



PUERTO RICO  
ECONOMIC  
FREEDOM  
INDEX



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CRECIMIENTO Y EXCELENCIA

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# PUERTO RICO ECONOMIC FREEDOM INDEX

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## INTRODUCTION

The Economic Freedom Index is a vital tool to promote growth and prosperity. There is a proven correlation between the level of economic freedom and individual and collective progress. The indexes further show that consistent economic development can only be attained by adopting economic policies that empower the individual and promote free enterprise.

Free market advocates around the globe are measuring the level of economic freedom in different countries. They use this information to promote public and economic policies that contribute to the development of economic freedom as a tool to achieve greater growth and prosperity in the world.

Meanwhile, Puerto Rico has experienced over a decade of almost uninterrupted economic contraction, resulting in the worst economic crisis in its history. Divisiveness of party politics calls for the intervention of non-governmental actors to help define long term economic and fiscal agenda. The Center for Economic Renewal, Growth and Excellence ("CRECE") is committed to advancing public policy based on the principles of economic freedom, personal responsibility and opportunity to spur growth in Puerto Rico. CRECE believes an index of economic freedom is an indispensable tool to provide objective quantitative and qualitative data required for effective, growth-driven decision making and policy development.

The focus of this investigation was to assess and rank Puerto Rico using the parameters established by the 2016 Index of Economic Freedom. The objective was twofold: (1) compile scattered economic data on Puerto Rico to better understand our current financial situation and (2) identify opportunities for improving economic freedoms in Puerto Rico.

Research Stages:

1. Analyze and break down formulas used in the 2016 Index of Economic Freedom
2. Investigate quantitative and qualitative sources used by 2016 Index
3. Replicate existing formulas if quantifiable objective data is available
4. Determine alternative sources and measures for criterias for which replicable data is unavailable
5. Recommend economic freedom ranking for Puerto Rico
6. Identify short term goals for improving the development of quantitative economic measures in PR Index

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## ABOUT THE 2016 INDEX OF ECONOMIC FREEDOM

<http://www.heritage.org/index/about>

The Index of Economic Freedom is an annual collaboration between the Heritage Foundation and the Wall Street Journal. The report ranks countries based on 10 quantitative and qualitative criteria, grouped into 4 key pillars:



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- Rule of Law (property rights, freedom from corruption);
- Limited Government (fiscal freedom, government spending);
- Regulatory Efficiency (business freedom, labor freedom, monetary freedom); and
- Open Markets (trade freedom, investment freedom, financial freedom).

Each criteria is graded on a 0 to 100 scale, in order to derive an overall score by averaging all ten economic freedom factors. The latest publication ranks 186 economies.

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## ABOUT CRECE

**CRECE (for its acronym in Spanish) is the Center for Economic Renewal, Growth and Excellence.** We are a nonpartisan, nonprofit organization dedicated to formulating, disseminating and implementing policies and practices that promote economic freedom, personal responsibility and opportunities in Puerto Rico and Latino communities in the United States to attain their full potential for growth and prosperity.

Growth is at the core of our mission. As a think-tank organization based in Puerto Rico, we are committed to advancing the same principles and policies that have proven time and again to best enable individuals and societies to thrive and prosper throughout the world. We are convinced that to prosper and attain individual and collective growth, Puerto Rico must urgently explore new strategies and policies that will enable the island to overcome the formidable structural and public policy challenges it is currently facing. CRECE seeks to become a key agent in the advancement of the Puerto Rican society as an integral and vibrant component of the increasingly larger Latino community in the United States.

CRECE is a proud member of the [Atlas Network](#), a global network of over 400 free-market organizations in over 80 countries dedicated to advancing the cause of liberty.

For more information about CRECE, visit us at [www.centrocrece.org](http://www.centrocrece.org) or call us at 787.766.1717 x. 6472.



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## ECONOMIC FREEDOM IN PUERTO RICO

### I. RULE OF LAW

Property Rights Score	70 (estimated based on qualitative data)
Freedom from Corruption Score	63 (same quantitative data as 2016 Index)

#### A. PROPERTY RIGHTS

**Description:** "The property rights component is an assessment of the ability of individuals to accumulate private property, secured by clear laws that are fully enforced by the state. It measures the degree to which a country's laws protect private property rights and the degree to which its government enforces those laws. It also assesses the likelihood that private property will be expropriated and analyzes the independence of the judiciary, the existence of corruption within the judiciary, and the ability of individuals and businesses to enforce contracts."

##### Unavailable Index Sources:

- EIU Country Commerce Report - Only covers 56 countries and does not include Puerto Rico. EIU website does provide shorter country profiles free of charge which do not include Puerto Rico. Country Commerce report of US is available for \$590.  
LINKS:  
<http://country.eiu.com/united-states>  
<https://store.eiu.com/Product.aspx?pid=480000248>  
<http://country.eiu.com/puerto-rico>
- Department of Commerce Country Commercial Guides - Profiles on 125 foreign markets. Does not include US or Puerto Rico.  
LINKS:  
<http://www.export.gov/ccg/>
- Department of State HR Practices - Profiles per topic regarding Human Rights in other countries. Does not include US or Puerto Rico.  
LINKS:  
<http://www.state.gov/j/drl/rls/hrrpt/>

##### Alternative Sources:

- Global Property Guide - Site aimed at residential property investors. Describes laws, taxes, transaction costs and other economic factors regarding property investments in 133



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countries/jurisdictions around the world. Data generated by in-house research, accounting firms, law firms, central banks and national statistics. Includes profile on Puerto Rico market.

LINKS:

<http://www.globalpropertyguide.com/Caribbean/Puerto-Rico>

<http://www.globalpropertyguide.com/Caribbean/Puerto-Rico/Inheritance>

<http://www.globalpropertyguide.com/Caribbean/Puerto-Rico/Buying-Guide>

- World Bank Group Doing Business 2016 - Report measures regulatory quality and efficiency. Though not focused on property rights, does include information on the process of registering property in Puerto Rico.

LINKS:

<http://www.doingbusiness.org/reports/global-reports/doing-business-2016>

<http://www.doingbusiness.org/data/exploreeconomies/puerto-rico/registering-property/>

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## OVERVIEW ON PROPERTY RIGHTS IN PUERTO RICO

The 2016 Index looks favorably towards countries that have clear property laws enforced by state that protect private property. It also weighs this against the likelihood that private property will be expropriated, the existence of an independent judiciary, and the enforceability of contracts.

