an on-going challenge. Immediate measures are needed to create a centralized and readily accessible information database that can be accessed by anyone seeking to establish a new business and comply with necessary regulations. Absence of clear instructions and readily accessible information, coupled with a labyrinth of agencies, procedures and regulations, inevitably raise the information costs of compliance, increase uncertainty about approval, and add to the

potential for unexpected delays and bottlenecks. While large developers can potentially overcome information costs through contracting permitting specialists, small and medium enterprises without such means are placed at a distinct disadvantage as they are forced to navigate the murky regulatory territory on their own accord, leading to a process of trial and error and inevitable delays.²⁸

Summary of Challenges: The Key Issues²⁹

In view of the issues raised above, the current economic challenges of Puerto Rico may be grouped under two broad categories:

- (i) Institutional Related; and
- (ii) Macro-economic Policy Related

Institutional Related

The Institutional Related challenges of Puerto Rico concern the following: (i) Permit Process; (ii) Absence of Standards, Norms, Transparency and Accountability in the Permit process; (iii) Absence of or inadequate Inter-Agency Coordination and Trouble Shooting Arrangement; (iv) Difficulties of Information Availability and Accessibility; (v) Flawed Recruitment Procedure and Technical Capacity of the public sector (vi) Absence of Bi-partisan Agreement to honor government decisions, caused by the changes in the administration; (vii) Oversized Public Sector and (viii) Code of Conduct for Businesses.

Macro-Economic Policy Related

These include: (i) Minimum wage requirements and their relationships to work habit, incentive to investment and labor productivity; (ii) Large government transfer payments and their relationship to a whole variety of economic and social impacts; (iii) Taxes and subsidies and their relationship to long-term sustainable economic growth etc.; and (iv) low employment elasticity of growth.

²⁸ Steven J. Davis & Luis Rivera-Batiz, *The Climate for Business Development and Employment Growth in Puerto Rico*, NBER Working Paper No. 11679, September 2005, pg 35-36

²⁹ See **Annex** for a comprehensive list of key issues.

While the list is neither comprehensive nor in order of priority, it may be treated as a starting point for advancing discussions on public policies and business development.

3.0 The Way Forward

The way to move forward would be first, to prioritize challenges in terms of their immediacy and second, to set a timetable in terms of their implementation. Below, an attempt has been made to provide a tentative road map to advance relevant actions.

1. Advancing Dialogue on the Permit Process

The President of the Puerto Rican Chamber of Commerce highlighted lags in the Permit Process as the most urgent of all issues hindering investment on the island (in a February 2006 statement) and outlined a Road Map/Work Plan to advance dialogue in this regard. In order to ensure that the Work Plan on the Permit Process receives broad based ownership, members of civil society organizations, including the opposition (the government-in-waiting), must be included in these discussions.

2. ICT and On-line Information

In addition to preparatory work for reforming the permit process, it is necessary to consider other initiatives that do not need to wait for complex reforms, but are important components that would complement reform. Such initiatives include, among others, making investor friendly information available on-line.

3. National Economic & Social Council: Outline of an institutional model for inclusive decision-making

In order to ensure balance and complementarity among the three avowed goals of the government, namely economic growth, environmental sustainability and social equity, several standards and norms are put in place to appraise policy proposals, both economic as well as non-economic. It is also important that these standards and norms are set in an inclusive manner and similarly policy-making processes should also become multi-criteria based and inclusive.

In this regard, institutional models that ensure inclusiveness in policy formulation by incorporating public-private-civil society organizations into such processes (not only on regular basis, but also on a normative one) are instructive. One such model is Ireland's National Economic and Social Council (NESC). Established through constitutional mandate as a statutory body and made up of government representatives, private sector and civil society organizations and trade unions, NESC is proving to be extremely effective institutional mechanisms for decision-making that allow mutually acceptable agreements and recommend policies that are accountable, transparent and mutually owned. In many countries, NESC also operate as central trouble shooting agencies assisting inter-agency coordination. It will be useful to study some of the NESC models.

4. New Public Sector

Strategies must be identified to reduce dependency on the expansive public sector, not to eliminate it, but to reshape it, making it more efficient and responsive. The approach will be not to decrease government, but increase governance, which involves governing through partnerships rather than through bureaucratic institutions.

It is important that the reform of public sector is given due attention. Public sector reform is never painless. Given the magnitude of the public sector and industrial over-regulation, it should come as no surprise that many Puerto Ricans will resist change. As salaried government employees, as recipients of transfer payments and public sector pensions, or as beneficiaries of government contract awards, subsidies, tax breaks and special regulatory advantages, many have serious financial and non-financial stakes in the public sector and therefore, it will be against their interest to promote change.³⁰ Therefore, developing strategies for managing change and making the transition as painless as possible is another challenge that Puerto Ricans must cope with. It is also important to remember that in matters of public sector reform the single most important element is political will. Notwithstanding their respective stand on the approach issue, the governing nexus (government as well as the opposition law makers) must make a clear commitment

³⁰ Steven J. Davis & Luis Rivera-Batiz, *The Climate for Business Development and Employment Growth in Puerto Rico*, NBER Working Paper No. 11679, Sep 2005, pg 4.

that as a governing group they are supportive of the overall reform agenda. Without this no reform will be possible.

