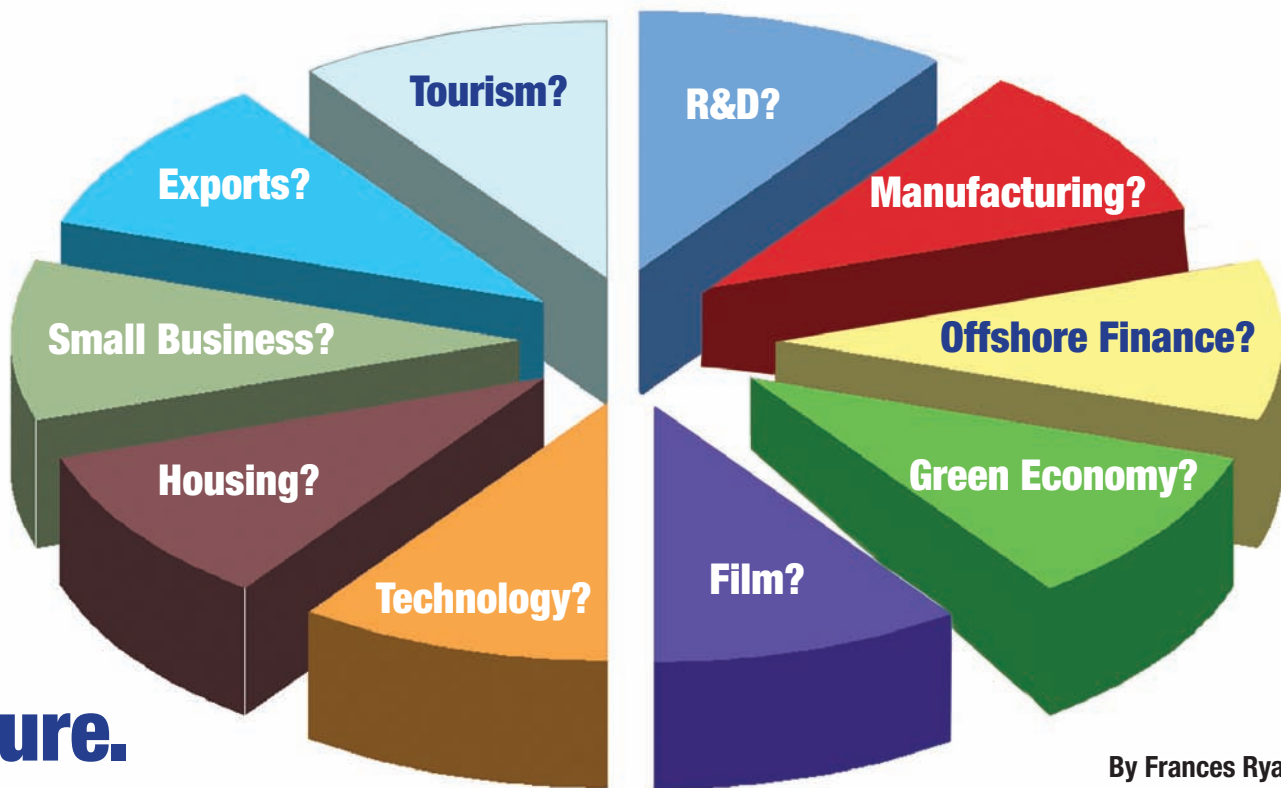


## THE SEARCH FOR A NEW ECONOMIC DEVELOPMENT MODEL

**Welcome to  
Puerto Rico's  
new diversified  
economy.  
Learn which  
sectors will  
drive growth  
well into the future.**



By Frances Ryan  
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finance company  
will mainstream  
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opportunities for local firms**

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*People to watch*



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# The diversified-economy model is born

**Puerto Rico stands to double in size in the next 10-15 years with the growth of multiple sectors, boosted by targeted incentives**



**Diversified  
economy**

BY FRANCES RYAN  
frances@caribbeanbusinesspr.com

**L**ong gone are the days in which Puerto Rico's economy could rely on one or two major industry sectors to drive economic activity and job creation.

For 30 years, Puerto Rico was a world-renowned low-wage, low-cost and low-tax haven for manufacturing companies. That period, however, ended as costs reached developed-country levels, and as globalization led manufacturing companies to migrate toward markets with much cheaper labor and other costs.

U.S. manufacturers in all sectors have, in fact, become more sophisticated. In the mid-1970s, the garment industry, a major pillar of the local manufacturing industry, slowly began to move to the Dominican Republic, Mexico, Costa Rica and, most recently, to China, India and throughout Asia.

