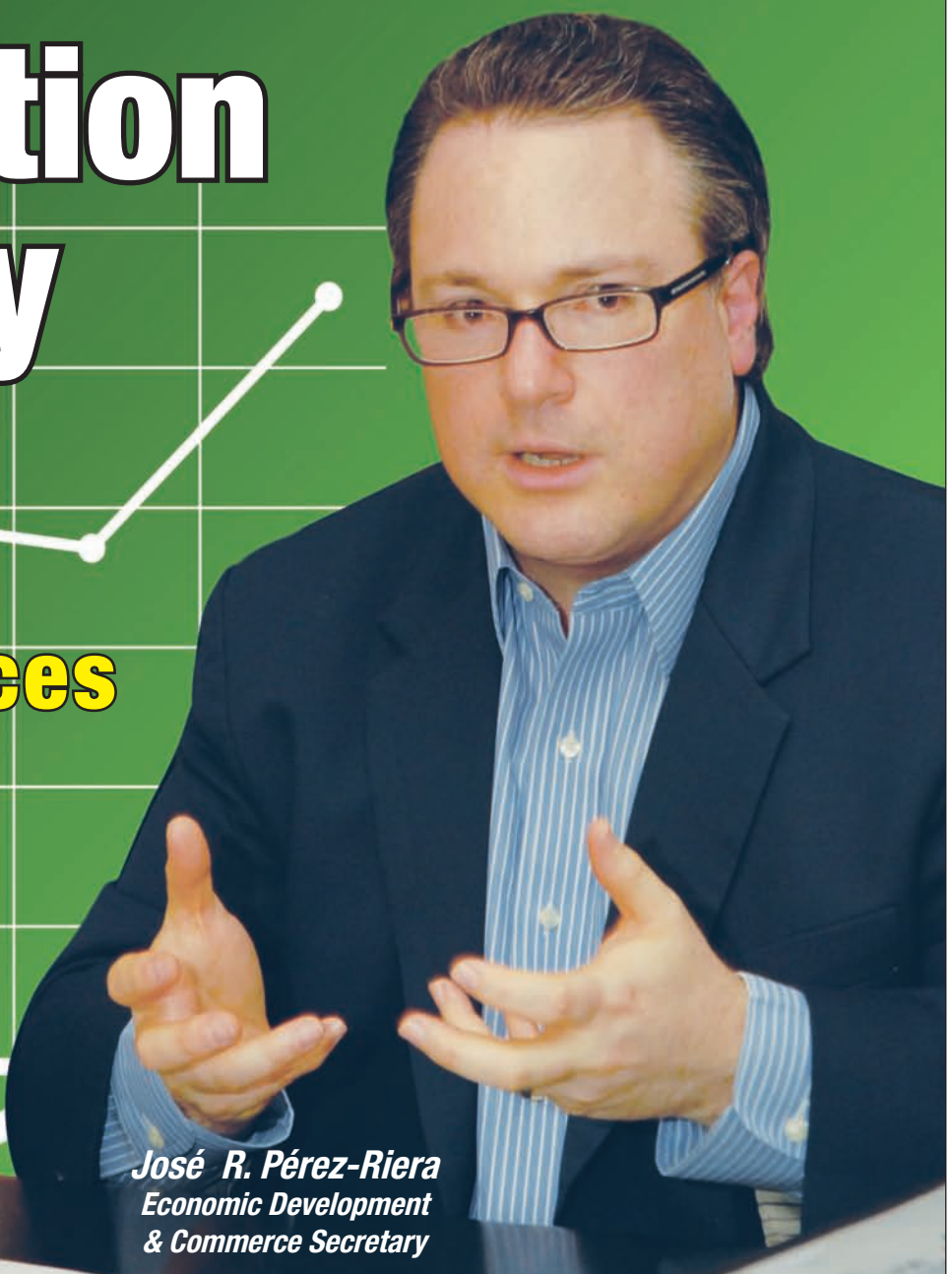


## The foundation for recovery is set

**Pérez-Riera: All pieces in place for full economic growth**



**José R. Pérez-Riera**  
Economic Development  
& Commerce Secretary

By John Marino  
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# Puerto Rico ready for growth

