

Population | 3.2 million

GDP per capita | 35,208 USD

Annual GDP growth | 3.4 %

Govt debt, % of GDP | 26 %  
After restructuring

HDI | .88/1



Capital | San Juan

# PUERTO RICO

## ISE Country Stocktaking

Key Findings, Future Scenarios and Critical Tasks for State Transformation  
June 2022

ISE's country stocktakings present a view of a country to evaluate opportunities for reform during pivotal periods in its development trajectory. Stocktakings diagnose countries' "open moments" and pathways for reform by assessing the performance and capability of various state functions and citizens' view of the state while mapping the various international partners operating in the country and the alignment of key stakeholders around a potential reform agenda. Based on this assessment, ISE lays out the key medium-term issues facing the country, outlines potential scenarios for the future of the country and presents critical tasks that could bring about the best-case scenario.

### The Current Reform Context

**Puerto Rico's debt crisis has significantly shaped its current reform context.** For the last four decades, Puerto Rico has depended heavily on bonds to fund expenses. The territory's reliance on debt, combined with a chronically vulnerable economy, meant that it was severely strained by the 2008 financial crash. In 2015 Puerto Rico declared that it was experiencing a fiscal "death spiral" and could no longer make debt payments. A year after the announcement, in June of 2016, the U.S. federal government intervened and passed the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA). PROMESA established an unelected Financial Oversight and Management Board (FOMB, locally referred to as la junta) to negotiate debt restructuring and to control Puerto Rico's budget, including through austerity measures like hiring freezes and the selling of public assets. Since the passage of PROMESA, proposed solutions to the debt crisis have reflected ongoing tensions related to the debt restructuring and payment processes, namely, how to prioritize the needs of Puerto Rico's people and its creditors relative to strict austerity measures—including proposed cuts to pensions, education spending and other government operations.

**A series of major natural disasters compounded the impact of the debt crisis, jeopardizing Puerto Rico's legitimacy and further harming its economy and society.** In September 2017, Hurricane Maria devastated the island, resulting in over 90 billion USD in damages and nearly 3,000 deaths. The pace of reconstruction remains slow: only 37 percent of the total 84.5 billion USD in federal funding has been dispersed. Both before and after the hurricane the government pursued a reform agenda that aimed to balance fiscal sustainability with investments in infrastructure, education and the civil service, but crisis response has largely taken precedence. Meanwhile, the collapse of the Rosselló administration in July 2019—and the appointment of Wanda Vázquez Garced as interim governor after a failed push to name Pedro Pierluisi by Rosselló—illustrated and deepened citizens' distrust of the state and its perceived insular ruling class. In March 2020, the COVID-19 pandemic introduced further economic and social challenges.

**Within this context, Puerto Rico's relationship with the U.S. federal government is both a contentious political issue and central to its recovery and reform.** Puerto Rico relies heavily on federal funding, but its relationship with Congress and the Executive has been acrimonious in the past. Under President Biden, the federal government promised to leverage unprecedented federal stimulus funding to respond to the Island's economic, fiscal and natural

shocks. In total, Puerto Rico is expected to receive more than 40 billion USD in federal funding over the coming years. Underlying funding issues is the long-standing question of Puerto Rico's status within the U.S. Currently the consensus to change Puerto Rico's status from territory to state is not in place, though Puerto Rico's current Governor, Pedro Pierluisi, has vowed to achieve statehood.

**Puerto Rico's adoption of a new Plan of Adjustment (POA) in January of 2022 and the subsequent restructuring of the government's debt is a significant milestone in the Island's recovery, but important steps to recovery and reform remain.** The POA reduces the largest portion of the government's debt, around 33 billion USD, by about 80 percent to 7.4 billion USD, saving Puerto Rico more than 50 billion USD in payments. The remaining steps to recovery include addressing underlying institutional and financial constraints—a condition Puerto Rico must meet to terminate the FOMB—and balancing fiscal austerity with recovery, accountable delivery to citizens and sustainable economic growth. Beyond recovery from the debt crisis, key reform issues include addressing corruption, prioritizing education and rebuilding infrastructure damaged by Hurricane Maria.

### Performance of Core State Functions in Puerto Rico

The following section provides an assessment of core state functions in Puerto Rico, considering the assets, constraints and opportunities for reform to reach its recovery and fiscal goals.