5. Code of Conduct for the Business Community

Finally, in countries where supply side problems are rife, i.e. where the rules are not very transparent, where the government (patron) retains the capacity to exert control on a selective basis to approve businesses, and where the practice of patronage distribution and cronyism runs high – individual entrepreneurs (client) tend to do everything possible, including, resorting to underhanded and often illegal means to secure their business interests. In doing so, they undercut and compete with each other, effectively helping to sustain a corrupt culture in the private domain that has inevitable spillover effects in the public domain. This represents a demand side problem where the business community perpetuates the existing corrupt practices of the public domain, effectively removing any pressure or incentive for the government to change. Unfortunately, the aforementioned supply side problems permeating from the bureaucracy (patron) cannot be cured without the necessary corresponding support of the private sector entrepreneurs (client) representing the demand side. Malpractices that originate from within the business community can be potentially reduced through the establishment and enforcement of, and strict adherence to, a code of conduct that all major businesses must be pressurized to sign on to.

4.0 Conclusions

There exists a tremendous amount of goodwill on the part of the Puerto Rican government and the business community to work together on the aforementioned issues, as evidenced through their joint participation in regular roundtables and forums. The maneuvering nightmare represented by the permit process must place highly on the agenda, and concrete actions to follow up on the road map envisioned by the Puerto Rican Chamber of Commerce are crucial in this regard. Simultaneous efforts must be made to tackle other associated issues, such as the use of ICT for information-sharing. Finally, it should be remembered that easing the permit process may not, by itself, produce the desired results. Work on other reform matters, both institutional as well as

macro-economic must continue in tandem as highlighted by the issues raised in the **Annex**. While Puerto Rico must confront a host of challenges, these are neither impossible to achieve nor are they radically different from challenges faced by other countries. Major societal actors must put their heads together and work collectively towards the shared goals of “the triangle of development”³¹ – peace, prosperity and equity for all.

³¹ Mr. Kofi Annan, Secretary General, *Larger Freedom*, the United Nations.

ANNEX 32

Macro-Economic

- 1) Do large government transfer payments undermine work incentive and lead to a deficit in work experience and marketable skills?

- 2) Given the substantial difference in the mean hourly wage in Puerto Rico (\$17.80) compared to the United States (\$10.38),³³ and given the comparatively lower educational attainment of the Puerto Rican workforce:
 - a) Is it productive to maintain the same minimum wage for the island and the mainland?
 - b) Does the minimum wage law discourage the hiring and firing of less skilled workers?
 - c) Does it suppress the growth of employment in industries and activities that rely heavily on less educated workers?
 - d) Does it diminish opportunities to acquire experience and training on the job?

- 3) Has the historically large role played by the public sector in employment and production softened competitive pressures on the island and discouraged the emergence of a vibrant private sector?

- 4) Do “buy local” laws - which effectively shield Puerto Rican business interests from foreign competition - unnecessarily raise prices for domestic consumers?

- 5) Do the aforementioned regulations promote a business culture that is focused on rent seeking?

- 6) Has section 936 of the U.S. tax code and other federal tax incentives created an industrial structure that is poorly aligned with the type of job opportunities needed by

32 All 11 questions in the Annex derived from: Steven J. Davis & Luis Rivera-Batiz, *The Climate for Business Development and Employment Growth in Puerto Rico*, NBER Working Paper No. 11679, Sep 2005, pg 33.

33 *Puerto Rico in Figures 2004*, Government Development Bank for Puerto Rico.

Puerto Rico's population? Has the result been to create a modest number of jobs at a tremendous cost to the U.S. treasury?

7) Has Puerto Rico's own tax code - full of provisions that benefit special business interests at the expense of general welfare - created a business climate in which profitability and survival rests on the ability to obtain favors from the government?

8) Do special-interest tax subsidies distort market price signals that would otherwise guide capital and labor to their best uses, lowering productivity in the process?

Institutional

1) How can Puerto Rico's regulatory environment be modified so that it does not act to the detriment of business entry, job creation and competition?

2) Do occupational licensing requirements really serve their purpose and maintain high industry standards? Or has their real effect been to restrict the supply of services and raise prices for consumers?

3) Given that the state is responsible for supervising the entry and location decisions pertaining to new businesses, what provisions are in place to check for corruption and patronage that can potentially allow established commercial entities the opportunity to block the entry of rivals and new entities?³⁴

³⁴ All 11 questions in the Annex derived from: Steven J. Davis & Luis Rivera-Batiz, *The Climate for Business Development and Employment Growth in Puerto Rico*, NBER Working Paper No. 11679, Sep 2005, pg 33.