## Sweeping reforms, new incentives sparking investment surge

BY JOHN MARINO  
marino@caribbeanbusiness.pr

With the passage of about a dozen new industrial incentives and sweeping reforms, from energy to permits, to attract investors over the past four years, Economic Development & Commerce Department (DDEC by its Spanish initials) Secretary José R. Pérez-Riera said Puerto Rico is now fertile terrain for investment and job creation.

Citing positive developments in traditional industries such as manufacturing and tourism, as well as new opportunities in exports of professional services and cinema, among others, he argued that the administration of Gov. Luis Fortuño's actions, which include implementing the biggest tax cut in modern Puerto Rico history, are already bearing fruit and will continue to deliver steadily improving results over time. Further evidence is the estimated 1.1% economic growth Puerto Rico is currently experiencing, as well as a surge in offshore investment on the island beginning in fiscal 2011, which ran from July 1, 2010 to June 30, 2011, following a six-year economic free fall.

During an exclusive interview with CARIBBEAN BUSINESS, the DDEC chief argued that the administration had to deal with the most important problem at the time, to stop the financial bleeding of the government when it first entered office in January 2009, before it could fully turn its attention to its economic-development agenda.

There was a \$3.2 billion government deficit, millions in unpaid bills to government contractors and millions more in interagency bills, as well as bankrupt public corporations without significant projects in



*Economic Development & Commerce Secretary José R. Pérez-Riera said the new incentives and reforms implemented this term have remade Puerto Rico into an attractive place to invest and do business.*

the pipeline. Moreover, the reforms and initiatives that formed the backbone of the administration's new economic-development push often required new legislation that was subject to thorough review by lawmakers, business members and community representatives, which often sparked changes that in turn

formed stronger bills.

All that took time, but the investment landscape has been transformed, and Pérez-Riera said the return to moderate economic growth and a brightening in several economic sectors are a direct result of the changes brought by the current administration.

Pérez-Riera isn't the only one talking about Puerto Rico's improved competitiveness. The outside world has noticed. Puerto Rico jumped four spots on the World Economic Forum's (WEF) 2012-2013 Global Competitiveness Report released this year, placing the island as best in Latin America and the Caribbean, and the island's highest ranking ever. It was the third straight year of positive movement on the Geneva-based WEF Index, which listed Puerto Rico in 35th place in 2011, 41st in 2010 and 41st in 2009.

"Puerto Rico hasn't entirely gotten past the difficult times that it has faced, and we aren't saying it has. We are the first to recognize that there are a lot of things that still have to be done, but it is indisputable that we have gotten on the right track and that we are heading in the right direction," Pérez-Riera said. "Puerto Rico is finally creating jobs again. We are, in fact, seeing job creation for the first time in six years. In fiscal year 2012, Puerto Rico created 18,000 net jobs. That was the first full fiscal year of job creation since fiscal year 2006. Investors now know that Puerto Rico means business again.

"We have been doing the right things from the beginning. We just haven't gotten yet to where we are going, but the path has been set and the future looks brighter now than it has for quite some time," he added.

### INVESTMENT SURGES

One of the best pieces of economic news in a recent wave of positive business headlines is a surge in investment, which rose four percentage points as a contribution to the entire economy in fiscal 2011, to 2.5% from minus 1.5%. Domestic

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demand, which also takes into account public spending, increased 11.5% that year, with much of the investment increase attributed by the Puerto Rico Planning Board to greater machinery and equipment purchases by the private sector and the development of new industrial and commercial buildings, energy projects and public works. It was the first domestic-demand increase in six years.