**According to the World Bank Group 2016 Doing Business Report, the process to register a property in Puerto Rico requires a total of 8 procedures and, on average, 192.5 days.**

The main delay can be attributed to the filing and deed review process at the Registry of Property. While this is intended as a procedural and substantive safeguard to ensure the validity of registration and preserve property rights, the workload and lack of digitalization result in significant delays. In an attempt to rectify this situation, regulations adopted under Act 216 of December 27, 2010 instruct the Registrar to either notify notary of defects in filing or accept the registration within 90 days after its filing. This term, however, is not strictly enforced. According to the Doing Business report, the registration of a Registrar-reviewed filing on average takes 180 days.

It is worth noting that the transference of most property rights generally do not require a filing at the Property Registry. It is, however, required in all cases involving a mortgage agreement. The following steps are generally observed in each property transfer:

1. Obtain a title report at the Property Registry - usually done by a public notary within 30 days of transaction. Process requires inspection of recorded and pending documents at the Property Registry in two digital databases and in physical books.
2. Obtain a property tax certificate at Municipal Revenues Collection Center (CRIM)
3. Obtain title commitment for title insurance which, while not required by law, is recommended and oftentimes required by mortgage banks.
4. Notary public prepares and authorizes purchase and sale deed. Process requires payment of notary fees corresponding to purchase price.



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5. Purchase of Internal Revenue stamps and Property Registry filing vouchers, to be cancelled on the original deed. Like with notary fees, cost is based on purchase price of property.
6. Deed is filed at the Registry of Property, who proceeds to review the documents as presented to ensure procedural and substantive validity. Upon completing inspection, Registrar may record the deed or return to notary for correction of defects.
7. Notary public is charged with notifying sale to the Department of Treasury following the transaction.
8. Notary public is charged with notifying change of owner to Municipal Revenues Collection Center (CRIM)

Furthermore, according to the Doing Business report, the property registry lacks both reliability and transparency. The majority of title or deed records are kept in paper format and there is no electronic database for checking encumbrances (liens, mortgages, restrictions, etc). Attempts to digitalize the registry have resulted in two different electronic filings systems, both accessible on site only. Puerto Rico does have electronic databases for recording boundaries and checking cadastral information, but multiple institutions are charged with this process making it highly decentralized (see Center of Recollections for Municipal Income, Puerto Rico Planning Board and Puerto Rico Registry of Property). **According to the Doing Business report, their measurements would rank Puerto Rico at a strikingly low 164 out of 188 economies on the issue of registering property. By comparison, New Zealand, Lithuania and Georgian lead the ranks, with the US coming in at 34. Puerto Rico's standing ranks it right below Algeria.**

Puerto Rico is also encumbered with complicated inheritance laws regarding private property. Real property is regulated by the laws of Puerto Rico regardless of owner's residence. This includes laws regarding forced heirship and additional requirements for validating wills written in other jurisdictions. Additionally, all inheritance procedures and issues regarding real property must be handled by Puerto Rico civil courts and agencies. According to the Global Property Report, inheritance procedures without conflicting interests between heirs may last from twelve to eighteen months.

On the issue of judicial independence and contract enforceability, the Doing Business Report again reiterates the problems faced due to the slow judicial system. In particular, a trial and judgement on a contract matter may last up to 500 days. Similarly, the quality of the judicial processes was criticized, achieving only 7 of a total of 18 possible points. The biggest deductions were due to lack of court automation and slow case management.



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## RECOMMENDED ECONOMIC FREEDOM INDEX SCORE ON PROPERTY RIGHTS

Based on the information available, one can draw the following conclusions on Puerto Rico Property Rights:

<b>Pros:</b>	<ul style="list-style-type: none"><li>• <i>Registered properties are given ample legal protections</i></li><li>• <i>Review by Registrars promotes independent judicial review of filings</i></li></ul>
<b>Cons:</b>	<ul style="list-style-type: none"><li>• <i>Unreliable infrastructure of property index</i></li><li>• <i>Lack of digitalization and automation in processes</i></li><li>• <i>Stringent laws regarding property inheritance</i></li><li>• <i>Slow land dispute resolutions</i></li><li>• <i>Slow contract dispute resolutions</i></li></ul>

Given the broad descriptions provided for scoring by the 2016 Index, Puerto Rico would likely receive a **score of 70**, a ranking comparable to countries like Botswana, Portugal, Qatar and Spain, among others.

The 2016 Index describes such a score as: "Private property is guaranteed by the government. The court system is subject to delays and is lax in enforcing contracts. Corruption is possible but rare, and expropriation is unlikely."

## HOW TO IMPROVE PROPERTY RIGHTS SCORE

The 2016 Doing Business report notes that digitalization is a key component in ensuring the efficiency and transparency of property rights. It notes:

"Over the past 5 years, 37 economies computerized their land registry. The average time required to register a property transfer in these economies fell by 38% - from 47 days to 29 - while global average only decreased from 55 days to 48." (See 2016 Doing Business, pg. 78).

While costly, the immediate benefits of such an initiative include:

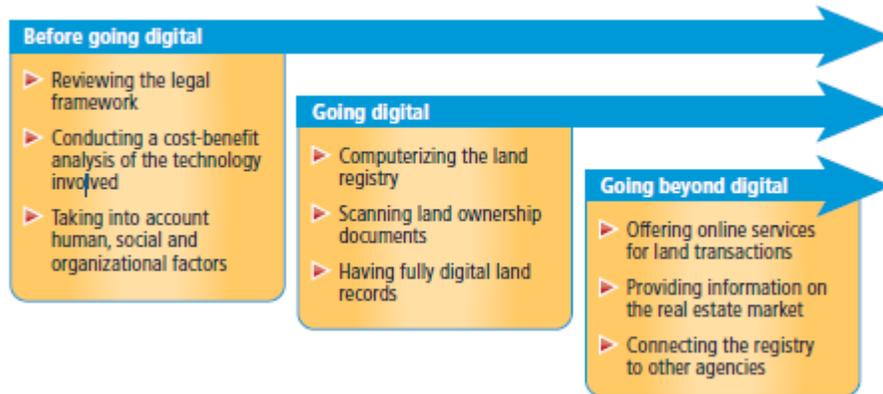
- Reduce duplication
- Consolidate processes into single database
- Improve tracking mechanisms
- Higher efficiency and quality control
- Greater transparency
- Improved data accuracy

This multi-step process progressively moves towards greater efficiency and transparency.



