



# TOURISM: A DRIVER FOR ECONOMIC GROWTH

October, 2016

## ABSTRACT

The tourism industry represents a strategic opportunity to reactivate the local economy. This reports shows how important the tourism sector is for Puerto Rico and how the Task Force can implement changes in the short-term.

## Inteligencia Económica

Presented to: Puerto Rico Hotel & Tourism Association

# EXECUTIVE SUMMARY

The main proposal for the Task Force from the tourism sector is to communicate to the Oversight Board that the best option for Puerto Rico's tourism industry, is to implement a Destination Marketing Organization ("DMO") run by the private sector. It has been proven that, for decades, the government has been incapable of providing stability and consistency to the sales and marketing efforts of the destination, reason why the private sector feels that a private organization should be the one leading this efforts, with an adequate public participation.

## Advantages:

1. **Fiscally neutral to the U.S. Treasury.** The DMO will be managed by a Board of Directors from the tourism industry with the participation of all sectors including hotels, restaurants, suppliers, tour companies, among others. It will have its own fiscal autonomy.
2. **Self-sufficient industry with assured government revenue.** This sector relies on tourists, which in the past years have grown steadily, and Puerto Rico has one of the highest occupancy rates in the Western Hemisphere. Additionally, the government receives a percent from the Room Tax, Casio taxes, consumption taxes, and others.
3. **These taxes are subject to repayment.** The government heavily relies on the growth of the tourism sector because of the Bonds already financed by the taxes generated by the industry.
4. **The government doesn't have to implement anything new.** The private sector already has the model to follow with the DMO, and through the efforts of this organization can create jobs, increase its growth and increase revenues to the government.

## Why the tourism industry is a priority

Reports published by the Federal Reserve Bank, Boston Consulting Group, and by former World Bank Chief Economist Anne Krueger<sup>1</sup>, all point to the tourism sector as a priority sector for potential growth.

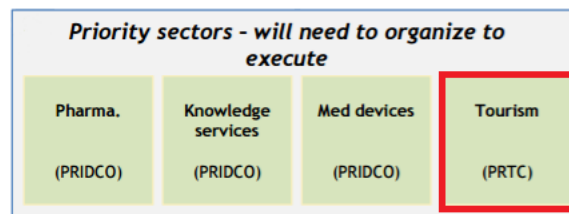


Figure 1: GBD, Boston Consulting Group Plan

- **Tourism is a fundamental driver of the local economy and job creation.** The tourism industry represents 6% of total GDP. It also hires employees with any kind of academic background, provides benefits, and provides opportunities for the employees to increase their wages.

<sup>1</sup> These reports will be expanded below.

- **Even under economic pressure, in the past 10 years the industry invested over \$3 billion.** While the economy struggled after 2006, the tourism sector invested over \$3 billion in remodeling hotels, new construction, advertisement, and other ventures.
- **Puerto Rico’s tourism sector has significant room for growth.** The number of visitors coming to the island is expected to continue its upward trend. If the Task Force gives the private sector the opportunity to drive Puerto Rico’s tourism expansion, many new visitors could be expected in the immediate years.
- **New money into the economy with hotels in the front line.** The revenues from the tourism sector is new money for our economy. Hotels, tour buses, restaurants, and others, are the first line in seizing revenues and paying the government.
- **The recovery of the U.S. economic provides a solid base to drive the recovery of the tourism sector.** The majority of the number of visitors the island receives comes from the U.S. The economic recovery of the mainland has provided the island with an increase in visitors. The U.S. economy is expected to continue its growth which will benefit Puerto Rico.

Many reports from different sources including the Federal Reserve Bank, Boston Consulting Group, among others, have prioritized the tourism sector as one of the top industries that can stimulate the economy in a short term for economic growth. Even back in 2011 a White House Report stated: “the Task Force has identified three industries that could potentially drive long-term growth and job creation on the Island. **In particular, Puerto Rico has a solid foundation on which to grow its clean energy, its role as an economic and tourism hub and gateway to the Caribbean and Latin America,** and its health care industries.”<sup>2</sup>

### **We ask the Task Force to guarantee the growth of the Tourism industry by**

1. Providing the private sector, the tools to guide this into maximizing its potential growth, by implementing a Destination Marketing Organization (“DMO”) run by the private sector.
2. Stopping the process run by Video Lottery to expand gambling machines throughout the island.