#### Governance

**Puerto Rico's status as a U.S. territory is central to its governance function and defines the Island's complex relations with the U.S. mainland.** As residents of a U.S. territory, Puerto Ricans' rights are limited compared to other U.S. citizens, and federal involvement in the Island's governance constrains the decision-making power of local actors. Following U.S. acquisition of the Island in 1898 from Spain, which colonized Puerto Rico in 1508, Puerto Rico was administered by U.S.-instituted military and civil governments. Since then, Congress and the Executive have acted to gradually increase Puerto Ricans' rights and sovereignty: in 1917 they were granted U.S. citizenship and the ability to elect their legislature; in 1947, they were granted the ability to elect their governor; and in 1952, to establish a constitution. Yet Puerto Ricans are not represented in U.S. Congress, nor do they have the right to vote for president. Since 1920, the Jones Act, which prevents foreign vessels from carrying goods between U.S. ports, has severely raised the cost

of imports, particularly liquidized natural gas. Puerto Rico's ample tax incentives, especially the lack of a federal income tax for most residents, put the Island in economic competition with mainland states. Yet the federal government caps funding for key social safety net programs, such as Medicaid, decreasing Puerto Ricans' access to basic services. Most recently, the prerogative of the unelected Financial Oversight Management Board (FOMB) to control Puerto Rico's budget has stripped power from the local government as it continues to navigate the debt crisis. The Island's territorial status has long been a point of contention in Puerto Rican politics—some political parties have organized around the goal of U.S. statehood and others independence—however, any resolution to the question depends on action from U.S. Congress, which has shown only meager interest in settling the issue and has little incentive to do so.

### **Government capacity remains a key challenge in Puerto Rico.**

The brain drain that has resulted from Puerto Rican migration to the U.S. mainland, combined with a history of mismanagement and corruption, has constrained the government's ability to fully deliver on its mandates. The FOMB has exacerbated capacity issues by outsourcing many government functions to consultants, particularly those related to public finance and fiscal affairs. While outsourcing is a common practice for many national and local governments, the influx of mainland U.S. consultants has not helped Puerto Rico to build local capacity, creates conflicts of interest, and—like with the FOMB itself—means that major governance questions are, in large part, determined by unelected, non-local actors. The result has been stalled reform agendas and increased mistrust between citizens, the government and the FOMB. The 2022 Plan of Adjustment (POA) presents a strategic opportunity to shift the trajectory towards enhanced cooperation and effective governance. The Puerto Rican government has also recently made efforts to engage with U.S. government officials and other key mainland stakeholders more substantially. However, the continuation of such engagements depends on the investment and willingness of future Puerto Rican and federal government administrations.

Key governance issues for Puerto Rico include:

- » Rocky but improving relations with the U.S. federal government informed by a legacy of colonialism and imposed rule, resulting in poor cooperation and complex systems of decision-rights
- » Inconsistent government capacity amidst a large-scale recovery
- » Significant mistrust between citizens, the government and oversight authorities

## **Security**

**In recent years Puerto Rico's domestic security has been threatened by violent crime, although the rate of incidents is dropping.** With approximately 20 homicides per 100,000 people, Puerto Rico has one of the highest murder rates in the U.S. High-profile killings include a wave of likely gang-related murders in 2019; six murders of transgender individuals in 2020, most of which have remained unsolved; the murder of an American tourist in April 2021; and the killing of three police officers in a carjacking in San Juan in January 2021. Similar to other civil servants, the Puerto Rican police force is discontented with poor working conditions and frozen pension funds, largely due to FOMB restrictions on retirement benefits. Over Halloween weekend in 2021, approximately 5,000

officers—nearly half the Island's total police force—did not show up for work in protest.

Key security issues for Puerto Rico include:

- » A recent trend of high-profile violent crimes that drive negative perceptions of the Island
- » Maintaining and managing its police force, which has been hit hard by austerity measures, similar to other public institutions

## **Rule of Law**

**Similar to its other state functions, the rule of law in Puerto Rico is structured and complicated by the Island's relationship to the U.S. federal government.** While Puerto Rico hosts its own federal district court, federal appeals cases are heard by the First Circuit, whose justices travel from Boston to San Juan for two sessions each year. Unlike local courts, federal proceedings are conducted entirely in English, which presents a decisive barrier for both jury selection and the dissemination and transparency of case law.