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FIGURE 8.2 What are the stages in projects for digitizing land records?



2016 Doing Business, pg. 80

## B. FREEDOM FROM CORRUPTION

**Description:** "Corruption erodes economic freedom by introducing insecurity and uncertainty into economic relationships...The higher the level of corruption, the lower the level of overall economic freedom and the lower a country's score."

### Available Index Sources:

- Transparency International's Corruption Perceptions Index (CPI) - Unless unavailable for a particular jurisdiction, the 2016 Index relies exclusively on this report to measure Freedom from Corruption. The report ranks perceived corruption levels in 175 countries. These raw scores given by the CPI are converted into Index values by multiplying by 10.

LINK:

<http://www.transparency.org/cpi2014/results>

### Alternative Sources:

- Global Competitiveness Report - Published yearly by the World Economic Forum examining the competitive performance of over 140 economies on 12 pillars. On the issue of Corruption, it considers the transparency of policymaking, reliability of police services, public trust in politicians, judicial independence, among others. It is worth noting, however, that due to lack of information, Puerto Rico was not included in the most recent Competitiveness Report (2015-2016).

LINK:

[www.weforum.org](http://www.weforum.org)



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- Worldwide Governance Indicators - Published by the World Bank, the WGI project reports on governance indicators for 215 economies. On the issue of corruption, it considers corruption control methods in each state.

LINKS:

[www.worldbank.org](http://www.worldbank.org)

<http://info.worldbank.org/governance/wgi/index.aspx#home>

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## OVERVIEW ON FREEDOM FROM CORRUPTION IN PUERTO RICO

The annual Corruption Perception Index gives Puerto Rico a score of 63 on a scale where 0 equals the highest level of perceived corruption and 100 equals the lowest level of perceived corruption. It does not grant country specific profiles on what data was used to draw said statistic.

The Global Competitiveness Index tries to shed light on the status of corruption in Puerto Rico by breaking down said issue into multiple criteria. **Puerto Rico excels in the strength of auditing and reporting standards, ranking 9 out of 144 jurisdictions. Similarly, the legal framework is touted for its efficiency (ranking 19 out of 144).**

**However, Puerto Rico is burdened by irregular payments and bribes (ranking 44 out of 144) and lack of transparency in government policymaking (ranking 66 out of 144). Perhaps most alarming of all, Puerto Rico has a consistent problem of favoritism in decisions of government officials (ranking 83 out of 144).**

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## RECOMMENDED ECONOMIC FREEDOM INDEX SCORE ON FREEDOM FROM CORRUPTION

On this factor, Puerto Rico can avail itself with the exact measures used by the 2016 Index given its inclusion in the annual CPI report. Consequently, it would earn a Freedom of Corruption **score of 63**, a ranking comparable to countries like Botswana, Cyprus, and Portugal, among others.

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## HOW TO IMPROVE FREEDOM FROM CORRUPTION SCORE

From the available research, the biggest factors weighing in against Puerto Rico on corruption regard favoritism in governmental decision and lack of transparency in policymaking.

Puerto Rico can learn from the best practices of high ranking countries in the Freedom from Corruption Score. New Zealand, for instance, has undertaken extensive efforts to penalize bribery and ensure a transparent, competitive and corruption-free government procurement system. As a result, it is tied for first place in the Corruptions Perception Index.



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## II. LIMITED GOVERNMENT

Fiscal Freedom Score	61 (used 2 out of 3 criterions from 2016 Index)
Government Expenditure Score	77 (same quantitative data as 2016 Index)

### A. FISCAL FREEDOM

**Description:** "Fiscal freedom is a measure of the tax burden imposed by government. It includes both the direct tax burden in terms of the top tax rates on individual and corporate incomes and the overall amount of tax revenue as a percentage of GDP."

#### Unavailable Index Sources:

- International Tax & Business Guide - Updated and published online by Deloitte. Does not include Puerto Rico and US report does not include territories.  
LINK:  
<https://dits.deloitte.com/#TaxGuides>
- IMF Reports - Do not consider Puerto Rico as a separate jurisdiction or economy to the US. Mentions regarding current credit and fiscal crisis are available, but not reference to tax rates.  
LINK:  
<http://www.imf.org/external/index.htm>

#### Available Index Sources:

- Worldwide Tax Summaries - Published only by PWC, including general information factsheets per country regarding taxation.  
LINK:  
<http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Puerto-Rico-Overview>
- EIU Country Profiles - Published by the Economist. Includes short factsheets per country on politics and economy.  
LINK:  
<http://country.eiu.com/puerto-rico>



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## Alternative Sources:

- The Tax Foundation - Independent tax policy research organization which publishes data on tax rates national and internationally. Includes research regarding Puerto Rico individual and income tax rates.

LINK:

<http://taxfoundation.org/article/corporate-income-tax-rates-around-world-2015>

- CIA World Factbook - Governmental publication lists taxes and other revenues as percentage of GDP for multiple countries and jurisdictions. Includes data for Puerto Rico.

LINK:

<https://www.cia.gov/library/publications/the-world-factbook/fields/2221.html>

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## OVERVIEW ON FISCAL FREEDOM IN PUERTO RICO

Tax brackets for 2015 range between \$9,000 and \$61,500. The level of income subject to gradual adjustment is \$500,000. Under the 2011 Tax Internal Revenue Code, Puerto Rico has a top marginal tax rate of 33% and a top marginal tax rate on corporate income of 39%. Recent changes to the tax code following Act 77 of July 1, 2014 have allowed for amendments allowing for alternative basic tax (ABT) brackets include:

- ABT income from USD 150,000 to USD 200,000: 10%
- ABT income from USD 200,000 to USD 300,000: 15%
- ABT income in excess of USD 300,000: 24%

**According to the Tax Foundation, Puerto Rico has the third highest general top marginal corporate income tax rate in the world, equal to the US and exceeded only by Chad and the United Arab Emirates.** By comparison, the average top corporate income tax rate is 22.9%, with every region in the world seeing a decline in the average tax rate in the past twelve years.