By the 1990s, many manufacturing plants had left or were leaving Puerto Rico for countries with lower wages.

During the island's manufacturing boom, Puerto Rico was virtually the only game in town. Central and South American countries weren't

producers of goods. Europe had literally been destroyed by the war. China, which had been invaded by Japan, wasn't even thinking about becoming the manufacturing world power it is today.

Puerto Rico's direct manufacturing jobs in the early '70s had reached a high of nearly 180,000 direct jobs. Indirect jobs were above 350,000.

Although most pharmaceutical companies did stay after the 1990s manufacturing exodus, many have automated their factories with robotics. Labor, while well-paid, wasn't growing. The direct result was that job growth stagnated in Puerto Rico.

In the meantime, Puerto Rico's economy has quietly diversified, becoming far more service-based. Such a transformation has been driven primarily by private-sector companies that have either reinvented their businesses, gone into new service-based industries or refused to close their operations to move elsewhere.

One thing is certain, according to industry experts interviewed by CARIBBEAN BUSINESS: Puerto Rico's diversified economy is here to stay.



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**FOCUS ON CONTINUITY**

To its credit, the administration of Gov. Luis Fortuño decided early on to seize the moment and pursue a higher mission on the strength of the diversified economy already in place when it took office in 2009.

“One of the greatest challenges that Puerto Rico has had in the past is being able to hold the line on economic strategies that make sense,” said José R. Pérez-Riera, secretary of the Economic Development & Commerce Department (DDEC by its Spanish initials), during an exclusive interview.

“The economy will always take time to show the effects of any given strategy that the government or private sector may attempt to implement, and many times these strategies are not given the time to succeed, and it has been precisely that lack of continuity that has resulted in a series of false starts that have cost us quite a bit.”

In other words, the administration has been persistent in the face of much criticism on implementing a development agenda that cannot easily be changed by future administrations, thus ensuring the continuity that has been missing to date and has led to changes in direction with every new government, no matter the political party.

“From 1994 to 2008, we saw the creation of at least eight different economic development plans, both from the public and private sectors,” added the architect of the government’s Strategic Model for a New Economy (MENE by its Spanish acronym), a blueprint designed to accompany the economy’s organic evolution and push it to enhanced results.

“The MENE was developed after having carefully considered and integrated the strengths of all previous efforts and seeking input from all sectors of government and the private sector,” Pérez-Riera said. “It has been widely published, analyzed and critiqued, and it is now recognized as the most comprehensive and diversified economic-development plan that Puerto Rico has ever had. The MENE is first and foremost a framework that can develop and evolve as need be, and that can change as our circumstances or worldwide



**“What many people, still in search of a so-called new economic model for Puerto Rico, don’t realize is that we already have a diversified economy, and that itself is an economic model.”**

—José Pérez-Riera, Puerto Rico  
Economic Development &  
Commerce Department Secretary

conditions demand.”

That includes, of course, shifts in the market segments of a diversified economy, which change over time.

**MANY SECTORS**

Within such a model, growth will come from various economic sectors, marking a new beginning for Puerto Rico.

Economic transformation isn’t new, either. Other economies have successfully diversified their economic activity, as is the case of Singapore or, closer to home, New York, which went from being a merchant economy more than 40 years ago to a diversified service-based economy with such sectors as banking, tourism and film at the core of their thriving economy.

In fact, many countries, which people couldn’t even find on a map 25 years ago, are now thriving

economies in today’s global community, including China, India, Taiwan and South Korea, to name a few. In the Americas, countries such as the Dominican Republic, Mexico, Costa Rica, Panama, Chile and Colombia, often thought of as depressed economies, have also transformed their economies, posting positive growth in recent years.

“Instead of just searching for a new economic model, Puerto Ricans in general, as well as the public and private sectors, need to embrace the fact that a diversified economy—if promoted correctly—can be powerful,” noted economist Joaquín Villamil, chairman of Estudios Técnicos.

“We have to rethink, reinvent and reposition Puerto Rico, or we are doomed to stay behind, or even worse, completely out of today’s global economy. We can’t continue to blame all our problems on the U.S. or other world situations. Instead, if we could recognize the tremendous potential a diversified economy could bring for us, we have a fighting chance of becoming, once again, a leading economy in the Americas,” Villamil added.

In fact, according to studies from the Puerto Rico Trade & Export Co., the island could double the size of the local economy and promote the kind of job creation it needs within the next 10-15 years if—and only if—a well-planned, diversified and service-based economy is properly stimulated.