**The rule of law in Puerto Rico is weakened by high-level public corruption.** The most notable recent case involved former Secretary of Education Julia Keleher, who pled guilty to two federal charges of wire fraud in June 2021 in exchange for a reduced six-month prison sentence. The mayors of the cities of Guaybano and Cataño were both indicted on federal corruption charges in 2021 in relation to bribes and kickbacks. The former mayor of Aguas Buenas also pleaded guilty to a bribery scheme involving waste removal, and the FBI has indicted several other public officials and private sector actors involved in the bribery schemes.

Key rule of law issues for Puerto Rico include:

- » Establishing and improving a culture of accountability after a series of notable public corruption scandals
- » Increasing transparency in key areas like procurement and judicial proceedings
- » Ensuring commitments of accountability and transparency from leadership in order to rebuild citizen trust

## **National Accountability Systems: Public Finance**

**Reforms to Puerto Rico's accountability and public finance systems could build legitimacy and help Puerto Rico gain sovereignty from the Financial Oversight and Management Board (FOMB).** Poor revenue collection, frequently delayed financial reporting, insufficient debt management and loose budgeting practices have all been cited as primary causes of the current debt crisis. To address these shortcomings, the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA) set out a list of fiscal reform requirements in 2017. PROMESA has stipulated that the Puerto Rican government must meet these requirements before it can terminate the FOMB and regain its fiscal sovereignty. They include complete and sustainable restructuring of the debt, timely financial reporting, budgeting in accordance with modified accrual accounting standards and the implementation of a balanced budget. Beyond the recent restructuring of its debt, Puerto Rico has made only limited progress in accomplishing reform.

**The recent debt restructuring provides both an opportunity and a critical risk to repair and create more sustainable accountability systems.** Specifically, Puerto Rico has the opportunity to improve accountable budgeting, liability management, accounting, reporting

and coordination. Puerto Rico's medium-term fiscal outlook largely depends on its ability to begin sustainably repaying its creditors, while simultaneously managing a tremendous inflow of federal Hurricane Maria and COVID-19 recovery funding and navigating the severe fiscal austerity measures envisioned by the FOMB (which creates a fiscal drag on GNP of around 0.9 percent). In the near term, key goals for the government include producing timely audited annual financial reports, improving fiscal transparency and budgeting practices and developing a clearer fiscal coordination structure via the Officer of the Chief Financial Controller (OCFO). As federal stimulus funding disappears over the next ten years, Puerto Rico will reenter the market on its own. These key fiscal reforms—in addition to more sustainable fiscal strategies and debt management policies—will likely be key to an effective and accountable state.

Key public finance issues for Puerto Rico include:

- » Continuing to address historically weak public finance and accountability systems in coordination with the FOMB, especially in the areas of budget transparency and procurement
- » Demonstrating credibility through consistent, sustainable payments to creditors
- » Preparing for the inevitable long-term drawdown of federal relief funding that has underpinned much of the recovery effort

## Asset Management

**Puerto Rico benefits from a strong cultural heritage and natural assets. These assets have contributed to the Island's economic development and helped build a shared Puerto Rican identity.**

The Island's cultural assets—from musical and visual arts to archaeological sites and archives—support the economy through entrepreneurship as well as tourism, which makes up about 8 percent of GDP alone. These assets also contribute to Puerto Rican communities' sense of place, social capital networks and resilience. The Island's natural assets are also rich resources that create identity and economic opportunity for Puerto Ricans. They include the Island's location in the Caribbean Ocean and along key trade corridors, its coastal heritage, from indigenous cave art to artisanal fishing, and its protected forests. In 2017, Hurricane Maria significantly damaged physical and cultural assets and connective infrastructure for all asset classes. However, recent economic recovery and incubation initiatives in damaged areas, along with proposed strategies for the restoration of cultural artifacts and art installations provide an opportunity for Puerto Rico to both repair and enhance the stock and management of its non-financial assets. While in 2020, the COVID-19 pandemic caused drastic declines in tourism, the industry rebounded with a record year in 2021, driven by the Island's effective pandemic management. Puerto Rico has an ongoing marketing strategy entitled "Discover Puerto Rico." A whole-of-island destination strategy that builds on this program could be a key medium-term opportunity for Puerto Rico to leverage existing natural and cultural resources through human development, connective infrastructure restoration, locally-led land management and environmental conservation.