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## RECOMMENDED ECONOMIC FREEDOM INDEX SCORE ON FISCAL FREEDOM

The Index relies on 3 main data points for their calculations. For Puerto Rico, these are:

- Top marginal tax rate on individual income - 33%
- Top marginal tax rate on corporate income - 39%
- Total tax burden as percentage of GDP - UNAVAILABLE

To translate these numbers into a Fiscal Freedom Score, "each of these numerical variables is weighted equally as one-third of the component... Fiscal freedom scores are calculated with a quadratic cost



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function to reflect the diminishing revenue returns from very high rates of taxation. The data for each factor are converted to a 100-point scale using the following equation:

$$\text{Fiscal Freedom}_{ij} = 100 - \alpha(\text{Factor}_{ij})^2$$

where  $\text{Fiscal Freedom}_{ij}$  represents the fiscal freedom in country  $i$  for factor  $j$ ;  $\text{Factor}_{ij}$  represents the value (based on a scale of 0 to 100) in country  $i$  for factor  $j$ ; and  $\alpha$  is a coefficient set equal to 0.03."

Only two of these numbers are readily available for Puerto Rico. For this, we have opted to average out the results of these two points for the final score. Consequently, Puerto Rico would earn a **score of 61**, a ranking comparable to countries like Luxembourg, the Solomon Islands and Portugal, among others.

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## HOW TO IMPROVE FISCAL FREEDOM

While income tax rate is but one aspect of what makes a country attractive for investment, current tax rates in Puerto Rico place the island at a disadvantage compared to other jurisdictions with greater fiscal freedom.

Top ranking countries in the 2016 Index demonstrate dramatically reduced individual tax rates. Qatar employs a flat 10% tax for all corporations (except for oil and gas sectors).

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## B. GOVERNMENT SPENDING

**Description:** "This component considers the level of government expenditures as a percentage of GDP. Government expenditures, including consumption and transfers, account for the entire score."

### Unavailable Index Sources:

- Economic Commission for Latin America - Publishes yearly Economic Survey of Latin America and the Caribbean however it does include Puerto Rico.

LINK:

[http://repositorio.cepal.org/bitstream/handle/11362/38715/S1500732\\_en.pdf?sequence=111](http://repositorio.cepal.org/bitstream/handle/11362/38715/S1500732_en.pdf?sequence=111)

- Inter-American Development Bank - Publishes yearly Macroeconomic Report on Latin America and the Caribbean however it does not include Puerto Rico.

LINK:

<http://www.cepal.org/en/publications/macroeconomic-report-latin-america-and-caribbean-june-2012>



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- Organisation for Economic Co-Operation and Development Data - Includes a wide array of country statistical profiles however does not include Puerto Rico. Does include limited data primarily on PR trade, immigration, patents, and maritime costs.  
LINKS:  
<http://stats.oecd.org/>  
<https://data.oecd.org/>

## Alternative Sources:

- EIU Country Profiles - Published by the Economist. Includes short factsheets per country on politics and economy.  
LINK:  
<http://country.eiu.com/puerto-rico>
- CIA World Factbook - Governmental publication lists taxes and other revenues as percentage of GDP for multiple countries and jurisdictions. Includes data for Puerto Rico.  
LINKS:  
<https://www.cia.gov/library/publications/the-world-factbook/fields/2221.html>  
<https://www.cia.gov/library/publications/resources/the-world-factbook/geos/rq.html>
- World Bank - Publishes online databank with economic and social data from multiple countries. Includes profiles on Puerto Rico as well as comparables with other countries, however data is only available through 2013.  
LINKS:  
<http://data.worldbank.org/indicator/GC.XPN.TOTL.GD.ZS>  
<http://databank.worldbank.org/data/reports.aspx?source=2&country=PRI&series=&period=>  
[http://www.theglobaleconomy.com/Puerto-Rico/Government\\_size/](http://www.theglobaleconomy.com/Puerto-Rico/Government_size/)
- Government Development Bank of Puerto Rico - Publishes economic data and annual economic fact sheet on government compiled statistics.  
LINKS:  
<http://www.bgfpr.com/economy/documents/PREconomicFactSheet-Dec2014.pdf>  
<http://www.bgfpr.com/economy/latest-information-monthly-indicators.html>
- Statistics Institute of Puerto Rico - Publishes and compiles governmental economic and social statistics.  
LINK:  
<http://www.estadisticas.gobierno.pr/iepr/>



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## OVERVIEW ON GOVERNMENT SPENDING IN PUERTO RICO

Puerto Rico began a period of economic downturn in 2006, coinciding with the phase-out of manufacturing tax preferences and the rise of gas/electricity costs. The situation was aggravated by staggering public debt, a result of high public expenditures, large government, consistently overestimated revenue projections, sales tax evasion and outmigration of the working class.

**According to the CIA Factbook, "Public debt rose to nearly 94% of GDP in 2014, the equivalent of \$15,600 per person, or nearly three times the per capita debt of the State of Connecticut, the highest in the US."**

As a result, Governor Alejandro Garcia Padilla recently announced that the Island could not pay back the multi-billion dollar debt and would seek to negotiate with its creditors.

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## RECOMMENDED ECONOMIC FREEDOM INDEX SCORE ON GOVERNMENT SPENDING

The Index uses the level of government expenditures as percentage of GDP as the baseline for this score. To translate this number into a government spending score, the following equation was used:

$$GE_i = 100 - \alpha(\text{Expenditures}_i)^2$$

"where  $GE_i$  represents the government expenditure score in country  $i$ ;  $\text{Expenditures}_i$  represents the total amount of government spending at all levels as a portion of GDP (between 0 and 100); and  $\alpha$  is a coefficient to control for variation among scores (set at 0.03)."

**According to the self-reported statistics of the Government Development Bank of Puerto Rico, 2013 saw a GDP of \$103.1 billion and consolidated government expenditures of \$28.6 billion. This means that governmental expenditures, as reported, constituted 27.7% of the GDP as of 2013. More recent data is not available through the government website.**

Using this information, Puerto Rico would earn a Government Expenditure **score of 77**, a ranking comparable to countries like Ghana, Panama, and Rwanda, among others.

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## HOW TO IMPROVE GOVERNMENT EXPENDITURES SCORE

The situation in Puerto Rico regarding Government Expenditures faces challenges on two fronts: high government spending and decreasing annual growth rate.