Pérez-Riera cited investment in renewable-energy and natural-gas projects and the public-private partnerships (P3s) program as boosting investment, and he said both will continue to grow in the foreseeable future. Some \$2 billion was invested in energy projects during this term, and the administration said that is expected to double to \$4 billion next term and will continue to grow afterward as Puerto Rico overhauls its energy sector and increases reliance on P3 projects for needed investments in public works the cash-strapped government can't afford.

The P3 program's first two mega deals, the long-term concessions of PR-22 De Diego Expressway and PR-5 and the Luis Muñoz Marín International Airport, represent a private-sector investment in Puerto Rico of \$3.7 billion over the next decades, but most of the nearly \$2 billion in cash the government has received is being used to pay off public corporation debt. Paying down debt will allow the Ports and Highways & Transportation authorities to invest in other projects themselves.

He said future deals would likely involve undertaking development of public assets, rather than taking over operations of existing assets, which will carry increased economic impact. Still, the existing deals provide a hard investment of \$2 billion in job-generating improvements and public-works projects over the life of the contracts. The operating standards imposed on the concessionaires also require a level of service and maintenance that will create jobs.

The DDEC chief said the legislation, which created the Puerto Rico Public Private Partnerships Authority (PPPA) and clear ground rules,



*Gov. Luis Fortuño announces a proposed 40-year concession of the Luis Muñoz Marín International Airport last summer. Such public-private partnerships are expected to be a major source of future investment in Puerto Rico's economy.*

has been a hit with potential investors, and the performance of the government in assuring the due diligence and transparency of the deals are earning Puerto Rico a reputation as a serious P3 player. P3 deals have now become common throughout Europe and South America, and Puerto Rico seems to have become a leader in this area within the U.S.

Despite the brutal fiscal pressure when it first took office, the Fortuño administration began a \$500 million local stimulus fund to finance public works throughout Puerto Rico and was able to work with Resident Commissioner Pedro Pierluisi to win more than \$7 billion in American Recovery & Reinvestment Act (ARRA) funding. A great missed opportunity, Pérez-Riera feels, is that less than \$1 billion of that went to infrastructure projects, as it was set up by Washington, D.C. It should have had a far greater economic impact and left Puerto Rico with developed assets such as new highways, bridges and communications infrastructure.

The P3 program will eventually grow robust enough to do what government's previous economic stimulus efforts failed to do: provide sufficient investment to update

Puerto Rico's public infrastructure to where it is supposed to be and provide a healthy jolt of investment from abroad.

"We have become a leader in the U.S. in terms of P3s; we are the go-to jurisdiction. The next projects that come out, you will see more development of new assets, which will have a greater economic impact and leave something of lasting value behind," Pérez-Riera said.

The administration's future plans in the P3 area include the following projects:

- Co-generation energy projects using natural gas and renewable energy
- Installation of a security & traffic-control camera system throughout major roadways in the San Juan metropolitan area
- Construction of new facilities for the Corrections & Rehabilitation Department
- Undertake a \$100 million extension of PR-5
- Undertake a \$750 million extension of PR-22 to Aguadilla
- Investments to improve technology and the physical plant of Puerto Rico Police Department facilities
- Move all possible projects to the

PPPA from the capital-improvement programs of the government's public corporations

- Expand free Wi-Fi to all town centers across the island

The DDEC chief reiterated a pledge made by the governor to double the amount of money available through the Green Energy Fund, which makes grants for residential and small business renewable-energy projects. The fund gave out \$20 million last fiscal year, but the annual investment will increase it to \$40 million over the next nine years, during which a total \$290 million will be granted. The idea is to double that entire amount, which is important given the Renewable Portfolio Standard goals that the administration has set for Puerto Rico as part of its renewable energy reform (Laws 82 & 83 of 2010).

#### NEW SOURCES OF CAPITAL, JOBS

The DDEC chief also backs an effort in the U.S. Congress to ensure that U.S. companies employ telecommunications and other employees in U.S. jurisdictions when benefiting from the U.S. consumer market.