Key asset management issues for Puerto Rico include:

- » Continuing to build on the resiliency and success of the tourism and entrepreneurship sectors to drive growth
- » Preserving and maintaining Puerto Rico's diverse set of

natural assets

- » Repairing the connective infrastructure that underpins the sustainable utilization of assets

## Market Engagement

**Puerto Rico's economy has experienced a stop-start recovery from the crisis in recent years. There is an opportunity for near-term growth driven by the export market, federal funding, and improvements to the business environment.** After three years of recession from 2016 through 2018, the Island's annual GDP growth rate rose just above zero in 2019 before falling again by 3.9 percentage points in 2020, largely because of the pandemic and its impact on the island's tourism export base. The Economic Activity Index indicates that economic activity rebounded in 2021 (by 2.9 percent compared to 2020), but has yet to reach pre-pandemic levels, which were already well below pre-Hurricane Maria levels. In the near term, austerity measures are expected to significantly reduce growth, so the Island will likely need to rely on investment activity financed by federal recovery funding to grow the economy. Economic growth will also likely require improvements to the investment climate, which is frequently assessed as strong for the region but weak when compared to the U.S. mainland.

**In the medium term, market growth will likely be driven by Puerto Rico's comparative advantages in key sectors, its competitive labor force, improving access to reliable energy and by leveraging its location through continued improvement to its logistics hubs.**

Manufacturing, particularly the production of bio-pharmaceuticals, basic chemicals and medical devices, is the main sector in Puerto Rico, constituting 47 percent of GDP. In addition to manufacturing, technical services and consulting, finance and tourism all play major roles in the economy and present competitive advantages for the Island. Promoting trade, historically the focal point of Puerto Rico's industrial policy, and diversifying exports beyond the medical and pharmaceutical sectors are also key areas for growth and reform. These market advantages are driven by a technical, bilingual and low-cost workforce with effective university-market pipelines in engineering and manufacturing science. The government intends to further develop these university-market pipelines through a new public-private "Workforce Group" and increased investment in Workforce Development Programs across fifteen municipalities. The Island's location is another advantage, and the government has prioritized the improvement of connectivity at various transportation hubs and the development of logistical capabilities to stimulate growth in the medium term. In addition to workforce and logistics development, the Department of Economic Development and Commerce (DDEC) has set out strategies to (1) reduce the cost of business and construction permits through initiatives like a Single Business Portal, (2) improve access to low-cost and renewable energy sources and (3) attract new investment for health tech, business support services and manufacturing reshoring.

Key market engagement issues for Puerto Rico include:

- » Effectively harnessing federal funding to spur economic growth
- » Building on comparative advantages in the tourism, bio-pharmaceuticals and medical sectors and harnessing a strategic location and competitive workforce
- » Developing and implementing strategies to diversify economic opportunities and reduce the cost of business

## Infrastructure

**Poor infrastructure—particularly the electrical grid—remains a significant challenge for Puerto Rico.** After 80 percent of the electrical grid was damaged during Hurricane Maria in 2017, the government moved to partially privatize electrical distribution on the Island. The Puerto Rico Electric Power Authority (PREPA) became insolvent around 2012 and has relied on long-term debt to finance its operations. In June 2021, LUMA Energy, a US-Canadian consortium, began a new public-private partnership with PREPA, with PREPA responsible for energy generation and LUMA responsible for distribution, maintenance and grid upgrades. Upgrades are expected to take ten years to complete. The U.S. Federal Emergency Management Agency (FEMA) has also allocated 9.4 billion USD to restore and improve the grid, the largest amount ever awarded by the agency for a single project. The viability of the PREPA-LUMA partnership remains questionable. Blackouts across Puerto Rico have continued, and consumer prices remain notably high, with Puerto Ricans paying rates that are nearly 50 percent higher than the average U.S. home. Under fiscal austerity, repairing and updating the electricity generation and transmission system will likely be arduous, especially efforts to transition the system to the legally mandated 40 percent renewable generation target by 2025.