**On the first of these, the CIA Factbook notes that "the gap between revenues and expenditures narrowed to 0.2% of GDP in 2014, although analysts believe that not all expenditures have been accounted for in the budget and a better accounting of costs would yield an overall deficit of roughly 5% of GDP in 2014."**



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On the second issue, the Statistical Institute of Puerto Rico noted an annual growth rate of  $-.02$  for 2013 and an alarming  $-0.9$  for 2014 (statistics published via [tradingeconomics.com](http://tradingeconomics.com)).

The combination of these two factors results in an unfavorable ranking for Puerto Rico.



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## III. REGULATORY EFFICIENCY

<b>Business Freedom Score</b>	<b>63</b> (same quantitative data as 2016 Index)
<b>Labor Freedom Score</b>	<b>79</b> (same quantitative data as 2016 Index)
<b>Monetary Freedom Score</b>	<b>77</b> (same score as United States)

### A. BUSINESS FREEDOM

**Description:** "Business freedom is a quantitative measure of the ability to start, operate, and close a business that represents the overall burden of regulation as well as the efficiency of government in the regulatory process."

#### Available Index Sources:

- World Bank Group Doing Business 2016 - Report measures regulatory quality and efficiency.  
LINK:  
<http://www.doingbusiness.org/reports/global-reports/doing-business-2016>

#### Alternative Index Sources:

- Global Competitiveness Report - Published yearly by the World Economic Forum examining the competitive performance of over 140 economies on 12 pillars. It is worth noting, however, that due to lack of information, Puerto Rico was not included in the most recent Competitiveness Report (2015-2016).  
LINK:  
[www.weforum.org](http://www.weforum.org)
- World Bank Group's Enterprise Surveys - Comprehensive survey study of company-level data in 135 economies. While it does not include Puerto Rico, it does mention observable trends among countries.  
LINK:  
[www.enterprisesurveys.org](http://www.enterprisesurveys.org)



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## OVERVIEW ON BUSINESS FREEDOM IN PUERTO RICO

The 2016 Index has identified 10 key factors to monitor the levels of business freedom in an economy. These are meant to reflect the ease of starting and running a business, vis-a-vis the burden of regulation in that jurisdiction. All 10 criterion are included in the World Bank's *Doing Business Report*.

For Puerto Rico, the results are as follows:

Criteria	Puerto Rico	International Average
Starting a business (# of procedures)	6 procedures	7.14 procedures
Starting a business (# of days)	6 days	21.09 days
Cost of starting a business (% of income per capita)	1.3%	24.48%
Starting a business minimum capital (% of income per capita)	0%	17.42%
Obtaining a construction permit (# of procedures)	20	14.58
Obtaining a construction permit (# of days)	165	166.02
Cost of obtaining a construction permit (% of income per capita)	6.2%	4.36%
Close a business time (years)	2.5 years	2.55 years
Cost of closing a business (% of estate)	11%	15.84%
Recovery rate for closing a business (cents on the dollar)	70.5	37.03

Overall, Puerto Rico ranks above average on limited number of procedures to start and end a business. However, the delays related to construction permits significantly affect its overall business freedom.

**This is reflected in the annual *Global Competitiveness Report*, which as of 2014 noted that the most problematic factor for doing business was inefficient government bureaucracy.**



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## RECOMMENDED ECONOMIC FREEDOM INDEX SCORE FOR BUSINESS FREEDOM

Given the inclusion of Puerto Rico in the annual *Doing Business Report*, we can avail ourselves of the same criterion as the 2016 Index to score Business Freedom.

Each factor from the *Doing Business report* "is converted to a scale of 0 to 100 using the following equation:

$$\text{Factor Score}_i = 50 \frac{\text{factor}_i}{\text{average}_i}$$

which is based on the ratio of the country data for each factor relative to the world average, multiplied by 50."

Given these numbers and the corresponding worldwide average, Puerto Rico would receive a Business Freedom **score of 63**, a ranking comparable to countries like Kuwait, Belize, and Iraq among others.

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## HOW TO IMPROVE BUSINESS FREEDOM SCORE

**Puerto Rico's Business Freedom score is most significantly affected by the encumbered, slow construction permit process. When assessing the overall efficiency of permit process, the *Doing Business report* ranked Puerto Rico at 135 out of 189. The alarmingly low score corresponds to above average number of procedures, time and costs associated with obtaining a permit.**

Not only does the complicated and long process affect business, it also lends itself to a worrying lack of transparency. The *Doing Business report* explains: "beyond causing confusion about how to proceed, construction regulations that are unclear or overly complicated can also increase opportunities for corruption" (pg. 63). The report also notes that this tendency was also observed as part of the World Bank Enterprise Survey - a research study focusing on companies in 135 countries. It found that the likelihood of a construction firm giving gifts in exchange for construction approvals is correlated with the level of complexity and costs of dealing with construction permits.

For Puerto Rico to improve its Business Freedom score, it must address the slow permit process without compromising on quality controls. Improved digitization of permit submissions and more transparent methods for following up on petitions could result in significant improvements.

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## B. LABOR FREEDOM

**Description:** "The labor freedom component is a quantitative measure that looks into various aspects of the legal and regulatory framework of a country's labor market. It provides cross-country data on regulations concerning minimum wages; laws inhibiting layoffs; severance requirements; and measurable regulatory burdens on hiring, hours, and so on."



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## Available Index Sources:

- World Bank Group Doing Business - Report measures regulatory quality and efficiency. NOTE: Data used by 2016 Index required utilizing information from 2016 & 2010 Doing Business reports.

LINKS:

<http://www.doingbusiness.org/reports/global-reports/doing-business-2016>

<http://www.doingbusiness.org/reports/global-reports/doing-business-2010/>

<http://www.doingbusiness.org/methodology/labor-market-regulation>

## Alternative Sources:

- Heritage Institute Issue Brief - 2015 Publication titled Puerto Rico Needs Economic Freedom, Not Bailouts

LINK:

<http://www.heritage.org/research/reports/2015/07/puerto-rico-needs-economic-freedom-not-bailouts>

- Puerto Rico Fiscal and Economic Growth Plan - 2015 recommendations prepared by the Working Group for the Fiscal and Economic Recovery of Puerto Rico, pursuant to executive order 2015-022

LINK:

<http://www.bgfpr.com/documents/PuertoRicoFiscalandEconomicGrowthPlan9.9.15.pdf>

- Puerto Rico's Economy: A brief history of reforms from the 1980s to today and policy recommendations for the future - 2015 Publication by The National Puerto Rican Chamber of Commerce

LINK:

<http://nprchamber.org/files/3-19-15-Puerto-Rico-Economic-Report.pdf>

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## OVERVIEW ON LABOR FREEDOM IN PUERTO RICO

**Puerto Rico shows significant assets in its labor market, with a ratio of 0.51 of minimum wage to the average value added per worker.** There are also incentives for employing workers under age 25, which facilitates hiring of new talent. Puerto Rico also enjoys important worker protections and job quality measures including some obligatory annual leave, paid maternity leave, and providing for women to work same hours as men.