Now, that is an opportunity many countries don’t have twice in a lifetime, much less in such a short period, added Pérez-Riera. “For a while, we were definitely a key player in the

region. But our competitive advantage was lost to Miami, which seized the opportunity to become the gateway to the Americas. However, with the kind of economic transformation we are seeing today, mostly driven by globalization, I firmly believe there is absolutely no other market in the Americas that has a greater potential or the combination of assets we [Puerto Rico] have to become the new service hub and economic gateway of the Americas,” Pérez-Riera continued.

“However, we have to believe it first. We have to think big and, most importantly, we have to act quickly because globalization isn’t waiting for us,” the DDEC secretary added.

In this week’s edition, CARIBBEAN BUSINESS takes a closer look at Puerto Rico’s new economic drivers, those sectors boosting the island’s new economic activity, which still includes manufacturing—with renewed focus on high-tech, biotech, aerospace and research & development—but now also include small business, offshore finance and insurance, technology agriculture, tourism, retail/commerce, export of goods and services, renewable energy, banking/insurance, film and entertainment services, health, federal procurement, certain housing niches, and more.

Some of these sectors are summarized below, while others are featured in stories throughout this special edition of CARIBBEAN BUSINESS.

**P.R. HAS EVERYTHING IT TAKES**

“What many people, still in search of a so-called new economic model for Puerto Rico, don’t realize is that we already have a diversified economy, and that itself is an economic model,” Pérez-Riera pointed out.

He added that MENE, a wide-ranging strategic economic-development plan, provides a clear blueprint for the island to grow its diversified economy.

As the proverbial “credit where credit is due” saying goes, the Fortuño administration and Secretary Pérez-Riera are responsible for recognizing such economic potential and articulating a strategic model with specific measures—some already taken by government—to activate the island’s diversified economy and seize its true economic-development

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potential.

While the focus of attention of late has been the island's historic six-year depression, the 14% economic decline and the loss of about 200,000 jobs, government and private-sector officials point to the island's continuing strengths as the foundation for the recovery just begun and the future of the new diversified economy.

It starts with the island's stability under the U.S. flag and high-quality services in the areas of banking, insurance, manufacturing, tourism, biotechnology, engineering, medicine, technology and pharmaceutical development—all tightly regulated by federal agencies.

"An advantageous geographic location, state-of-the-art transportation and telecommunications networks, and world-class infrastructure, all offer rapid access to emerging markets and provide an ideal setting for business," said Barry Lewin, vice president of Hilton Worldwide, which represents 60% of the island's branded hotel rooms.

In the area of education and despite huge challenges faced by K-12 public schools, more than 25,000 academic degrees are conferred in Puerto Rico each year, including about 10,000 in science and engineering. Puerto Rico is home to more than 150 regional offices of Fortune 500 companies, at least 35 of them from the Fortune 100.

The island's manufacturing companies—which still produce three of the top-20-selling prescription drugs in the U.S. (or 25% of the world's pharmaceutical-manufacturing capacity)—are paving the way for the industry's evolution into the emerging biotech and research & development sectors.

Puerto Rico moved up six notches, to 35th out of 142 jurisdictions evaluated, in the 2011-2012 edition of the World Economic Forum's Global Competitiveness Report, showing the most improvement among the top-35 economies in the world.

"For foreign companies, ease of doing business is the key to breaking into the U.S. mainland market. With our strategic location and economic stability, coupled with our Spanish heritage and language, and shared culture and traditions with Latin America and the rest of the Caribbean, Puerto Rico is the ideal service hub of the



Americas," Pérez-Riera added.

"All local airports are controlled by the U.S. Department of Homeland Security, with oversight by U.S. Customs & Border Protection, helping maintain a busy U.S. free-trade zone that is exempt from federal income tax and delivers a fully bilingual business environment. Greater San Juan's Luis Muñoz Marín International Airport is among 28 U.S. airports to unveil a new passenger-screening program to make check-in more convenient for qualifying travelers—yet another asset for companies seeking to enter the U.S. market," explained Jaime López, DDEC's chief development officer, in charge of the island's air and maritime access strategy.

Puerto Rico is a premier Caribbean destination for tourism, and its convention center is the largest in the Caribbean.

Below is a summary of some of the sectors that will be built on these strengths. For a closer look at some of them, see other articles throughout this edition.