**While secondary to the electrical grid, Puerto Rico's other infrastructure poses significant long-term risks.** According to the American Society of Civil Engineers (ASCE) 2019 Infrastructure Report Card, roadways and solid-waste removal are of particular concern for the Island. Roadways in Puerto Rico are often built and repaired below professional standards and allow for trucks much heavier than most U.S. roadways, leading to early pavement failure. In addition, 11 of Puerto Rico's 29 landfills are not up to federal standards and are quickly filling. The EPA estimates that the Island's landfill capacity will max out in 2023. Along with specific technical improvements, ASCE recommends Puerto Rico develop an asset management framework and an infrastructure plan. The Biden administration has highlighted its investment in Puerto Rico's infrastructure via the Infrastructure Investment and Jobs Act, which provides the Island with 900 million USD for roads and highways, 225 million USD for bridges, 456 million USD for public transit and 13.6 million USD for EV chargers. However, access to finance for improving infrastructure outside of one-off federal investments and disaster relief funding remains a key challenge, particularly due to PREPA's poor fiscal position and Financial Oversight and Management Board (FOMB)-imposed austerity measures that limit large capital investments.

Key infrastructure issues for Puerto Rico include:

- » Enhancing the resiliency and management of the electrical grid
- » Developing investment strategies to renew and repair the infrastructure stock that fits within a constrained fiscal environment
- » Effectively leveraging recent large-scale federal funding to jumpstart infrastructure renewal
- » Prioritizing and sequencing critical infrastructure projects

## Human Capital

**Puerto Rico has a highly educated and bilingual human capital pool, but it is threatened by significant levels of out-migration.** Between 2010 and 2020, Puerto Rico's population declined 11.8

percent, by far the largest population decline of any U.S. state or territory during the same period—West Virginia is second at 3.2 percent. In addition to reducing Puerto Rico's human capital, over the long-term out-migration will decrease Puerto Rico's tax base while simultaneously requiring infrastructure upgrades to handle an aging population. Other U.S. states have largely tackled brain drain by restructuring their economies to encourage out-of-state immigration. For example, some states have established themselves as tech and research hubs to compete with California's Silicon Valley. Through its appealing tax policies and by providing opportunities for remote, albeit temporary, workers, Puerto Rico has recently attracted tech entrepreneurs, particularly those focused on cryptocurrencies. But longer-term strategies to draw new residents through economic restructuring could prove difficult due to widespread public backlash. Many Puerto Ricans fear that mostly young, white U.S.-mainlanders could replace the local population.

**Availability and access to schools remains a key issue for Puerto Ricans.** Following a broad wave of school closures due to damage caused by Hurricane Maria, the Department of Education has pursued strategies to “consolidate” the public school system and update teacher placement and enrollment systems. Despite these measures, education outcomes are declining. Two-hundred and fifty schools were a part of the post-hurricane education reform, and under the current Education Secretary Eliezer Ramos Parés' “master plan,” 83 more schools are slated for closure by 2026. The lack of education funding has resulted in discontent among teachers, whose pay and pensions are constrained by the Financial Oversight and Management Board (FOMB). Long-term funding for higher education is also a crucial challenge in Puerto Rico, particularly for the Island's flagship research institution, the University of Puerto Rico (UPR). The FOMB reduced the University's general fund by 48 percent for FY22. Other FOMB-imposed cost-saving measures include increased tuition, faculty reductions, freezing of teacher pension plans and reduced benefits.

Key human capital issues for Puerto Rico include:

- » Developing and executing a long-term strategy to slow out-migration
- » Mitigating barriers to primary and secondary education access caused by significant school closures
- » Developing a financially sustainable model for higher education that meets workforce needs

## Citizenship & Social Policy

**Puerto Rico's insolvent pension system is central to the Island's debt crisis and has been a critical component of debt restructuring negotiations.** In 2015, pension liabilities from the Island's three public employee retirement systems—the Employees' Retirement System (ERS), the Teachers' Retirement System (TRS) and the Judiciary Retirement System (JRS)—constituted 70 percent, or 49 billion USD, of the Island's 70 billion USD debt. The Financial Oversight and Management Board's (FOMB) fiscal plans have routinely encouraged cuts to retiree benefits, particularly within the ERS—a move deeply opposed by citizens and politicians. In a compromise, the 2022 debt restructuring package includes zero cuts to pensions of current defined-benefit ERS retirees but eliminates near-term cost-of-living adjustments and converts TRS and JRS pensions to defined-contribution, 401(k)-style plans.



