

## Puerto Rico 2028 Transformational Agenda: The Path to Economic Stability, Navigating Growth Amid Structural Challenges

September 30, 2024

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### Discussing the issues all Puerto Rican's Must Listen to

We began discussing the seven key issues crucial to electing Puerto Rico's next President, or for that matter, any candidate running for public office. These issues impact the Governor, Resident Commissioner, Mayors, and Legislators alike. We aim to offer recommendations to improve the quality of life for all Puerto Ricans. We will explore each of these topics leading up to the elections:

1. Immigration (Published August 19, 2024)
2. Economy and Inflation (Published August 26, 2024)
3. Healthcare (Published September 2 and 16, 2024)
4. The Puerto Rico Transformational Agenda (Published September 9, and 23 2024)
5. Climate Change and Environment
6. Crime and Public Safety
7. Education

### Puerto Rico's Economic Challenges: A Complex Landscape

Puerto Rico's economic challenges have been the subject of intense discussion for years. Beneath its idyllic beaches and swaying palm trees, a fiscal storm has been brewing. While political leaders focus on large infrastructure projects, ribbon-cutting ceremonies, and expanding government healthcare plans to secure votes, significant underlying problems remain. These include large structural imbalances, an inability to balance budgets, and a lack of long-term fiscal planning.

As we direct Puerto Rico's attention toward the local and U.S. elections, we think this is the right time to assess the shape of the Puerto Rico economy by analyzing several forecasts that have been made available by the Puerto Rico Planning Board, the International Monetary Fund, and Birling Capital's forecasts.

Puerto Rico's Government has made its strategic infrastructure investments the cornerstone of economic progress, though primarily with federal reconstruction funding of \$90 billion, of which \$1.8 billion was pegged to this budget and an added \$2.7 billion in debt service savings, the government now has \$4.5 billion in ample resources to expand and strengthen the Island's infrastructure.

This infusion has led to a marked increase in economic optimism, as evidenced by the upward revision of the GDP growth projection by the Puerto Rico Planning Board, which increased from 1.80% to a robust 2.80% or 56% higher and 300% more than the 2023 GDP of 0.7%.

Also, the IMF's Regional Economic Outlook, which includes Puerto Rico, states that the economy will moderate to 2.0% in 2024. The Island experienced a significant downturn in economic activity during the first half of the year, with key sectors like manufacturing showing some resilience. However, overall growth is constrained by weaker external demand and tighter fiscal and monetary policies.

Lastly, at Birling Capital, we offer a less optimistic outlook for Puerto Rico's GDP growth, with rates of 1.5% by 2024 and 1.2% by 2025. This cautious outlook is based on the recent increase in construction activity, which, although significant, may need to be revised to sustain such high growth rates in the coming years.

Moreover, please note that the current Puerto Rico Planning Board Forecast is above the U.S. forecast of 2.7%. We would like to know which econometric model the Board uses for such a high GDP number for Puerto Rico.

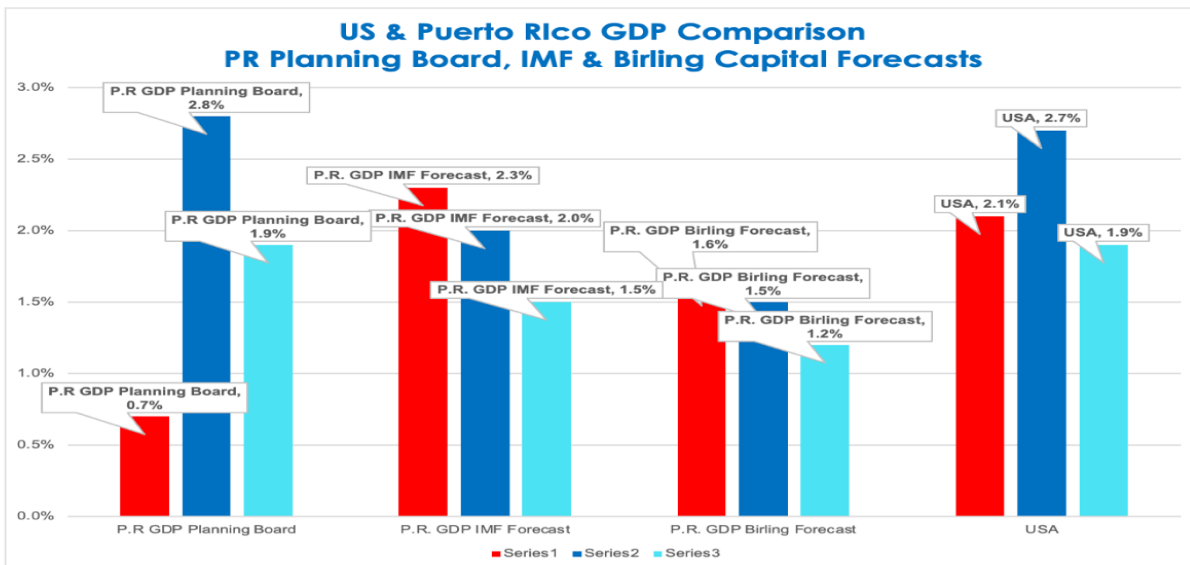
Please note that Puerto Rico's growth relative to the U.S. in 2022 was a GDP of 3.36% compared to the US GDP growth of 1.94%, an event not seen in two decades.