Additionally, Puerto Rico allows for some flexibility in firings due to redundancies, particularly as no third party interference is required in the dismissal process. It does, however, have some issues given its priority rules for redundancies and reemployment.



# PUERTO RICO ECONOMIC FREEDOM INDEX

It is worth noting, however, that the criteria contemplated by the Index focuses primarily on laws applicable to the private sector. The Heritage Foundation points out that "public employees in Puerto Rico receive twice as much vacation time as mainland public employees". Furthermore, it notes that "layoffs are onerous" on businesses.

## RECOMMENDED ECONOMIC FREEDOM INDEX SCORE FOR LABOR FREEDOM

The 2016 Index has identified 6 key factors to monitor the levels of labor freedom in an economy. These are meant to assess the effectiveness and efficiency of the regulatory framework of a country's labor market. All 6 criterion are included in past editions of the World Bank's *Doing Business report*.

It is worth noting, however, that some of these factors have not been compiled since the 2010 edition of the *Doing Business Report*, for which not all numbers are fully up to date.

CRITERIA	PUERTO RICO	INTERNATIONAL AVERAGE
RATIO OF MINIMUM WAGE TO AVERAGE VALUE ADDED PER WORKER	0.51	0.36
LEGALLY MANDATED NOTICE PERIOD FOR REDUNDANCY DISMISSAL (WEEKS OF SALARY)	0	5.3 weeks
MANDATORY SEVERANCE PAY FOR REDUNDANCY DISMISSAL (WEEKS OF SALARY)	0	12.18
DIFFICULTY OF HIRING INDEX (SCALE FROM 0-100) *2010 STATISTIC	22	29.88
RIGIDITY OF HOURS INDEX (SCALE FROM 0-100) *2010 STATISTIC	0	23.75
DIFFICULTY OF REDUNDANCY DISMISSAL (SCALE FROM 0-100) *2010 STATISTIC	20	29.10

Using these numbers, "each of the six factors is converted to a scale of 0 to 100 based on the following equation:

$$\text{Factor Score}_i = 50 \times \text{factoraverage} / \text{factor}_i$$



# PUERTO RICO ECONOMIC FREEDOM INDEX

where country *i* data are calculated relative to the world average and then multiplied by 50. The six factor scores are then averaged for each country, yielding a labor freedom score.”

Given these numbers and the corresponding worldwide average, Puerto Rico would receive a solid Business Freedom score of **79**, a ranking comparable to countries like Bahrain and Micronesia, among others.

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## HOW TO IMPROVE LABOR FREEDOM SCORE

Puerto Rico enjoys a remarkably high labor freedom score, particularly with regards to its strong workforce, good job quality protections, and flexible hiring/dismissal processes. However, the Index itself does not contemplate the situation in public service, which would significantly affect its overall score if included. Furthermore, the report does not consider labor participation rates or outmigration tendencies in its scoring.

The Puerto Rican Chamber of Commerce recently published an economic report which discussed the current economic situation, including the labor market. Among other recommendations, it noted that Puerto Rico should:

- “Shift long-term and current taxes and other incentives to focus on investment that directly encourages the hiring of Puerto Rican citizens;...
- Ensure that policies emphasize growth in labor intensive versus capital intensive industries;... and
- Adjust public assistance programs to ensure that reservation wages do not depress job creation and labor participation.” (pg 3-4)

These recommendations are echoed by the Puerto Rico Fiscal and Economic Growth Plan, a report prepared by field experts pursuant a gubernatorial executive order. It further suggests changes to promote labor freedom from a structural and practical standpoint, including enacting legislation to:

- “Establish a uniform work day and enable employers to provide flexible work week schedule;...
- Provide option for overtime to be calculated based on hours worked in excess of 40 hours per weeks, not in excess of 8 hours per day;...
- Ease December bonus payment waiver process;...
- Reform mandatory severance and allow performance-based retention; and...
- Limit mandatory severance pay at six months; exclude non-cash benefits from severance calculations.”

These proposals would further labor freedom in the Island while addressing some of the key labor market issues not contemplated in the Index.



# PUERTO RICO ECONOMIC FREEDOM INDEX

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## C. MONETARY FREEDOM

**Description:** "Monetary freedom combines a measure of price stability with an assessment of price controls. Both inflation and price controls distort market activity. Price stability without microeconomic intervention is the ideal state for the free market."

### Alternative Sources:

- Sound Money Project - A blog run as an initiative of the Atlas Network, dedicated to presenting scholarly articles on economic freedoms.

LINK

<http://soundmoneyproject.org/2015/07/a-comparison-of-monetary-freedom-in-the-u-s-and-australia/>

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## OVERVIEW ON MONETARY FREEDOM OF PUERTO RICO

With few exceptions, monetary freedom in Puerto Rico is directly linked to the situation in the United States. The federal government regulates inflation rates and affects price controls by subsidizing industries. While the effects are felt differently in Puerto Rico vis a vis other states given the differences in federal funding and resources, the local government plays a limited role on this issue.

The United States currently holds a score of 77 on the Monetary Freedom Scale. The Sound Money Project, an Atlas Institute Initiative, notes that the US said score has meant that the US has dramatically dropped in ranking from 6th to 88th in 6 years. They add that this has occurred primarily as "the Federal Reserve has exercised increasingly unrestrained discretionary authority."

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## RECOMMENDED ECONOMIC FREEDOM INDEX SCORE FOR MONETARY FREEDOM

Given the limited reach of local government in this area, Puerto Rico would earn a similar if not identical score to the United States on this item. For these reasons, we recommend a **score of 77**, a ranking similar to countries like Azerbaijan, Mexico, Fiji, and Costa Rica, among others.