**Aside from the government-supported pension system, Puerto Rico's social policy is comprised of an amalgam of federal programs, which routinely do not meet the needs of vulnerable citizens.** Almost half of all Puerto Rican residents rely on Medicaid for health coverage. Yet the Island's allotment of federal coverage for Medicaid spending (FMAP) has until recently been capped at 55 percent through fixed block grant funding, unlike open-ended, formula-based funding received by states. Puerto Ricans are not eligible for federal Supplemental Nutrition Assistance Program (SNAP) benefits, Supplemental Security Income (SSI) or the Earned Income Tax Credit (EITC). In 2021, the American Rescue Plan and related legislation temporarily increased federal contributions to Medicaid from 55 to 76 percent and permanently expanded the EITC and Child Tax Credit programs. Fixed-rate block grant funding for the Nutritional Assistance Program (NAP) and a local EITC make up the remainder of the Island's safety net. However, forty-four percent of Puerto Ricans have incomes below the poverty line and remain in need of increased social assistance.

Key citizenship and social policy issues for Puerto Rico include:

- » Managing expectations around key benefits and social services amid austerity, while still meeting Puerto Ricans' basic needs
- » Developing more effective strategies for poverty reduction and social assistance
- » Harnessing recent increases in federal assistance to bolster the social safety net

## Disaster Resilience

**Puerto Rico's disaster resilience largely hinges on its relationship with the federal government, its management of disaster funds and recovery processes and its ability to respond to citizens' needs amid compounding crises.** In September 2017 Hurricane Maria devastated the Island. The category 5 storm resulted in nearly 3,000 deaths and over 90 billion USD in damages to homes, schools, water systems and the power grid. The disaster was made worse by the unfolding debt crisis, and later, COVID-19, which reached the Island in March of 2020. As it responds to multiple crises, one of Puerto Rico's greatest challenges is the effective management of disaster recovery funds. Puerto Rico's Central Office for Recovery, Reconstruction and Resiliency (COR3) handles over 36 billion USD in recovery funds, mainly from FEMA and the U.S. Department of Housing and Urban Development (HUD). While almost all recovery funds have been obligated to specific projects and programs, only 24 percent have been disbursed. This is largely because of the limited capability in COR3 to efficiently administer the subcontracting of funds, as well as burdensome federal bureaucracy—in particular, bureaucracy imposed by HUD under the Trump administration (2017-21). Managing, dispersing and accounting for disaster recovery funds is further complicated by the number of different funding streams. These streams include substantial individual and public assistance and natural hazard mitigation grants from FEMA, COVID-19 relief, fiscal support under the CARES Act and American Rescue Plan and over 20 billion USD of Community Development Block Grant Disaster Recovery (CDBG-DR) funding managed by HUD. CDBG-DR funding in particular has been a key issue in Puerto Rico. CDBG-DR grants are meant to fill recovery gaps felt by citizens in areas like housing, community development, and public services. However, applications are often delayed by complex federal and local bureaucracy. Less burdensome disbursement bureaucracy

from federal agencies could help COR3, along with Vivienda, the housing authority responsible for CDBG-DR funds, access aid. As outlined in its 2021-2024 strategic plan, COR3 could also benefit from improved financial and grant management practices, including the development of stronger investment costing, monitoring and close-out capabilities. Finally, many programs and policies for medium- and long-term disaster response overlap with wholesale redevelopment efforts in Puerto Rico, which are currently constrained by austerity measures imposed by the Financial Oversight and Management Board (FOMB). Because of these overlaps, Puerto Rico is challenged to balance short-, medium- and long-term goals for recovery and redevelopment and to effectively prioritize investments.

**In general, Puerto Rico has been credited with a strong response to the COVID-19 pandemic, however, its healthcare system presents capacity risks.** Puerto Rico's success in responding to COVID-19 can be largely attributed to its geographic position as an Island and strict lockdown measures during the beginning of the pandemic. Through the American Rescue Plan's Coronavirus State Fiscal Recovery Fund and the Coronavirus Local Fiscal Recovery Fund, Puerto Rico received a total of 4.02 billion USD in additional government funding. The Puerto Rican government's priorities for the funds are economic development, "quality of life," future projects and "government of excellence." Projects aim to meet immediate public health needs, repair infrastructure, improve housing and education and provide fiscal relief to municipalities. These funds could also help to address the continued risk posed by the limited capacity of Puerto Rico's healthcare system. While hospital beds and other technical equipment are readily available, a lack of medical personnel—sparked by a mass exodus of doctors following Hurricane Maria—has made the provision of intensive care to patients difficult. According to the U.S. Health and Human Services Administration, 72 of Puerto Rico's 78 municipalities are "medically underserved."