Based on this historical context, we reaffirm that expecting construction momentum to outpace economic trends consistently may be overly optimistic, almost like expecting lightning to strike twice in the same place.

While Puerto Rico has demonstrated resilience and growth potential, forecasts for the U.S., Eurozone, and global economies suggest a more moderate trajectory. This nuanced perspective highlights the opportunities and challenges facing Puerto Rico's economic trajectory, providing stakeholders with a more realistic assessment of its growth prospects. Below is a chart showing the projections of the International Monetary Fund, P.R. Planning Board, and Birling Capital so you can notice the differences.



### Three Economic Perspectives of Puerto Rico's Economic Growth for 2024-2025



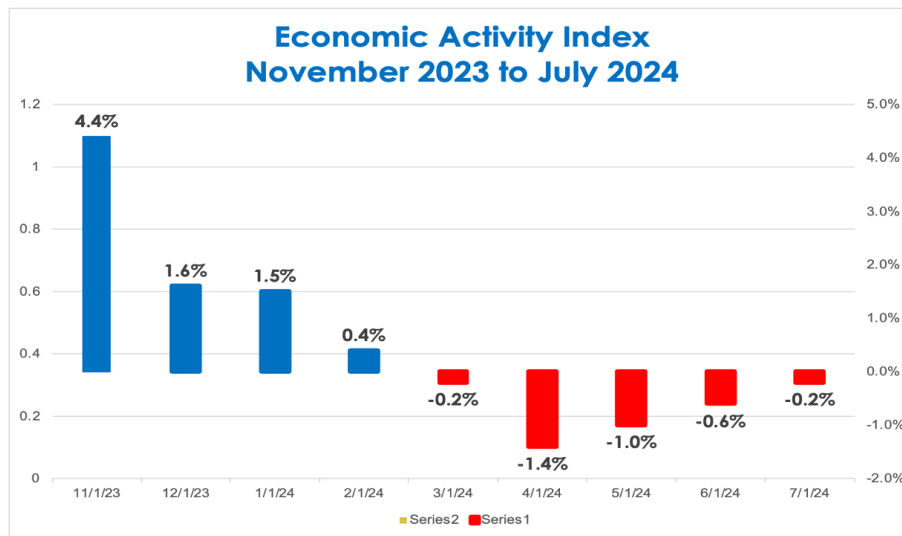
Sources: IMF World Economic Outlook, Puerto Rico Planning Board & Birling Capital

### Understanding the Economic Activity Index

Another benchmark that saw robust growth in January 2021 was the Economic Activity Index produced by the Economic Development Bank for Puerto Rico, which measures employment, electric power generation, gasoline consumption, and cement sales. It has been in contraction since November 2023. It fell to 4.4%, continuing in December 2023 to 1.6%, January 1.5%, and February 0.4%. In negative numbers since March 2024 at -0.2%, April -1.4%, May -1.0%, June -0.6%, and July -0.2%. The EAI has been falling for nine consecutive months.