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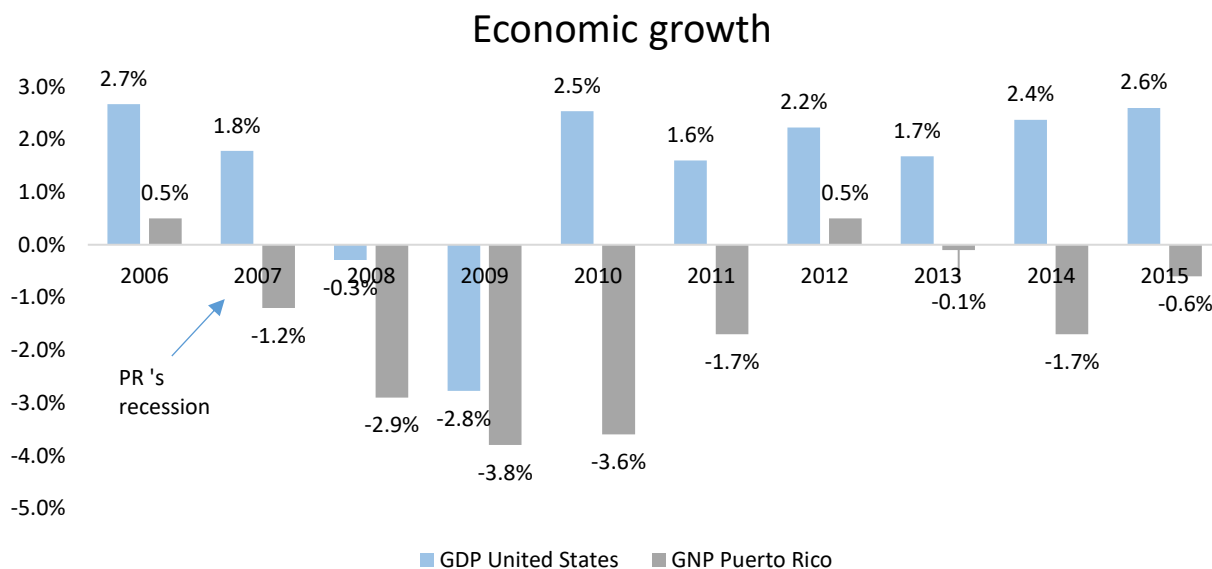
<sup>2</sup> See Report by the President’s Task Force on Puerto Rico’s Status  
[https://www.whitehouse.gov/sites/default/files/uploads/Puerto\\_Rico\\_Task\\_Force\\_Report.pdf](https://www.whitehouse.gov/sites/default/files/uploads/Puerto_Rico_Task_Force_Report.pdf)

# Tourism Industry in the island

## Puerto Rico's economic reinvention process

After a decade under depression, local policy makers have not found an effective set of economic policies to reactivate the local economy. Puerto Rico is the only U.S. jurisdiction that continues under depression eight years after the financial crisis of 2008. Since the launching of Operation Bootstrap in 1948, the local economy has been strongly correlated to the U.S. business cycles, providing stable periods of economic growth. Nevertheless, for the first time, the local economy is decoupling from the mainland, representing an amazing challenge to the state government and the recently appointed Fiscal Oversight Board. As PROMESA proposes, the debt restructuring and fiscal reform to be successful, depends on the stabilization of the local economy. Puerto Rico urgently need an economic program capable of reactivating economic growth, create jobs, wealth, while expanding the tax base.

There is a consensus among local economists, that Puerto Rico faces a structural economic problem. Moreover, the economic model created under "Operation Bootstrap" became obsolete right after the elimination of Section 936 in 1996, which affected the Island's main competitive advantage to attract new investment and retain manufacturing facilities. It's not a coincidence that the local economic and fiscal crisis started right after the Section 936 phase out period, provided by a Congressional act in 1996, and ending 10 years later.



Graph 1: Planning Board, Statistical Appendix 2015; Bureau of Economic Analysis

Different independent studies have recommended that Puerto Rico needs to diversify its productive structure by expanding several industries where the Island has regional competitive

advantages; tourism being one of these. In 2014, The Federal Reserve Bank of New York, published a paper titled “An Update on the Competitiveness of Puerto Rico’s economy” where the FED recommends that the local government needs invigorated efforts to raise economic growth by reducing barriers to job creation and labor participation.