#### OFFSHORE BANKING

The island's longstanding banking institutions, including three commercial banks and two leading international money centers, with combined assets of \$75 billion, have paved the way to Puerto Rico's offshore banking and insurance sectors, which are some of the most attractive in the Western Hemisphere.

The laws and incentives are on the books, and some banks and insurance companies already have a local presence in these offshore sectors.

The potential, according to industry experts interviewed by CARIBBEAN BUSINESS, is for Puerto Rico to become the Hong Kong of the Caribbean, referring to the massive financial sector in the former British colony, which has long survived using the same offshore finance and insurance model: A bank or insurance company sets up in one location (in this case Puerto Rico) to do offshore business with countries and clients around the region.

#### FEDERAL PROCUREMENT

The federal government's procurement market, which represents \$500 billion annually, is becoming an increasingly important target for many businesses in Puerto Rico. Tapping into this market is also a perfect fit

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with government plans to boost exports of both products and professional services.

Puerto Rico has great opportunities to substantially increase its share, especially by securing federal-procurement opportunities.

Aixa Barzaga, president of Executive Uniforms, said: "I am a true example of the federal-procurement program for minority- and women-owned businesses. I have been certified, as such, with the federal government for many years, which has been pivotal in the globalization and growth of our company."

Executive Uniforms, which has been in the market for more than 25 years, is a leading manufacturer of uniforms, with local operations supporting 80 employees.

Local businesses already have nearly \$1 billion in annual contracts from the federal government. DDEC's Pérez-Riera is looking to double that by 2015.

#### SMALL BUSINESSES PROLIFERATE

"Small businesses are the backbone of any local economy. During difficult economic times, small businesses are even more important for helping create and maintain jobs. One of the most important trends in the small-business trade is exporting products and services, which is no longer reserved for large companies," said Ignacio Veloz, president of the Puerto Rico United Retailers Association (CUD by its Spanish acronym).

"Globalization has leveled the playing field for small businesses. Through technology and strategic alliances, small businesses can be even more effective in a global economy than their larger counterparts," Veloz added.

For example, a group of 20 small-business firms is scheduled to participate in Panama's largest trade expo in March.

In addition to the CUD, other private-sector organizations and government agencies, such as the Government Development Bank, U.S. Small Business Administration, PromoExport (a division of the Trade & Export Co.) and the Small Business & Technology Development Centers, are offering incentives to support and finance small and midsize



businesses.

#### TOURISM

Puerto Rico's tourism industry, which barely contributes 6% to the island's gross domestic product (GDP), has the potential of becoming a leading economic-development sector, said Ismael Vega, chairman of the Puerto Rico Hotel & Tourism Association (PRHTA).

"It is vital, however, to encourage the creation of a private-run destination marketing organization to successfully promote Puerto Rico and increase destination demand, which will drive the number of visitors and the industry's overall profitability."

"As tourism grows, our industry will have to grow. Then, we definitely will have to think about building more hotels, as well as diversifying the local product with different kinds of hotels," explained Clarisa Jiménez, president of the PRHTA. "But we need to push demand up to secure long-term industry growth."

A total of 37 hotels have opened or been upgraded since 2009, representing an \$835 million investment and 1,981 hotel rooms. The opening of just the Sheraton Puerto Rico Convention Center Hotel, W Retreat & Spa Vieques and St. Regis Bahía Beach Resort accounted for an investment of \$523 million and the creation of 1,000 jobs.

The new Nautical Law, with attractive tax credits and development incentives, is expected to provide smooth sailing for the local industry, with an estimated \$1 billion annual economic-development potential within the next 10-15 years.

#### FILM &

##### ENTERTAINMENT INDUSTRY

The new Film Industry Economic Incentives Law, approved in March, expanded eligible projects to include documentaries, short films, music videos, video games and the filming of live shows, as well as feature films.

There is a 25% tax credit for industry infrastructure projects, and a reduced tax rate of 4% to 10% on film-studio profits. Through the concept of "Film Development Zones," the law also provides incentives for the establishment of world-class film-production studios.

"This is the new growth industry in

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Puerto Rico,” ensures film producer Santos Rivera, president of Latitude Films. “In such a short period, the new law has been a ‘shot in the arm’ for the local advertising industry, enabling many of them to bring their TV-commercial productions back to Puerto Rico while promoting local talent.”

Another attractive component of the new law is its attractive infrastructure incentives. “This will enable Puerto Rico to attract and develop its own studios and soundstages, making us a full-service, one-stop film destination, open for business year-round,” said Mariela Pérez, executive director of the P.R. Film Committee.

This is also an important labor-intensive industry, she added, that will support long-term job creation.

