

SPEECH

Summary of the Report on the Competitiveness of Puerto Rico's Economy

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As prepared for delivery

Thank you. I also want to express my appreciation to the Chamber for the opportunity to discuss the study, which is titled “Report on the Competitiveness of Puerto Rico’s Economy.” I want to thank the members of the panels we have assembled to discuss our recommendations and I look forward to hearing their views.

As with President Dudley, what I have to say reflects my own views and not necessarily those of the Federal Reserve Bank of New York or the Federal Reserve System.

When we look at Puerto Rico we clearly see a number of features that make it a strong and potentially highly competitive economy: Literacy rates and educational attainment compare favorably with most economies in the region, and have nearly caught up with those on the mainland, the labor force is bilingual, the economy is open and occupies a central position in the Caribbean which provides a gateway between the U.S. mainland and Latin America, and the close ties to the U.S. mainland provide it with many advantages.

So the challenge to policymakers is clear—harness the Island’s considerable strengths to raise living standards and improve growth. This is obviously not a simple task. At its most basic, however, it directs policymakers to address head on the various impediments in the economic and policy environment that are preventing the Island’s resources from being most productively utilized.

Puerto Rico has made noteworthy efforts in recent years to address different aspects of competitiveness—but we believe more can be done. In the study, the team outlines five policy recommendations that, in their view, address features of the economic environment that have a significant impact on the Island’s economic performance.

The first, and perhaps the most fundamental, is to reduce barriers to job creation and labor force participation. Creating jobs and encouraging active participation in the labor market, particularly among the Island’s young and less educated, is a significant challenge facing Puerto Rico and a top priority for policymakers. We recommend focusing on policies that spur the creation of job opportunities and improve incentives to work. One possible first step would be to consider a young-worker subminimum wage that targets workers under the age of 25. This would be a significant extension of the Island’s current “youth subminimum” wage and would be designed to expand incentives for firms to hire young workers and provide training at early stages of their working lives. The wage could be stepped up at regular intervals so that it would match the federal minimum over a number of years. At the same time, Puerto Rico might consider reexamining its entitlement programs in order to improve incentives to seek employment.

If these policies proved successful in improving employment rates and overall economic outcomes, a policy to address problems associated with the high minimum wage more generally could be considered. Because Puerto Rico’s productivity has not kept pace with the U.S. mainland economy, continued upward adjustments to the minimum wage tied to increases on the mainland will increasingly limit job opportunities on the island. One option would be to reduce the minimum wage on the Island and replace the income lost by workers earning the minimum wage by increasing Puerto Rico’s earned income tax credit. Together, these actions could leave minimum wage workers with the same net income they had before, but increase job opportunities for workers currently priced out of the market. Another option would be to hold the minimum wage steady in nominal terms for a period of time to allow productivity on the Island to catch up. Again, this could be combined with an expansion of the earned income tax credit. In this way, policymakers could continue to increase the after-tax income of low-paid workers while improving job opportunities.

The second recommendation relates to the fact that an efficient and competitive energy sector is essential for the wider success of the Puerto Rican economy. Energy is a major input in all households and businesses. Best practice suggests that a regulatory commission should be set up to oversee the Puerto Rico Electric Power Authority to protect consumers and improve the efficiency of its operation. It is standard on the U.S. mainland, as well as in other countries, for a monopoly utility to be subject to regulatory commission oversight, even when the utility is owned by the government. The commission would help oversee a shift from oil to natural gas for electricity generation—a move that is compelling in cost terms.

The overall business climate is a key factor underpinning the competitiveness of firms and the economy in which they operate. Independent studies suggest that Puerto Rico continues to lag the mainland and regional peers in the ease of doing business. These studies do find some progress in recent years following the institution of several measures aimed at improving the business environment. But further efforts to streamline regulatory processes and reduce red tape appear to be warranted. Separately, the high cost of shipping is a substantial burden on the Island's productivity. One option could be to seek a temporary exemption from the Jones Act, for instance for maybe five years, in order to evaluate whether these restrictions really are a substantial cause of elevated shipping costs and to allow for an assessment of the costs and benefits of a permanent exemption.

A fourth recommendation relates to the Island's respected and well-established higher education industry. Colleges and universities are important assets that can help countries actively participate in the expanding knowledge economy. One way the Island can build on these assets is to continue to foster partnerships between industry and higher education. Economic research has shown that these partnerships tend to offer localized economic benefits by increasing economic activity associated with the creation, development and commercialization of new products or processes. One way forward would be for the government of Puerto Rico or a non-profit institution on the Island to help establish a center of excellence focusing on the development of globally important technologies by providing seed funding and incentivizing industry investment.

Finally, the economy's growth potential is strongly influenced by the quality of government policies. Policymakers considering how best to improve the Island's competitiveness continually face decisions on a host of proposals with both immediate and longer-term costs and benefits. Accordingly, greater efforts should be made to evaluate specific policies routinely to determine if the benefits exceed the costs. In this way, the best ideas will have a chance to be adopted while those found lacking can be eliminated. An independent government agency should have the resources to supply this type of analysis to the public.

In addition, the quality of government policies depends on accurate and timely economic and demographic data. Many useful economic indicators pertaining to the U.S. mainland are simply not available for Puerto Rico or are still being developed, for example, measures of home prices, commercial vacancy rates and consumer confidence. More resources should be devoted to improving and expanding data collection.

These five recommendations should not be viewed as providing a quick fix, nor as measures that would provide short-run stimulus to the Island's economy, but rather as steps to help improve Puerto Rico's competitiveness over time. We present them for consideration and discussion, and invite feedback from stakeholders on the Island regarding their implementation and expected impacts. And we want to begin that conversation today, with in depth panel discussions to evaluate the first two recommendations: to reduce barriers to job creation and labor force participation, and to reform the energy sector to increase competition and reduce costs.

I will now turn the meeting over to our moderator, Miguel Soto-Class, the president of the Center for the New Economy, who will introduce the panelists and moderate the discussion.

RESOURCES

Resumen del Informe sobre la Competitividad de la Economía de Puerto Rico

QUICK LINKS

Report on the Competitiveness of Puerto Rico's Economy

Dudley: The Competitiveness of Puerto Rico's Economy: Reducing the Cost of Doing Business and Improving Labor Market Opportunities
