CRECE
CENTRO PARA RENOVACIÓN ECONÓMICA, CRECIMIENTO Y EXCELENCIA

ROAD TO PROSPERITY NEWSLETTER

Vol. 1, No. 5

The Center for Economic Renewal, Growth, and Excellence (CRECE, for its Spanish acronym) and Intelligent Economics have partnered to bring you ***The Road to Prosperity Newsletter***. This periodic publication offers concise yet comprehensive economic analyses, providing insights for informed policy decisions that advance free entrepreneurship and economic freedom in Puerto Rico. From industry overviews to policy impacts, each issue is crafted to be an essential source of information with a primary emphasis on Puerto Rico's recovery efforts post-María and post-COVID, complemented by insights into U.S. and global trends.

Are tariffs protection or limitation?

Tariffs are taxes or duties imposed by a government on imported goods and services. They are used as a tool in international trade policy to regulate foreign competition, protect domestic industries, and generate revenue for the government.

To understand if tariffs are good or bad depends on a government's goal to impose them. Those in favor of tariffs argue that these serve to protect domestic industries. By making imported goods more expensive, tariffs help domestic producers compete more effectively with foreign companies and potentially preserve jobs in local industries. But, given the inflationary effect of tariffs on the cost of imported goods, consumers will end up paying higher prices. Therefore, purchasing power decreases, which can disproportionately affect lower-income households.

Tariffs have an important role in economic history. In fact, tariffs triggered the American Revolution, as people in the U.S. started to protest the British government, claiming "taxation without representation" for imposing taxes on tea, sugar, and paper. In the U.S., tariffs were a main source of revenue for the federal government until 1914. The U.S. started lowering tariffs post WWII after joining the General Agreement on Tariffs and Trade (GATT), a treaty between many countries. The declining trend continued until 2018, when the Trump administration increased tariffs, particularly on Chinese imports, sparking a trade war. Although increases stopped in 2020, presently, tariffs remain above pre-2018 levels. The Biden administration maintained tariffs on imports from China and implemented tariffs on other products in 2024 like semiconductors, solar cells, and others.

The government of Puerto Rico collects tariffs from certain products, such as cement, sugar, plastic, gasoline, petroleum, vehicles, and boats. The tax applies if the product has been introduced, sold, consumed, used, transferred, or acquired in Puerto Rico and is paid only once. Revenue from

said tariffs amounted to $2.61 billion in Fiscal Year 2016 (FY2016), $2.99 billion in FY2020 and an estimated $1.95 billion in FY2024. The decline has been attributed to the decrease in revenue from Act 154 companies, which are foreign corporations taxed at a different rate.

Whether tariffs work or not can also depend on the economy. As an island, Puerto Rico relies on imports, and taxes on imports significantly affect free trade and economic freedom. Imposing taxes on foreign goods to deter international trade and favor local producers will most likely reduce supply, limit selection and raise consumers prices. Even if the objective of tariffs is to protect local industries, they have the unintended consequence of distorting the market. By favoring a fewer number of local producers based on purchasing power, competition decreases, and consumers end up paying higher prices for fewer options of goods.

Consumers pay the cost of price controls

Last month, Democratic presidential candidate, Kamala Harris, proposed the first-ever federal ban on price gouging for food and groceries. Her opponent, Donald Trump, quickly criticized the idea, calling it "SOVIET Style Price Controls".

Are price controls and anti-price gouging policies the same?

Price controls are governmental restrictions on the prices that can be charged for goods and services in a market. Anti-price gouging policies are legal measures designed to prevent excessive price increases, particularly during emergencies or crises when demand for essential goods skyrockets.

Price controls have been widely used throughout history. In ancient Rome, price controls were used to combat inflation. In the 1980s and 1990s various Latin American countries implemented price controls to curb hyperinflation. During World War II, the U.S. implemented price controls to prevent wartime inflation. In 1971, President Nixon imposed temporary (90-day) wage and price controls to curb inflation. **In all these instances price controls failed.** In Rome, while price controls were in place, merchants hoarded goods or sold them illegally. In Latin America, price control policies created shortages of goods and black markets. In the U.S., while Nixon's policies provided temporary relief, inflation rebounded when they were lifted.

