

# **Puerto Rico's Fiscal Challenges Will Likely Impact the University of Puerto Rico**

By Don Sutherland

In a scenario that played out during the recent financial crisis and ensuing recession, state governments witnessed a sharp contraction in their revenue. In response, numerous states imposed funding reductions on their public university systems. Even as the U.S. economy has grown for some six years since the end of the Great Recession, a subset of states are confronting structural revenue shortfalls on account of tax policy changes they had adopted under the rosy assumption that tax reform is more than a modest driver of economic activity. As the anticipated surge in economic activity failed to materialize, those states found that they were simply left with larger fiscal deficits than they had anticipated. Those states present the larger challenge to public university systems, as structural fiscal deficits are the result of policy design, not fluctuations in the business cycle.

Puerto Rico's ongoing fiscal crisis falls into the structural category. Puerto Rico has been experiencing a persistent decline in population for more than a decade. Its population peaked at 3,826,878 in 2004. By 2014, it had fallen more than 7% to 3,548,397. Moreover, the rate of decline has been accelerating in recent years. The average annual rate of decline was 0.8% for the 2004-14 timeframe. Since 2010, Puerto Rico's population has fallen by an average of 1.2% per year. This continuing decrease in population could result in "brain drain" as both youth and skilled employees relocate outside of Puerto Rico, increased funding burdens from a rising retiree-to-worker ratio, and a decline in the natural rate of economic growth as productivity and investment decrease.

Considering those trends and their implications, Puerto Rico will move aggressively to try to resolve its long-term fiscal challenges. The University of Puerto Rico (UPR) system will likely be impacted.

On September 9, 2015, the [Working Group for the Fiscal and Economic Recovery of Puerto Rico](#) released its plan for addressing Puerto Rico's fiscal challenges. The plan includes measures related to the University of Puerto Rico that seek \$100 million in savings in FY 2018, \$200 million in FY 2019, and \$300 million in FY 2020. To generate these savings, the Working Group recommended that Puerto Rico "enact legislation to gradually adjust [the] revenue base underlying [the] general fund formula-based appropriations to the UPR in order to exclude debt service and pension costs." Barring the release of new details, this general recommendation would shift growing responsibility for the University's debt service and pension costs to the UPR system. In the context of a declining population, growing share of older persons, and a projected decline in enrollment, this shift could impose stiff financial constraints on the University. This legislative remedy would be in addition to a proposed extension of a freeze in Puerto Rico's annual appropriation to the University and a separate measure aimed at redirecting approximately \$62 million in casino slot revenues from the University to the Health Insurance Administration.

A group of 34 hedge funds, the "[Ad Hoc Group of Puerto Rico](#)," have also called for reductions in subsidies paid to the UPR. Hence, it appears that there is agreement between Puerto

Rico and a number of its creditors about reducing funding to the UPR, making such an outcome likely.

Reduced funding would result in programmatic and non-programmatic changes, tuition changes (the Government's Working Group suggests means-testing tuition to mitigate the impact on low-income students), and employment changes (the Government's Working Group recommends public employment attrition with a 2% annual target).

Appreciable or larger funding reductions and/or the transfer of post-employment benefit responsibility to the UPR could create accreditation-related risks. Areas in which UPR institutions could face increased scrutiny under the Middle States Commission on Higher Education's (MSCHE) Standard VI (Planning, Resources, and Institutional Improvement), if not earlier under outgoing Standard 3 (Institutional Resources) broadly include:

- Alignment of financial planning and budgeting with the institution's mission and goals
- Sustainability of current practices and programs
- Resources adequacy relative to the UPR's operations
- Assessment and monitoring of the adequacy and efficient use of institutional resources
- Examinations of independent audits to assure continuing financial viability

The UPR had recently faced a severe accreditation shock when MSCHE placed 10 of the system's 11 campuses on probation in June 2010. That extraordinary development resulted from a number of events and factors that disrupted the UPR's operations and otherwise adversely impacted the University. The UPR undertook far-reaching changes in a highly-compressed timeframe to address its accreditation challenge and quickly returned to good standing.

The lessons of this experience are two-fold. First, an accreditation action related to Puerto Rico's deteriorating finances could have a system-wide focus. The magnitude of Puerto Rico's fiscal challenges makes a system-wide focus more likely than an institution-to-institution one. Second, the UPR's rapid success in restoring good accreditation standing demonstrates a capacity for big, fast change and crisis management.

For now, even as it is likely that the UPR system will be affected, the size of the impact remains uncertain. Moreover, various policy initiatives aimed at addressing the Commonwealth's fiscal challenges entail complex trade-offs, all of which add to the degree of uncertainty. For example, sizable reductions in education investments could generate near-term fiscal savings at a larger long-term cost of foregone human capital development. Such an outcome could undercut Puerto Rico's ability to create a more dynamic and competitive economy in a world that is becoming increasingly knowledge-intensive.