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"That is an extraordinary initiative, a very smart way for the U.S. to help meet its fiscal obligations while increasing national employment. Of course, for Puerto Rico, it would be an incredibly advantageous initiative inasmuch as Puerto Rico would provide the most attractive option cost-wise under the U.S. flag," he said. "President Barack Obama seems to support the initiative, as do some Republicans as well, so it may be a consensus legislation for the next term. It makes all the sense in the world."

The developing legislation in Washington, D.C., is aimed at bringing overseas telemarketing jobs back to the U.S. Senate President Thomas Rivera Schatz told CARIBBEAN BUSINESS he would pass local legislation patterned on what is being considered in Congress and a few states, which would create 40,000 to 50,000 jobs locally, almost immediately. Many companies on the island are profiting from this market, but creating jobs in other countries making calls to customers here. Those 40,000 to 50,000 jobs belong here.

Pérez-Riera also sees opportunity for Puerto Rico in certain federal tax-reform discussions beginning next year, regardless of who takes the White House. Puerto Rico officials hope it will help increase acceptance for a U.S. Tax Code Section 933-like proposal since a chief aim of the national reform would be to attract an estimated \$2 trillion in profits invested overseas by U.S. companies. Puerto Rico could be one path toward repatriation, according to a proposal by Resident Commissioner Pedro Pierluisi, which has widespread backing and was modeled on initiatives provided by the private sector.

Pierluisi's Puerto Rico Investment Promotion Act (Pripa) would push in Congress the amending of Section 933, which defines the tax treatment of individuals living in Puerto Rico, to make it available to domestic corporations operating on the island.

The new plan is being sold as having the ability to increase revenue to the U.S. Treasury and even boost the stateside economy because it would encourage firms to bring billions of



*Cement sales is one of several economic indicators that have been rising, pointing to a rebounding economy and increased construction activity.*

dollars in profits back home. Under the plan, a company would be subject to federal taxation on its worldwide income, except that earned in Puerto Rico. Moreover, as a domestic rather than a foreign firm, a corporation could distribute its earnings to its U.S. parent in the form of a dividend under Section 243, which allows the parent company to deduct 70%, 80% or 100% of that dividend, depending on its ownership stake in the subsidiary.

The move would provide an additional incentive for companies to set up and expand operations here from other overseas sites.

#### DEPRESSION ENDED IN MAY

Beyond the investment increase, other economic indicators, pretty much across the board, are climbing, painting a clear picture of moderate improvement, according to a range of observers, many of whom remain skeptical that the growth will be enough of a kick to create sufficient jobs for the unemployed. The island's economy grew 1.1% in fiscal 2012 (ended June 30), the first expansion since the onset of the recession in 2006, and is expected to continue to grow at the same pace during the current fiscal 2013, which began July 1, according to the Puerto Rico Planning Board.

The Government Development Bank's Economic Activity Index (GDB-EAI) began showing positive economic growth in December 2011 for the first time in six years, and it has kept showing an improvement each month since then for

nearly three straight quarters.

By all counts, that indicates a technical end to Puerto Rico's long economic recession. Most U.S. economists define a recession as at least two quarters of economic contraction, so a general rule is to call one over after at least two quarters of growth. That would put an end to the island's great recession back in June.

No matter how you measure it, however, Puerto Rico's tough economic times have added up to not just a recession, but a full-blown depression, which is most often defined as two years of recession or a significant decrease of the economy. Puerto Rico qualifies on both counts, as the economic downturn, which began in March 2006, will complete six years next month and has already resulted in a total contraction of nearly 14%, economists say.

#### ECONOMIC INDICATORS PAINTING CLEAR PICTURE

The unemployment rate fell to 13.5% in August, the lowest since 2008, though still higher than any U.S. state, according to the U.S. Bureau of Labor Statistics. While the labor-force participation rate continues to be a worrying factor, with only four of six able-bodied workers actively seeking work, total employment has also been on the rise.