### Economic Activity Index



Below, we highlight the four components and their performance:

#### 1. Non-farm Payroll Employment:

- Total seasonally adjusted non-farm payroll employment averaged 964,000 jobs in July, reflecting an annual growth rate of 2.3%.

#### 2. Electric Power Generation:

- Seasonally adjusted electric power generation amounted to 1,647.4 million kWh in July.
- Year-over-year (YoY) changes showed declines of 1.2% in June and 0.2% in July.

#### 3. Gasoline Consumption:

- Preliminary estimates for seasonally adjusted gasoline consumption were 64.6 million gallons in June and 66.5 million in July.
- However, YoY comparisons indicated significant declines of 11.2% and 10.6% for June and July.

#### 4. Cement Sales:

- Cement sales in July reached 1.23 million bags, reflecting a 2.1% MoM rise and a 3.1% YoY increase.

During the current administration, the Island has witnessed a commendable average economic growth rate of 2.43% of GDP during the three years combined, marking the highest sustained rate in a decade and a half. The unemployment rate in August fell to 5.70%, the lowest in 50 years; the labor participation rate is 43.90%, which, when both benchmarks compared to 2021, both show 60% or more in progress.

### **A Burdensome Government**

At the core of Puerto Rico's issues lies an oversized government, amounting to 20.5% of the Island's GDP, significantly higher than most U.S. states, where state and local government spending typically ranges from 10% to 20%. This overreliance on government spending stems from Puerto Rico's unique political and economic status and decades of politically motivated economic decisions rather than sound fiscal policies.

### **The Debt Crisis**

Puerto Rico's bankruptcy is the culmination of years of fiscal mismanagement. The \$35 billion financial collapse devastated the Island's residents, wiping out years of savings, retirement funds, and investments. Many went from living comfortably to struggling with poverty, while the government, without remorse, continued to dictate the economy. Despite this, Puerto Rico's potential for growth and development remains vast, with critical sectors holding untapped opportunities for investors and economic advisors.

### **Seven Key Factors of Economic Struggles:**

- 1. Lack of Economic Freedom:** The Fraser Institute ranks Puerto Rico last among the 50 U.S. states and territories regarding economic freedom, scoring a dismal 2.6.
- 2. Debt Crisis:** The Island's debt burden has severely limited its ability to invest in infrastructure and essential services.
- 3. Population Decline:** A shrinking population with a Total Population loss of 696,736 or 18.29% due to migration to the mainland U.S. has led to a reduced tax base and lower consumer demand.
- 4. Natural Disasters:** Puerto Rico has been hit by devastating hurricanes (e.g., Maria in 2017) and earthquakes, damaging infrastructure and hindering economic recovery.
- 5. Economic Dependency:** The economy's dependence on a few key industries, like manufacturing at 46% of the Island's GDP and tourism at 7% of GDP, but taken together equal to 53% of Puerto Rico's GDP, the economy has challenged diversification. Recently, 46% of the GDP was celebrated in the local press, and it should concern everyone that our economy is so reliant on one economic sector.
- 6. Discrimination in Federal Funding:** Puerto Rico's current governance model impacts its access to federal funds, and we always highlight healthcare. The U.S. States receive \$13,000 per capita in healthcare funds, while Puerto Rico gets only \$4,000—69% less, creating an annual \$29 billion shortfall. This funding discrimination by Congress is one of the main reasons Puerto Rico faces a systemic risk in the healthcare ecosystem. Furthermore, Puerto Rico lacks the autonomy to address its economic issues effectively.
- 7. Political and Institutional Factors:** Puerto Rico's income inequality is exacerbated by its political status as a U.S. territory. These gaps in federal support leave low-income Puerto Ricans more exposed during economic downturns, with fewer safety nets to mitigate the impacts of poverty. Compounding these structural issues is the Island's political fragmentation and reliance on patronage politics, which prevent the implementation of coherent, long-term policies to reduce inequality. Political instability, frequent corruption scandals, and a lack of solid leadership focused on doing the right thing rather than merely winning elections have stymied efforts to address critical issues like unemployment, housing, and public health. This short-term, election-driven

approach undermines the Island's capacity to develop and sustain policies that promote economic mobility and reduce disparity, leaving Puerto Rico vulnerable to more profound social and economic divides.