Usually, those in favor of price control policies want to protect consumers from price gouging, especially for essential goods like food, medicine, and housing, during times of crisis. Price restrictions are also used to stabilize

inflation in times of hyperinflation or redistribute income as is the case of rent control in New York City and federal minimum wage laws.

However, no matter if price controls stem from the desire to help consumers, restrictive policies have negative consequences. Price controls interfere with the natural balance between supply and demand that could result in shortages or surpluses. If prices are set too low, then producers may stop selling to avoid losses, causing a shortage. On the other hand, if prices are set too high, the surplus of product is possible. In both scenarios, the efficiency of the local market suffers, reducing predictability and productivity in the business environment. Moreover, they affect performance of the production line, and create black markets where essential goods are sold at higher prices, defeating the initial purpose of price restrictions.

At the federal level, there are no established measures for price controls or anti-price gouging policies. However, at the state level, many jurisdictions have laws against price gouging, particularly during declared emergencies. The specific terms of said laws differ from state to state. For instance, in California and Texas businesses can't increase the price of essential goods by more than 10% during emergencies.

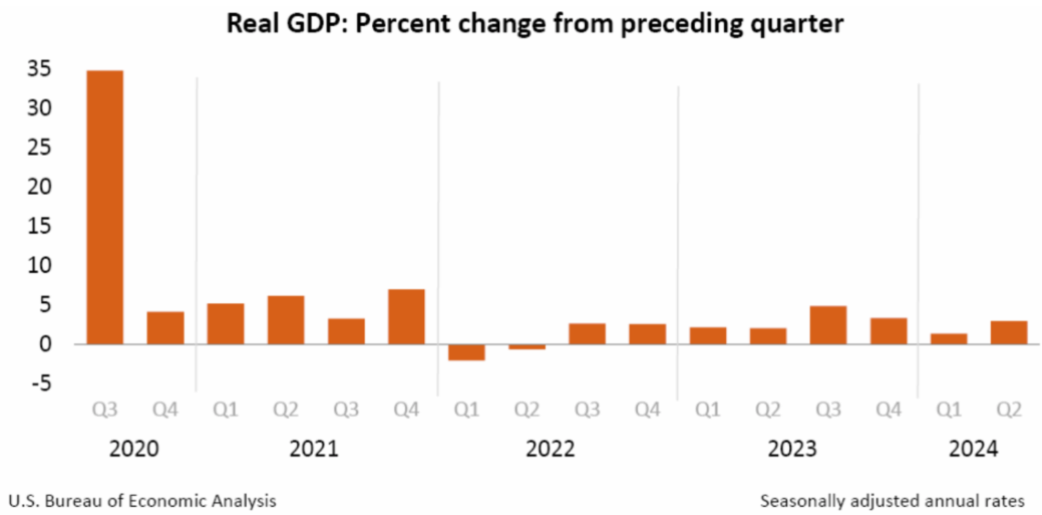
In Puerto Rico, there are laws to prevent price gouging, especially during emergencies. The Department of Consumer Affairs (DACO, for its acronym in Spanish) issues and oversees compliance of said measures during emergencies, such as hurricanes. Temporary price freezing mandates usually apply to essential goods and services, such as food, water, gasoline, and construction materials.

Anti-price gouging laws enjoy widespread popularity, with approval ratings reaching 80% in states like Alabama and Kentucky. In contrast, price controls consistently generate people's dislikes, and their outcomes are historically negative.

Politicians and elected officials must understand that price controls create distortions in the economy that lead to higher inflation. When market pressures are not managed effectively, inflation problems can arise as fixed prices get closer to actual production costs. To promote a healthy economic environment and encourage business growth, it is crucial to balance regulation with market flexibility, fostering sustainable development.

Revised data indicates the U.S. economy demonstrated resilience in the second quarter of 2024, achieving a growth rate of 3%.

Recently the Bureau of Economic Analysis (BEA), issued revised data indicating that the U.S. economy grew at an annual rate of 3% in the second quarter of 2024. Actual results beat initial estimates and projections of 2.8%. In the first quarter, the economy expanded at an annual rate of 1.4%.