Key disaster resilience issues for Puerto Rico include:

- » Maintaining good relations with the U.S. federal government to ensure close coordination on the accountability of funds and to address bureaucratic roadblocks
- » Improving the management of government-led recovery projects, especially the timely dispersal of funds
- » Increasing the capacity of the healthcare system to meet the needs of communities

## Key Medium-Term Issues for Puerto Rico

Based on ISE's assessment of the performance and capabilities of core state functions, there is a set of key issues and trends that Puerto Rico will need to address in the medium term.

- 1. Balancing continued fiscal austerity while promoting recovery and growth.** The Plan of Adjustment is a major stepping stone. With a clear understanding of its fiscal picture, Puerto Rico is free to further plan for and devote resources to its long-term recovery. However, this will need to be accomplished amid continued fiscal austerity imposed by the Financial Management and Oversight Board (FOMB). Navigating this challenge will require effective strategies to coalesce stakeholders and reform efforts, clear prioritization in managing tradeoffs and deft political leadership that sets expectations for citizens.

2. **Demonstrating public sector accountability and improving institutional capacity.** Puerto Rico’s debt crisis and a recent history of high-profile government scandals and resignations decreased trust in public institutions and exacerbated tensions with the federal government, particularly under the Trump administration. Poor fiscal discipline, delayed recovery efforts and inequitable and unreliable service delivery have left many Puerto Ricans with a negative view of both local and federal government, illustrated most clearly by the numerous protests across the island. Demonstrating the ability to accountably deliver on its promises will be a key task for the government in the years ahead as it seeks to “build back better.”
3. **Articulating and executing a strategy for sustained economic growth.** Physical devastation and financial crises have led to inconsistent economic growth in Puerto Rico. Despite efforts by the government to reposition the economy, growth has largely been dominated by short-term wins, such as in the cryptocurrency and tech sectors. Going forward, Puerto Rico will need to determine a clear economic pathway backed by strategic investments for sustainable growth. Recent efforts to leverage Puerto Rico’s geographic position in the Caribbean could serve as a foundation for this strategy.
4. **Counteracting outmigration and human capital drain.** Puerto Rico has suffered from a large and consistent outmigration, posing a key risk for recovery. Dwindling economic opportunities, natural disasters and easy travel to the U.S. have incentivized many Puerto Ricans to depart for the mainland. The most obvious effect of this “brain drain” is decreased economic activity, but it also presents other barriers to transformation, from a smaller tax base to reduced capacity in public institutions.

## Scenarios for the Puerto Rico of the Future

Future medium-term scenarios for the Island are driven by factors that are difficult to predict, including the continued threat of natural disasters. Key drivers of the future in Puerto Rico likely include (1) the availability and distribution of recovery funds from the federal government; (2) changes to the relationship between the government and the Financial Oversight and Management Board (FOMB); (3) changes to the relationship between the Island and federal government, such as Puerto Rico gaining statehood; and (4) commitment to accountability reforms—among others. Below are illustrative future scenarios:

1. **Time machine status quo:** With the support of federal funding, Puerto Rico rebuilds and restores its economy, basic infrastructure and growth to pre-crisis levels. Yet, basic institutions have not been strengthened—and even became weaker due to outsourcing in the civil service—and fiscal strategies remain unsustainable, threatening to repeat past mistakes and again plunge the Island into debt distress.
2. **Default and descent:** Federal recovery funding never fully arrives because of political changes in Washington or because it is squandered by weak fiscal management and investment institutions in Puerto Rico. Even in a constrained economic environment, the FOMB requires deeper austerity measures to manage repayments to the Island’s creditors, leading to a collapse in the delivery of services, continuous social upheaval and out-migration of the Island’s youth.
3. **Life support:** Puerto Rico is granted statehood, fundamentally

changing its relationship with the federal government and FOMB, while opening new financing channels for recovery, economic growth and social programming. Yet, even with this bright fiscal and economic picture, basic institutions fail to grow, and there are still concerns from citizens about the accountability, responsiveness and financial sovereignty of the state government.