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## HOW TO IMPROVE MONETARY FREEDOM SCORE

Puerto Rico can advocate for changes at a federal level to improve the monetary freedom score in the Island and in the United States. Best practices can be derived from high scoring countries on this topic:

- Dominica improved its performance by undergoing a comprehensive effort to restructure the economy that included the elimination of price controls.



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- Denmark has a well-established history of maintaining monetary stability, limiting subsidies and controls to rent and medications.
- New Zealand removed all farm subsidies two decades ago, which in turn spurred the development of a diversified agricultural sector.
- Chile's government price supports for agriculture are less than 5% of total farm receipts, one of the lowest among OECD countries.



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## IV. OPEN MARKETS

Trade Freedom Score	80 (used U.S. score and added estimated penalty)
Investment Freedom Score	70 (same score as United States)
Financial Freedom Score	70 (same score as United States)

### A. TRADE FREEDOM

**Description:** "Trade freedom is a composite measure of the absence of tariff and non-tariff barriers that affect import and exports of goods and services. The score is based on two inputs: trade-weighted average tariff rates and non-tariff barriers."

**Available Index Sources:**

- 2012 World Development Indicators - World Bank Publication that compiles relevant, high-quality comparable statistics on economy and quality of life. Provides weighted tariff average. Publication includes Puerto Rico on most statistics.

LINK:

<http://data.worldbank.org/sites/default/files/wdi-2012-ebook.pdf>

**Alternative Sources:**

- Duty Calculator Country Guide - Published online by Global Trade Solutions, guide presents country profiles on import duty and taxes.

LINK:

<http://www.dutycalculator.com/country-guides/Import-duty-taxes-when-importing-into-Puerto-Rico/>

- The Declining Economic Freedom of the United States - Article by economist and professor James Gwartney, published on the Inside Alerts website.

LINK:

<http://www.insidesources.com/the-declining-economic-freedom-of-the-united-states/>

- 2013 Enabling Trade Report - Published by World Economic Forum, report discussed trade challenges and opportunities worldwide, including Jones Act.

LINK:

[http://www3.weforum.org/docs/WEF\\_SCT\\_EnablingTrade\\_Report\\_2013.pdf](http://www3.weforum.org/docs/WEF_SCT_EnablingTrade_Report_2013.pdf)



# PUERTO RICO ECONOMIC FREEDOM INDEX

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## OVERVIEW ON TRADE FREEDOM OF PUERTO RICO

Given Puerto Rico's unique relationship with the United States, it is considered part of its customs territory and subject to all its Free Trade Agreements. As a result, the trade freedom score for Puerto Rico is intrinsically tied to that of the United States as a whole.

The United States currently holds a score of 87 on the Trade Freedom Scale, with an average tariff rate of 1.5%. Economist James Gwartney notes that the decline of the United States' overall index score is significantly affected by the "restrictive regulatory trade barriers" and "higher non-tariff barriers."

**Puerto Rico's trade freedom is also affected by the high sales and use tax (commonly known as IVU) which is charged at a rate of 11.5%, payable regardless of import value.** Furthermore, like other noncontiguous parts of the United States, Puerto Rico is subject to the Jones Act cabotage rules, which prevent any ships sailing under a foreign flag to carry cargo from the mainland ports. According to the World Economic Forum (WEF), the Jones Act "is the most restrictive of global cabotage law and an anomaly in an otherwise open market like the United States." The detrimental effects of this law were validated by the US International Trade Commission, which according to the WEF found that "repealing the Jones Act would have an annual positive welfare effect of US \$656 million on the economy."

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## RECOMMENDED ECONOMIC FREEDOM INDEX SCORE FOR TRADE FREEDOM

Given the limited reach of local government in this area, Puerto Rico would earn a similar if not identical score to the United States on this item. For these reasons, we recommend a **score of 80**, rounding down from the United States score of 87. The ranking is similar to Timor-Leste and Turkmenistan, among others.

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## HOW TO IMPROVE TRADE FREEDOM SCORE

Puerto Rico can advocate for changes at a federal level to improve the trade freedom score, particularly with regards to the overturning of the cabotage laws included in the Jones Act. Efforts on this issue have been undertaken by the multiple administrations in conjunction to other affected areas like Alaska, Hawaii, Guam and the United States Virgin Islands. Similarly, it can take steps to decrease the tax burden on trade.



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## B. INVESTMENT FREEDOM

**Description:** "Investment Freedom measures the constraints on the flow of investment capital in a country. An ideal country would allow individuals and firms to move their resources into and out of specific activities without restrictions."

### Available Index Sources:

- 2015 National Trade Estimate Report on Foreign Trade Barriers - Country profiles provided by the Office of the United States Trade Representative. Report does not include Puerto Rico.  
LINK:  
<https://ustr.gov/about-us/policy-offices/press-office/reports-and-publications/2015/2015-national-trade-estimate>

### Alternative Sources:

- Lex Mundi Guide to Doing Business Series - Country profiles on general information on legal and business infrastructures around the world. 2012 Puerto Rico profile was prepared by McConnell Valdes LLC, a Lex Mundi member firm.  
LINK:  
[http://www.lexmundi.com/lexmundi/Guides\\_To\\_Doing\\_Business.asp](http://www.lexmundi.com/lexmundi/Guides_To_Doing_Business.asp)
- A Guide to Doing Business in Puerto Rico - Official government guide developed by the Department of Economic Development and Commerce  
LINK:  
<http://www.bgfpr.com/documents/AGuidetoDoingBusinessinPR-II.pdf>
- UHY Doing Business Report - 2015 publication generated by UHY del Valle & Nieves, an accountancy, business management and consultancy services organization.  
LINK:  
<http://www.uhy.com/wp-content/uploads/Doing-Business-in-Puerto-Rico.pdf>

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## OVERVIEW ON INVESTMENT FREEDOM OF PUERTO RICO

Like all international commercial activities, foreign investment in Puerto Rico is subject to most United States laws and regulations. These include restrictions on foreign investments regarding mergers, acquisitions, and takeovers, among others. There are also federally mandated reporting requirements under the Department of Commerce for foreign direct investments.



