

PUERTO RICO COMPARED WITH HONG KONG AND SINGAPORE				
Countries	GDP per Capita (on Purchasing Power Parity Basis, Current International Dollars)	Maximum Individual Tax Rate	Corporate Tax Rate	Government Spending as a Percentage of GDP
Puerto Rico	38,647	33.0%	39.0%	22.8%
Hong Kong	60,553	15.0%	16.5%	18.7%
Singapore	90,724	22.0%	17.0%	19.2%

Sources: KPMG, IMF

Drawing Opportunity from Disaster

by Richard W. Rahn

RESTRUCTURING PUERTO RICO'S ECONOMY SHOULD ACCOMPANY REBUILDING THE HURRICANE-RAVAGED ISLAND

The disastrous hurricanes that struck Puerto Rico might provide the excuse for the necessary, fundamental reform on the island. Puerto Rico has spent most of the past 12 years in recession, leading to its current bankruptcy. The bankruptcy was caused by gross fiscal mismanagement over the last few decades. Only during the term of Gov. Luis Fortuno (2009-13) was any serious attempt to right the ship, but Mr. Fortuno was ultimately defeated by the government unions.

Puerto Rico now has a federally appointed oversight board to try to sort out the mess. The task was difficult before the latest hurricane, but now it will require even more radical measures.

Puerto Rico, an island of about 3.4 million people, is a largely self-governing territory of the United States. Its gross domestic product per capita is about two-thirds of the America average. Puerto Ricans are U.S. citizens who can freely move to the U.S. mainland, as they are increasingly doing, including many of the best and brightest, seeking better opportunity.

Why is not Puerto Rico richer? Singapore and Hong Kong were island colonies of the United Kingdom that, although being poor 50 years ago, have achieved spectacular economic success, now both having a higher per-capita income than the U.S. Singapore

achieved its independence in 1965, and Hong Kong remained a British colony until 1997 when it was transferred to China, again as a largely self-governing colony.

Why have Singapore (population 5.7 million) and Hong Kong (population 7.4 million) done so much better than Puerto Rico? All three jurisdictions have tropical climates for most of the year and are subject to hurricanes. Puerto Rico, although small (3,515 square miles), is still much larger than either Hong Kong or Singapore and has more natural resources.

Singapore and Hong Kong each have a smaller but much more efficient civil service than Puerto Rico — without the union problems. They have had better governance. Both individual and corporate tax rates are much higher in Puerto Rico, discouraging business investment. Hong Kong and Singapore have more economic freedom, ranking respectively No. 1 and 2 (the U.S. ranks number 11) in the latest ranking in the Annual Economic Freedom of the World Report prepared by the Fraser Institute. Crime is an impediment to economic growth. Puerto Rico's crime index (compiled by Numbeo) is 65.4, not horrible by world standards, but considerably higher than New York City's (45.2) and vastly worse than Hong Kong's (20.1) and Singapore's (16.9).

Puerto Rico also suffers from much greater interference in its economy from the United States — much of it well-intentioned but still destructive — than Singapore and Hong Kong ever did from Britain, or than Hong Kong does from China today. For instance, the century-old Jones Act — just temporarily waived by President Trump this past week — required that only U.S. ships could bring goods back and forth between the U.S. and Puerto Rico, greatly increased shipping costs for the island. Many U.S. laws and regulations that Puerto Rico must abide by make Puerto Rico less internationally competitive. The U.S. extends federal welfare rules and benefits to Puerto Rico, which has the perverse effect of causing many to opt for welfare rather than work in lower-wage Puerto Rico. As a result, Puerto Rico has a much lower labor force participation rate than the U.S., Singapore or Hong Kong.

Puerto Rico suffers from too many mismanaged government-owned enterprises, notably the power company, which is now also bankrupt and in no position to invest the necessary amounts to rebuild the power system. It should be immediately sold to a private international power company that agrees to make the necessary investment to give the island a modern and lower-cost power system. Other state-owned enterprises also need to be sold. A review of U.S. federal laws, regulations and rules should be made with the intention of throwing out those that have interfered with economic growth and international competitiveness (some of these changes will need to be approved by the U.S. Congress).

Both individual and corporate tax rates need to be lowered to levels considerably less than the U.S. (after the expected U.S. tax reform) to make Puerto Rico once again attractive for investment. Both Hong Kong and Singapore prove that a jurisdiction does not need high tax rates to generate sufficient revenue to provide for all the necessary functions and benefits of government.

Finally, the U.S. government should consider refinancing the remaining portion of the government debt — after the private-sector haircuts — and perhaps including a modest transition loan at the current low rates that the U.S. government pays (this should be long-term debt to give the Puerto Rican economy time to right itself). The loans should only be given once the Puerto Rican constitution is amended to provide for balanced budgets and guarantees that the old tax-and-spend ways will be prohibited.

The current Puerto Rican economy will neither support statehood or independence. Once the economy is restored, a rational decision can be made as to which way its citizens wish to go.

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