

Puerto Rico's economy at tipping point, P.R. Investment Summit speakers say

By : XAVIRA NEGGERS CRESCIONI

xavira@caribbeanbusiness.pr; cbprdigital@gmail.com

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*O*pportunities lay in knowledge-based economy

Puerto Rico's economy is at a tipping point, creating risk as well as great opportunities, said the keynote speakers who addressed a group of about 200 prospective candidates for moving to Puerto Rico to benefit from Laws 20 and 22 at the P.R. Investment Summit, held last week at the Condado Vanderbilt Hotel.

Former Gov. Luis Fortuño passed the incentives created under former Economic Development & Commerce Secretary José Ramón Pérez-Riera with little fanfare in 2012. After the last election, Gov. Alejandro García Padilla's administration began touting these tax breaks—which include a 0% tax on investment income and a 4% tax on service income, such as a hedge fund's management fees—to promote investments in real estate, boost services and consumption, and attract foreign businesses to the island.

To date, 205 people have moved to the island under Act 20/22 decrees. They are expected to invest \$10 billion in Puerto Rico over the next two years, according to the Economic Development & Commerce Department (DDEC by its Spanish acronym).

"Puerto Rico is in the process of a great reinvention. We are at an inflexion point and, after years of decline, asset values here are creating generational opportunities," billionaire Nicolas Prouty, CEO of Putnam Bridge Funding, who has invested \$750 million in Puerto Rico, told a packed ballroom.

Official statistics indicate local employment has dropped by 200,000 to 925,000 jobs since 2006, and the local labor-participation rate stands at 41%, but they don't tell the truth about Puerto Rico's economy because they exclude informal economic activity—which accounts for 35% to 40% of the overall economy, Prouty said.

The fact the government's recent sale of \$3.5 billion in junk bonds—the largest sale of noninvestment-grade bonds in the history of municipal markets—raised \$16 billion in orders also shows long-term confidence in Puerto Rico, said Prouty, who attributed recent credit downgrades largely to the effect of the island's shrinking population on the local tax base.



*Popular Inc. Chairman, President & CEO
Richard Carrión*

PARALLEL TO OPERATION BOOTSTRAP

There is a parallel between Puerto Rico's poverty and a feeling of hopelessness before Operation Bootstrap, which moved the island's economic base from agriculture to industry and brought 25 years of record growth to the island, and Puerto Rico's state of affairs today, before moving from an industrial-based to a knowledge-based economy, Popular Inc. Chairman, President & CEO Richard Carrión and DDEC Secretary Alberto Bacó Bagué said.

"This is the place. This is the time. This is happening now. You are part of the second grand transformation of Puerto Rico," Bacó said.

Puerto Rico's economy should grow by 3% to 4% in 2015, fueled by recent expansions in aerospace and other keys sectors combined with direct investment, he added.

"Problems created in decades can't be solved in months. But the government has taken a series of difficult and necessary measures to address the current situation, such as reforming the pension system, presenting a balanced budget and executing the recent general-obligation issue," Carrión said. "We are at a critical turning point that presents, as other turning points I have mentioned, great opportunities."

"Puerto Rico was transformed in the 1950s with the shift from an agrarian to an industrial economy. We were transformed yet again in the late 1970s when new tax incentives promoted a higher value-added type of manufacturing," he said.

"Today, we stand at the threshold of yet another economic transformation, from an industrial to a knowledge-based economy. This is a global phenomenon, so we have to ask ourselves: Does Puerto Rico have what it takes to compete in this new economy? I am convinced it does."

To prosper, Puerto Rico's tax system and energy costs must be revised and the island's labor-participation rate must be raised to about 60%, Carrión said, adding population flight must be stemmed by the creation of high-quality jobs.

"A critical element here has to be how to put growth back into the equation...I think we are in a juncture to attack a couple of those problems that are fundamental," Carrión said. "These tax breaks present remarkable opportunities in the service sector...basically to any business that exports services outside of the island."

Even without these incentives, Popular Inc. opted to reduce its back office operation on the mainland U.S. to 300 people from 550 people, transferring those without posts to the island to do similar functions, he said. This decision was fueled in part by the fact salaries and healthcare costs in Puerto Rico are 60% and 33% lower, respectively, than those stateside.

The opportunities will be provided by the island's switch from a primarily industrial economy to a knowledge-based economy, keynote speakers agreed. Under Law 20, service companies— lawyers, financiers and publicists, among others— must create a minimum of three jobs and sometimes many more. Euro Pacific Capital Inc., BloxTrade, PricewaterhouseCoopers and Sun West Mortgage, alone, are creating more than 300 jobs fueled by Law 20 decrees.

If each person with a Law 20 decree creates 25 jobs on average, that's 5,000 new jobs. And if each person creates 50 jobs that's 10,000 jobs, said Carrión, adding that, "these are very good jobs being created. Jobs that pay \$40,000, \$50,000 and \$60,000 a year....We are saying we don't want your income tax; we want your payroll tax."

"The creative, talented and hardworking people of Puerto Rico deserve an economy that gives them opportunities to develop their full potential, without leaving this beautiful island. Attracting investment is essential to achieve that goal," Bacó said.