4. **Independence and innovation:** Puerto Rico leverages federal funding and debt restructuring to not only restore its economy and infrastructure but also to begin strengthening local institutions and opportunities for sustainable growth. Armed with more accountable and effective institutions, the Island, either independently or as a state, becomes a regional leader for governance and service delivery innovation through digital solutions and investment in its world-class logistics, manufacturing and supply chain service sectors—all together delivering quality jobs, responsive services and participatory representation to its citizens.

## Key Opportunities and Critical Tasks

To avoid the worst-case scenario above and reach for fiscal and economic independence, Puerto Rico can undertake a series of preliminary critical tasks in the medium term.

### Sustainable and accountable management of public finance and investment

With the initial debt restructuring deal legally cleared and the Plan of Adjustment (POA) going into effect, Puerto Rico’s medium-term fiscal outlook depends on its ability to begin sustainably repaying its creditors and managing a tremendous inflow of federal recovery funding, while simultaneously navigating the severe fiscal austerity measures envisioned by the FOMB. Key near-term goals for the Pierluisi administration will include producing timely audited annual financial reports, improving fiscal planning and budgeting practices, creating platforms for greater citizen engagement in budgetary practices and developing a clearer fiscal coordination structure via the Office of the Chief Financial Officer (OCFO). As federal stimulus funding disappears over the next ten years, Puerto Rico will need to be prepared to reenter the market on its own, and these key fiscal reforms—in addition to more sustainable fiscal strategies and debt management policies—will be key to an effective and accountable state.

### Economic growth through strategic cluster and partnership development

A clear industrial policy or related economic strategy is needed to re-think and clarify the Island’s economic future during continued austerity. Strategies could focus on building productive market clusters and setting out the prioritization of investments and partnerships in key sectors like tourism and manufacturing as well as new sectors like health tech. In addition to improving the Island’s enabling environment for business and investment, this kind of foundational market strategy could provide a basis for a new and energized partnership between the state and private sector that could supply sustainable jobs and revenue.

### Digital solutions for modernized governance and citizen engagement

During the COVID-19 pandemic and throughout the reconstruction process, the government demonstrated its capacity to manage complex governance problems and develop digital solutions to urgent service delivery needs. Continued investment in digital

solutions to citizen-state communications, service delivery and persistent anti-corruption challenges could make the state more inclusive, accessible, accountable and responsive to citizens. Empowering, integrating and scaling the Puerto Rico Innovation and Technology Service (PRITS) and its digital delivery initiatives across the government could present another opportunity to amend and modernize Puerto Rico's compact.

## An updated long-term vision for Puerto Rico paired with clear implementation systems

While the 2018 Plan Para Puerto Rico and multiple agency-level plans outline near-term strategies for recovery, the government could consider producing an updated plan for the current context that (1) re-commits to recovery efforts through specific investments and structural reforms in the near term and (2) provides a foundation for more transformational change to the social compact in the medium term. More importantly, any new planning would benefit from robust implementation mechanisms that break down strategic visions into requisite programs and policies that deliver results for communities. To avoid further “plan fatigue” the government and its partners could evaluate systems for stakeholder management and decision-making to learn from past successes and failures.

## Conclusion

Puerto Rico continues to have the opportunity to move beyond recovery from crises to efforts for long-term transformation. The debt restructuring agreement with the Financial Oversight and Management Board (FOMB) will allow for more sustainable planning, with a clearer picture of available resources and constraints. Recent economic growth in the tech sector, a strong tourism industry, sustained government stability after a period of civic and political upheaval and improved relations with the federal government are all signs that Puerto Rico can capitalize on this moment. The challenges, however, remain significant. Austerity measures imposed by the FOMB will limit resources and pose difficult tradeoffs, while a stagnant economy and ineffective service delivery have pushed many Puerto Ricans to migrate. How Puerto Rico navigates these challenges and works with key stakeholders—especially communities, businesses and the federal government—will determine its trajectory beyond the “crisis-to-recovery” dynamic to one of durable transformation and renewal.