Some 18,000 jobs were created last fiscal year and 6,000 so far this fiscal year, after Puerto Rico lost some 166,000 jobs going back to fiscal year 2006. Only 30,000 of the total jobs lost over the past seven

and a half years correspond to this administration, and ever since fiscal year 2012, Puerto Rico has been in job-creation mode. Pérez-Riera noted that the current administration cut the rate of job loss in half during its first full year in power, then set out to erase it completely and begin to create jobs. The rate of job growth is on track to increase by 25% this year and should continue to show such healthy margins in the future as the island's economic recovery takes hold and the full strength of the new reforms and incentives takes hold, the DDEC chief said.

Home sales, for example, totaled 15,573 last year, a 30.4% improvement over the previous year. New-home sales surged 49.7% to 3,465, while existing-home sales grew 25.7% to 12,108.

Cement sales, a big indicator of construction activity, have plummeted throughout the economic depression, dropping 13.5% in 2008, 29.6% in 2009 and 20% in 2010, before turning the corner last year to increase by 5.2%.

Exports, meanwhile, have been on the upswing for an even longer period. They fell 4.9% in 2009, but then climbed 1.4% in 2010 and 5.2% in 2011, when at \$64.88 billion, they registered the highest level in Puerto Rico history.

Car sales have also been driving up the confidence of officials that an economic turnaround has begun. They rose by about 13.3% last year, after increases of 1.5% in 2011 and 17.3% in 2010. They were hammered during the recession, falling 15.6% in 2009, 11.6% in 2008 and 12.9% in 2007, but sales are hotter than ever right now. They surged 20% in May, 31.3% in June, 13.4% in July, 21.2% in August and 91% in September.

Retail sales have also been on a moderate rise, climbing 2.3% so far this fiscal year, 2.5% in fiscal 2012 and 1.7% in fiscal 2011. They have increased for the past 24 months.

In further signs of improvement, new corporation registrations increased 14% last year, setting a new annual record, and are up 0.5% so far this year. Meanwhile, bankruptcies have fallen 11.2% during this year, after decreasing by 10.4% in fiscal 2012.

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"The numbers paint a clear picture of an improving trend," Pérez-Riera said.

#### THERE'S LIFE IN THE TRADITIONAL ECONOMY

While much of his focus has been on staking out opportunities in new areas, the DDEC czar pointed to promising developments in manufacturing and tourism, twin pillars of jobs and economic development since the founding of modern Puerto Rico.

"For 22 of the past 28 months, manufacturing has been in an expansionary mode. Those who say manufacturing is dead in Puerto Rico are just wrong," he said, pointing to the results of the Purchasing Managers Index (PMI) of Puerto Rico, which is put together by the Puerto Rico Manufacturers Association and the Puerto Rico Statistics Bureau.

The sector is being bolstered by an aggressive push into the federal procurement market by companies here, as well as high-tech operations, such as pharmaceuticals and life sciences, but now also aerospace and computer software operations.

Pérez-Riera said the sector is increasingly investing in automation and processes to hold down costs, one reason why employment levels are lagging behind the historic highs of the past.

The tourism industry has also been doing better. The average daily rate increased 3.9% last year and the revenue per available room (RevPAR), an important industry measure, increased 5.1%. Hotel occupancy is up 2% so far this fiscal year, after growing 1.7% in fiscal 2012, remaining flat in fiscal 2011 and growing 2.8% in fiscal 2010. It hit 67.9% in fiscal 2012, the highest level since fiscal 2007, according to the Puerto Rico Tourism Co.