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At a local level, current economic conditions in Puerto Rico lend themselves to financial insecurity. Furthermore, all foreign investments are subject to Island's high taxation rate, which affects investment freedom. On the other hand, the local government offers a wide variety of strong industry specific economic incentives including:

- Agricultural Incentive Act (1995)
- Economic Incentives for the Development of Puerto Rico Act (2008)
- Tourism Development Act (2010)
- Foreign Trade Zones Incentives
- Green Energy Incentives Act (2010)
- International Insurer and Reinsurer Act (2011)
- Cruise Industry Incentive Act (2011)
- Export Services Act (2012) - More commonly known as Act 20
- Act to Incentivise the Transfer of Individual Investors to Puerto Rico (2012) - More commonly known as Act 22
- International Financial Entities Act (2012)

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## RECOMMENDED ECONOMIC FREEDOM INDEX SCORE FOR INVESTMENT FREEDOM

The Index deducts points for the implementation of restrictions, considering areas like treatment of foreign investments, foreign investment code, restrictions on land-ownership, sectoral investment restrictions, expropriation of investments without fair compensation, foreign exchange controls, and capital controls. Additional points are deducted for security concerns or lack of investment infrastructure.

Given the limited reach of local government in this area, Puerto Rico would earn a similar if not identical score to the United States on this item. While Puerto Rico currently faces a period of significant financial insecurity - a penalty under the 2016 Index scoring guide - it also benefits from aggressive incentive programs aimed at facilitating foreign investment with preferential treatment over national investment. For these reasons, we recommend a **score of 70**, an identical score as the United States as a whole. The ranking is similar to Bahrain, Cabo Verde, Costa Rica, France, Iceland, Japan, Jordan and Mexico, among others.

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## HOW TO IMPROVE INVESTMENT FREEDOM SCORE

Puerto Rico can advocate for changes at a federal level to improve the investment freedom score, particularly streamlining the bureaucratic requirements on foreign investment. At a local level, taking



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affirmative steps to reassure investors on economic security while bolstering foreign investment program can result in an improved score.

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## C. FINANCIAL FREEDOM

**Description:** “Financial freedom is a measure of banking efficiency as well as a measure of independence from government control and interference in the financial sector. An ideal banking and financing environment has limited level of government interference and independent central bank supervision and regulation of financial institutions limited to enforcing contractual obligations and preventing fraud.”

### Alternative Sources:

- Federal Deposit Insurance Corporation - Federal US government corporation charged with maintaining stability and confidence in banks. Relevant publications include FDIC Community Banking Study and Important Banking Laws compendium.

LINKS:

<https://www.fdic.gov/regulations/laws/important/>

<https://www.fdic.gov/regulations/resources/cbi/report/cbi-full.pdf>

- Dodd-Frank Wall Street Reform and Consumer Protection Act - Legislation aimed at promoting financial stability following the economic crisis in the US and the resulting banking industry bailouts.

LINK:

[http://thomas.loc.gov/cgi-](http://thomas.loc.gov/cgi-bin/bdquery/z?d111:HR04173:@@L&summ2=m&#major%20actions)

[bin/bdquery/z?d111:HR04173:@@L&summ2=m&#major%20actions](http://thomas.loc.gov/cgi-bin/bdquery/z?d111:HR04173:@@L&summ2=m&#major%20actions)

- Financial Stability Oversight Council - Federal US Government organization charged with identifying excessive risks in financial system and respond to emerging threats. Has the authority to set aside regulations published by Consumer Financial Protection Bureau.

LINK:

<https://www.treasury.gov/initiatives/Documents/FSOCbylaws.pdf>

- Comisionado de Instituciones Financieras de Puerto Rico - Spanish website for the Office of the Commissioner of Financial Institutions. Includes news alerts on new regulations, links to relevant legal resources as well as general information articles on the banking industry.

LINK:

<http://www.ocif.gobierno.pr/index.htm>



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## OVERVIEW ON FINANCIAL FREEDOM OF PUERTO RICO

Puerto Rico is subject to the United States federal regulatory framework regarding the banking and financial industry. As a result, it is subject to the emerging regulations under the Dodd-Frank 2010 financial reforms, which according to the 2016 Index, have increased both costs and uncertainty in the financial sector. The act established a Financial Stability Oversight Council, tasked with identifying and halting emerging threats due to excessive risks. It also established a Consumer Financial Protection Bureau which monitors compliance as well as regulates to prevent unjust practices. At a local level, these matters are handled under the Office of the Commissioner of Financial Institutions.

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## RECOMMENDED ECONOMIC FREEDOM INDEX SCORE FOR FINANCIAL FREEDOM

The Index score financial freedom by looking at five broad areas: (1) extent of government regulation of financial services, (2) degree of state intervention in banks and other financial firms through direct or indirect ownership, (3) extent of financial and capital market development, (4) government influence on the allocation of credit, and (5) openness to foreign competition.

Given the limited reach of local government in this area, Puerto Rico would earn a similar score to the United States on this item. For these reasons, we recommend a **score of 70**, the same score as the United States as a whole.

The Index describes a **score of 70** as that of **limited government interference** where credit allocation is influenced by the government, and private allocation of credit faces almost no restrictions; government ownership of financial institutions is sizeable; and foreign financial institutions are subject to few restrictions. The ranking is similar to Albania, Botswana, Chile, Colombia, France, Germany Israel, and Spain, among others.

**It is worth noting, however, that Puerto Rico is currently facing the burden of increasing financial insecurity, detracting from the capacity of many institutions to operate normally.** This insecurity has reached such an extent that the Commissioner has been forced to address local newspapers to calm rising concerns on how the governmental situation should not affect liquidity in financial institution (see El Nuevo Dia July 31, 2015 article "Instan a la Calma"). While this factor is not considered in the scoring criteria, it certainly has a negative effect on financial freedom as aspired to by the Index.



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## HOW TO IMPROVE FINANCIAL FREEDOM SCORE

Puerto Rico can advocate for changes at a federal level to improve the financial freedom score, particularly with regards to ensuring more streamlined regulations following the Dodd-Frank Act. Best practices can be derived from high scoring countries on this topic:

- Australia, the top ranked country on financial freedom, implemented aggressive banking reforms in 2010 aimed at fostering greater transparency and competition.
- In New Zealand, the financial system has remained stable as prudent regulations allowed banks to withstand the global financial turmoil with little disruption.
- Sweden's financial sector has regained much of its stability, in part due to sensible regulations and prudent lending practices.



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