#### A CHANGING MANUFACTURING INDUSTRY

Despite its many challenges, the manufacturing sector still accounts for more than 40% of the local GDP.

Puerto Rico also has one of the world’s best incentives packages for local manufacturers under Law 73 of 2008. It offers a fixed 4% tax rate, even lower rates for “pioneering projects” and a 50% tax credit for local and recycled projects, among other benefits.

“We are trying to reinvigorate traditional industries in novel ways, through legislation and targeted incentives to promote the growth of agricultural biotech projects, and aggressive new rum-industry incentives designed to promote the sale of Puerto Rican rum throughout the U.S.,” Pérez-Riera explained.

Many of these incentives have now taken root and are beginning to show results. Despite generally tough times for manufacturing, both locally and across the globe, the Puerto Rico Industrial Development Co. has promoted 217 projects with 183 firms, which, combined, have committed to making a \$522 million investment and creating 12,467 jobs.

A growing group of local entrepreneurs is proving that if you have the vision, creativity and willingness to face the odds with the right business plan, local manufacturing can still be a viable enterprise.



#### RESEARCH & DEVELOPMENT

The enactment of Law 150, which amended the Government Ethics Law (Law 12 of July 24, 1985), lifted prohibitions against University of Puerto Rico (UPR) professors and researchers working as consultants for private firms the UPR licenses to develop patented technologies, or to start their own commercial ventures.

It allows the UPR to draw up contracts with professors and researchers to facilitate the transfer of technology and commercialization of intellectual property approved by the university president, who must submit an annual report to the Government Ethics Office on such transactions approved during the year.

Another significant step was passage of legislation for the Science District, which increased incentives for researchers to locate on the island, as well as funding for the Puerto Rico Science, Technology & Research Trust to invest in promising startups to commercialize new technology, plus the creation of a Science, Technology & Research District.

#### EXPORT SERVICES

Equally important is the push to increase exports of goods and services to fuel future economic development. A series of initiatives have been directed at spurring exports,

including professional services.

The Fortuño administration has identified about 500 small and mid-size companies that are prime candidates for growth through exports of the goods and services they provide.

“Part of the challenge is to encourage companies to look beyond Puerto Rico, where many have grown comfortable with the benefits of staying within the local market. As more businesses break through the fear of exporting, the island’s benefits will become clearer, and other businesses will follow suit,” Pérez-Riera explained.

“Selling overseas creates jobs here at home, because companies have to hire locally to make products [if they are manufactured locally] and service those customers whether the products are made here or not,” he told CARIBBEAN BUSINESS. “The important thing is for the companies to have headquarters in Puerto Rico, because the more they grow, the more they hire.”

An upcoming example of the local government’s commitment to supporting export efforts is the first Economic Development Summit between New York and Puerto Rico, sponsored by DDEC, which takes place in April. The event aims to foster partnerships between local firms and New York-based minority

companies to win large state and federal contracts (CB Feb. 16).

On the private-sector front, the associations for Manufacturers, Engineers & Land Surveyors, Products and the Chamber of Commerce formed the Business Alliance to promote and support local export activity to Latin America and the Caribbean. Their first commercial mission to the Dominican Republic, in conjunction with the DDEC, was a success with more than 100 meetings recorded, which resulted in transactions of more than \$18 million.

#### GREEN ECONOMY

Renewable-energy projects, such as Walmart’s \$25 million solar panel program, are at the core of Puerto Rico’s new green economy, slated to become an increasingly important source of jobs and economic development in the future.

Much of the catalyst comes from efforts by government officials to turn one of Puerto Rico’s big negatives, such as the high cost of power, into a positive. In addition, growing awareness about the benefits of a green economy has spurred related efforts by business and consumers to look for ways to cut their monthly power bills.

The green segment also includes related efforts in the waste-management field, with big business opportunities in the recycling of garbage, used tires, glass and a host of other materials. Green consumer products are also poised to grow locally, as well as construction-related materials from the anticipated boom in LEED buildings (the acronym for the Leadership in Energy and Environmental Design standard of the U.S. Green Building Council).

The Fortuño administration has also enacted incentives for renewable-energy projects, including matching grants of up to 60% of a project’s cost from the Green Energy Fund, which will be funded with \$290 million over the next 10 years. Large projects can benefit from a 30% federal-government tax credit, as well as local incentives for producers, and the government has committed to pushing the projects forward on a fast track.

Already in different stages of development are seven large-scale renewable-energy projects with a combined \$1.3 billion investment. ■