"We are adding more hotels, we are slowly but surely establishing new niches, like the high-end luxury market," Pérez-Riera said, pointing to 2,000 new rooms inaugurated during this term and another 1,800 in the pipeline. "We are an exotic place under the U.S. flag and we should be able to do some of things that Hawaii has done to become a leader in the tourism sector. Those have been missed opportunities of



*Investment in energy projects, such as the Pattern Santa Isabel Wind Farm shown here, reached \$2 billion during this term and is expected to double to \$4 billion next term.*

our past that become the opportunities to conquer for our future."

He mentioned the rebirth of the Dorado Beach into the Ritz-Carlton Reserve, a key project for the island's ascent to the high-end market, as well as the completion of the Condado Vanderbilt Hotel. Pérez-Riera believes tourism's real promise lies not in renovating existing properties, but in transforming huge empty spaces, such as the former Roosevelt Roads Navy base in Ceiba into a tourism development.

The powerful incentives under Law 118, or the Municipal Development Act, aim at attracting large-scale developers looking to undertake a \$1 billion to \$2 billion project that has the potential to transform the economies of some of the island's hardest hit municipalities.

Finally, tourism ad campaigns should get steadier management under a destination marketing organization (DMO) concept, where the private sector will play the major role in the marketing of the island.

#### THE REFORM, INCENTIVE REVOLUTION

Much of the improvement, Pérez-Riera said, is the result of a series of reforms and new industry incentives that have fortified Puerto Rico's competitiveness, as evidenced in its steadily improving WEF ranking.

"Over the past three years, the

government has implemented the fiscal and structural reforms that have led to our highest position ever. This clearly signals Puerto Rico is on the right course with the implementation of the Strategic Model for a New Economy, our comprehensive economic-development plan," Pérez-Riera said.

A series of reforms have reshaped the investment landscape, while a fortified mix of new and renovated incentives are pointed at the types of investment Puerto Rico is seeking to attract and encouraging the development of native capital through expanded exports of goods and, increasingly, professional services.

The biggest reform was the tax reform, which took full effect in the year 2011. It represents the largest tax cut in modern Puerto Rico history and also resets rules to reward work and encourage saving and investment. A further cut to the capital-gains tax is now on the horizon, according to officials.

Another big effort was the permits reform, with Puerto Rico's permitting process consistently being cited as a major obstacle to investment, with years-long waits for responses killing many projects. The new system is a paperless one, with most applications done over the Internet. Pérez-Riera noted that despite recent problems at the Minillas

Government Center, with the discovery of asbestos in one area, the new permitting system continues functioning normally thanks to the fact that the system is paperless and it can be accessed from offsite locations through the Internet.

The effort goes hand in hand with a wider effort aimed at putting a host of citizen and business services online, at PR.gov, which has dramatically saved time and cut costs for government customers. Now, everything from registering a corporation to getting good-conduct certificates for a job can be undertaken online, rather than spending a day or more visiting a government office.

A problem with the permitting overhaul is that big municipalities that handle their own permitting haven't been integrated into the system yet, and delays still occur from the autonomous municipal governments that can issue their own permits. Pérez-Riera said he expects municipalities to migrate to using the same central-government permitting system because they can save money by doing so, and failure to do so may put those towns in a disadvantageous position compared to smaller towns that decide to use the powerful permits platform.

Another big reform was the renewable-energy reform, which intends to foster a wave of investment in the sector and bring down the high cost of energy, which remains perhaps the biggest obstacle to doing business in Puerto Rico. The reform set hard targets for the government to adopt renewable energy, established incentives for new energy-project developments and offered fast-track review of proposals. While electricity prices remain high, the reform has sparked a wave of large- and small-scale solar and wind energy development, as well as finally getting waste-to-energy projects off the ground.

The government's vital conversion to a natural gas program is also underway.

The administration also revamped incentives to traditional industries, such as manufacturing and tourism, to encourage development, and it has introduced new incentives to increase offshore investment in Puerto Rico, as well as encourage exports by local companies.