This growth was primarily driven by:

1. Increased Consumer Spending: There was a notable rise in consumer spending, particularly in services such as healthcare, housing, utilities, and recreation.
2. Private Inventory Investment: Businesses increased their inventory investments, which contributed significantly to the GDP growth.
3. Nonresidential Fixed Investment: Investment in business equipment and intellectual property also saw an uptick.
4. Government Spending: There was an increase in government spending, which further bolstered the economy.

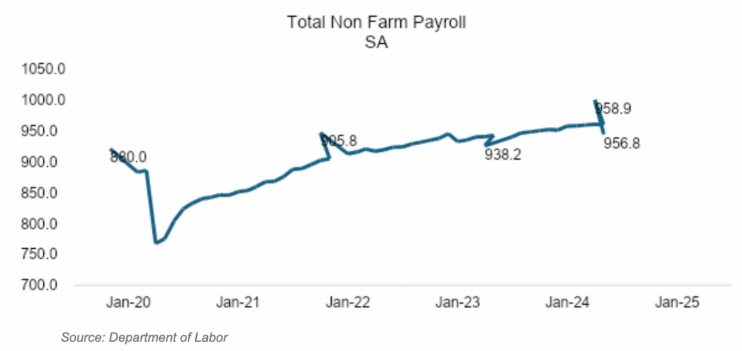
Revised GDP growth rate data for the second quarter show that both exports and imports played notable roles:

1. Exports: There was an increase in exports, particularly of goods such as industrial supplies and materials, as well as services like travel. Higher export figures pushed GDP growth.
2. Imports: Actual import figures, which are subtracted in the GDP calculation, were lower than initially estimated. This revision helped improve the overall GDP.

In Puerto Rico, employment remains stagnant

Seasonally adjusted non-agricultural wage employment in Puerto Rico was 956,800 in July 2024, or 2,100 less than June 2024 (958,900). When compared to July 2023 (939,700), wage employment in Puerto Rico increased by 17,100 employees.

Although employment remains high compared to the previous year and historical figures since 2006, month-over-month data indicates a slowdown.



The participation rate - the number of people who can work and are actively working - in July 2024, was 43.8%, higher when compared to the same the same month in 2023, but well below the national average in the U.S. of 62.7%. Most of the people who are not working are women who are taking care of children or studying.

The unemployment rate - people who can work and are actively seeking work - was estimated at 5.8%, a reduction from 6.0% in July 2023, but above the national average of 4.2%.

Inflation remains high at 2.4% in July 2024

In July 2024, the Consumer Price Index was 136.898, an increase of 0.5% compared to June 2024 and of 2.4% compared to July 2023. This means that overall prices increased 0.5% compared to June and 2.4% compared to July 2023. The inflation rate remains above the 2% target set by the Federal Reserve Bank.

Subcategories that saw significant inter-year increases were cereals (rice, wheat, oats, etc.) 2.3%, household services (cleaning, laundry, gardening services) 8.9%, and tobacco and related products (cigarettes, vaporizers, and consumer paraphernalia for tobacco products) 7.3%.

While overall inflation has gone down, it remains high among important products like food and beverages, which affects consumers' ability to feel optimistic about lower overall prices. When the cost of food, gasoline, and utilities is high, consumers have less money for savings and discretionary spending.

Category	Jul 2024 Δ
ALL ITEMS	**2.4%**
Food and Beverages	**3.3%**
Food	2.7%
Cereals and cereal products	2.3%
Meats, poultry, fish, and eggs	1.8%
Other foods	2.8%
Food away from home	5.7%
Alcoholic Beverages	1.8%
Housing	**1.9%**
Rent of primary residence	1.9%
House furnishings and Services	1.9%
Household services	8.9%
Apparel	**0.6%**
Men's and boy's	2.1%
Footwear	2.1%
Transportation	**1.3%**
Motor fuel	2.7%
Motor vehicle maintenance and repair	2.0%
Medical Care	**4.0%**
Recreation	**3.0%**
Education and Communication	**1.8%**
Other Goods and Services	**2.9%**
Tobacco and related products	7.3%