Efforts to address these issues have included debt restructuring, infrastructure investment, and attempts to attract new industries and businesses to the Island. Discussing these topics and potential solutions can be a part of your interest in economic development and growth. However, it's essential to recognize that addressing Puerto Rico's financial challenges is a multifaceted and ongoing process.

### **Why Puerto Rico Struggles the pivotal question of the divergence in economic prosperity and political stability.**

We provide our thoughts on what led to our failure and the analysis of these concepts and their applicability to Puerto Rico.

**1. Inclusive vs. Extractive Institutions:** we must distinguish between inclusive and extractive institutions as the fundamental determinant of a nation's success. Inclusive institutions provide equal opportunities, foster innovation, and distribute power broadly, whereas extractive institutions concentrate power and wealth in the hands of a privileged few.

**Puerto Rico's Current Direction:** Historically, Puerto Rico has grappled with extractive institutions marked by political corruption, lackluster management, and economic inequality. Nevertheless, recent efforts to reform governance, combat corruption, and enhance transparency suggest a shift toward more inclusive institutions. However, the journey toward true inclusivity with economic freedom continues to elude us and remains a work in progress.

**2. Creative Destruction:** underscores the importance of innovation and replacing outdated industries with new ones as a catalyst for economic growth.

**Puerto Rico's Current Direction:** Puerto Rico has made commendable strides in diversifying its economy, particularly in sectors such as pharmaceuticals, biotechnology, and renewable energy. These initiatives align with the principles of creative destruction, but sustained growth necessitates consistent investment in research, development, and education.

**3. Political Centralization vs. Decentralization:** Exploring the balance between centralized and decentralized political systems is imperative. Excessive centralization can lead to extractive institutions, while decentralization can foster competition and accountability. Our heavily centralized Department of Education needs to improve our students. Decentralization allows education authorities at the local level to customize their educational programs to meet their communities' specific needs and preferences. This can lead to more relevant and practical education.

Local control often increases accountability because decision-makers are closer to the students, parents, and teachers. Decentralized systems tend to encourage innovation and experimentation. Local authorities can try different teaching methods, curricula, and policies to see what works best for their students. When educational decisions are made locally, they can respond more quickly to changing demographics, economic conditions, and technological advancements.

Decentralization promotes greater community involvement in education. Parents, teachers, and community members have a more direct say in running schools. In a decentralized system, schools may compete for students, improving quality and efficiency as schools strive to attract and retain students.

**Puerto Rico's Current Direction:** Education in Puerto Rico has led to governance issues, teacher shortages, low academic achievement, language barriers, migration, and questionable special education, among other topics.

**4. Role of External Factors:** the influence of external factors, including global markets and geopolitics, on a nation's trajectory. Puerto Rico's economic problems have been influenced by a combination of factors, some of which can be attributed to internal and external factors.

**Puerto Rico's Current Direction:** Puerto Rico's economy is intricately linked to U.S. policies, trade agreements, and global economic trends. Understanding and skillfully navigating these external factors are crucial for the Island's economic development.

### The Last Word: The Path to Prosperity is paved with change

While the Island has shown positive signs of moving toward more inclusive institutions and embracing creative destruction, it confronts ongoing challenges. These encompass the need for sustainable innovation, reaching a viable economic model that works without Federal Funding, and the critical role of external forces in shaping its future. The path to prosperity for Puerto Rico is paved with innovative ideas and a resilient commitment to progress with a strong focus on reaching economic freedom.

Puerto Rico needs a sustained commitment to strengthening institutions, fostering innovation, and effectively managing its relationship with the United States and the global economy. This comprehensive approach is vital for Puerto Rico's long-term economic and political stability.

With its unique economic landscape and potential for development, Puerto Rico is a prime example of how change can drive progress. By harnessing the spirit of innovation and fostering an environment that welcomes new ideas, thus our prosperity lies in the marriage of visionary thinking and effective governance.

As Stanford Economist Thomas Sowell once said: **"The first lesson of economics is scarcity: there is never enough of anything to fully satisfy all those who want it. The first lesson of politics is to disregard the first lesson of economics"**.



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