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The island's film industry is on the move after a package of new incentives. Incentives in place since March 2011 have resulted in about 30 productions produced on the island, generating about \$80 million in investment. Recent examples include television episodes for Showtime's "The Big C" and the movie "Runner, Runner" with Ben Affleck and Justin Timberlake. "Runner, Runner" pumped \$35 million into the local economy.

Puerto Rico's aggressive incentives, talented local crews, varied backdrops, solid infrastructure and sound legal protections are continuing to pay off in the effort to grab film-industry attention. The island is hoping to land major productions that can bring investments topping \$200 million.

Films mean direct and indirect jobs, and get money flowing through the local economy, Pérez-Riera said.

Leading industry publication Variety has trumpeted Puerto Rico's varied settings, noting the island has stood in for Iraq, Vietnam, Spain, Brazil, Cuba and various other "far-flung places" as filmmakers increasingly look to the island for its diverse locales and capable crews.

One of the more innovative laws is the new services export law (Law 20 of 2012), which establishes a 4% tax rate for the export of local professional services. The law's objective is to encourage local professional-services firms, from computer consultants to tax counselors, to export services beyond Puerto Rico shores. It is also aimed at getting large professional-services firms from major places such as New York City to establish operations on the island, which is expected to result in further integration of Puerto Rico into the global economy.

A related effort, Law 22 of 2012, seeks to attract high-net-worth individuals to Puerto Rico by eliminating all taxes on any passive income they receive when they decide to relocate to the island, if they haven't lived here for the past 15 years.

"There is a lot of interest in these new incentives," Pérez-Riera said, adding that they will both attract off-shore global concerns to the island and encourage the development of local professional-services firms



*New film-industry incentives put in place in March 2011 have attracted about 30 productions to the island, and more and larger productions are in the pipeline. One of the biggest films shot here was last summer's "Runner, Runner," with Ben Affleck and Justin Timberlake.*

into international players. "Puerto Rico can become the Singapore of the Americas."

#### THE CASE FOR CONTINUITY

For Pérez-Riera, one of the big problems of Puerto Rico has been the lack of continuity in its economic-development plans, which has been aggravated by revisions made by subsequent New Progressive Party (NPP) and Popular Democratic Party administrations.

"This constant change is what has Puerto Rico stuck in neutral," Pérez-Riera said.

That's one reason why he and other officials argue that the NPP administration should be re-elected, but it is also why the DDEC chief has been pushing for the private sector to assume some responsibility for promoting Puerto Rico and assuming ownership of the Strategic Model for a New Economy.

"We need to leverage our efforts from outside of government and have the private sector help us with the promotion," Pérez-Riera said.

The administration has established industry advisory councils in important areas, where private-sector members have helped establish policy and coordinated promotion efforts. The five councils are: banking, insurance & cooperatives; trade & exports; tourism & entertainment; cinema & creative services; and manufacturing.

While private-sector bodies, from



*Government officials expect new highway construction over the next four years using both public and private funding. Above is PR-66, which was extended to Río Grande during this term.*

the Manufacturers Association to the Hotel & Tourism Association, are vital entities doing important lobbying for their specific industry, Pérez-Riera also sees the need for broader private-sector input that could effect a wider economic policy perspective and a more sustained promotional push from the private sector.

Pérez-Riera has also worked on putting the assets of the government to work for various industries. The Puerto Rico Industrial Development Co. (Pridco), for example, now uses its substantial industrial holdings for many types of uses, and at reasonable rates by allowing its buildings to be used beyond manufacturing when appropriate,

and working with the municipalities to make productive use of idle factory space at a very low cost, so long as the municipalities invest and create jobs.

In many cases, small businesses have established themselves in previously vacant Pridco facilities that municipalities have rehabilitated while paying rent as low as \$1 per month.

"We have to put our limited resources to work the best way we can, and promote those things that make us unique, and that can be used as competitive advantages," he concluded. ■

*See Editorial on page 17*