The FEDs report included tourism as an important sector that the government should promote. **“The agenda also outlines plans to promote tourism and knowledge-based services, industries considered to have a strong growth potential on the Island and already a focus of initiatives for new job creation”**.<sup>3</sup> Also, they recommended that local policy makers should create a more dynamic business environment.

Another economic report commissioned by the government in 2013 to the Boston Consulting Group (BCG), recommended maximizing the tourism industry as one of the five priority sectors identified to be strengthened. **BCG consultant recommended to strengthen the tourism industry by target emerging niche markets including luxury, ecotourism, medical, cultural and sport tourism**. BCG estimates that by implementing a new strategy the tourism sector is able to create 20,000 new jobs in five years.

Already local coalition of businesses presented another proposal for the Task Force which also mentions the tourism sector as an economic driver by allowing Puerto Rico to bend the requirements for visa from tourists and international students. The goal is to increase the number of visitors by 20%. An increase of 15% of visitors will generate 8,520 jobs in the island<sup>4</sup>.

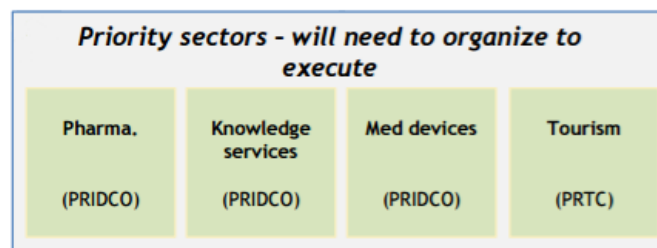


Figure 2: GDB, Boston Consulting Group

This report presents a brief analysis of the potential of the tourism industry to become a key driver of the economic recovery, but more important, a relevant industry in Puerto Rico’s new economic development program. The Puerto Rico Tourism and Hotel Association (PRTHA), strongly believes that it is time to implement a new policy that maximizes the industry’s potential. PROMESA and the fulfillment of the fiscal reforms to be implemented by the Fiscal Oversight, provides a unique opportunity to execute a new strategy to position Puerto Rico as a world class tourism destination.

<sup>3</sup> See “An Update on the Competitiveness of Puerto Rico’s Economy” by the Federal Reserve Bank of New York, July 31, 2014, p.8.

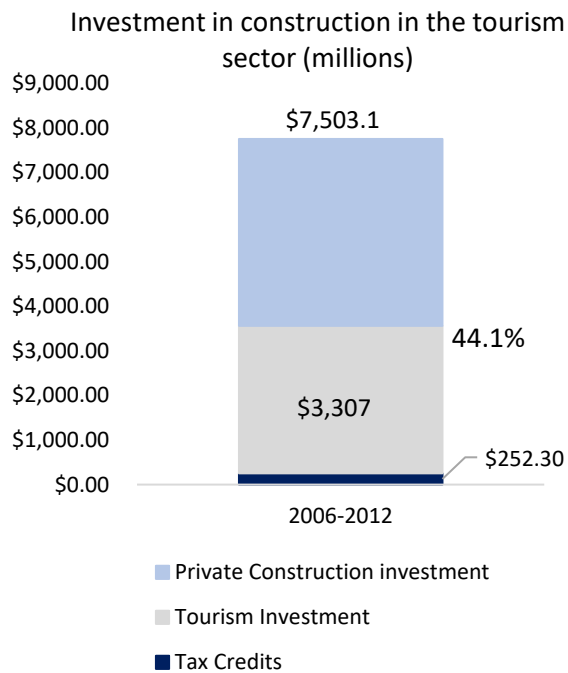
<sup>4</sup> See “Empresarios por Puerto Rico presenta su fórmula al “task force” by El Nuevo Día

<http://www.elnuevodia.com/negocios/economia/nota/empresariosporpuertoricopresentasuformulaaltaskforce-2250383/>

## The tourism industry as an economic driver

Tourism plays an important role in determining the trends of the overall economic cycle and several specific economic activities role. Since the recession began in 2006, many sectors that drove the economic growth on the island, such as construction and manufacturing, crashed in the years that followed by downsizing labor, cutting costs and investments in any way they could. This affected the Puerto Rican population enormously, which led to more than 300,000 residents leaving the island for the mainland.

Still, in the midst of a recession, other sectors which were alienated, felt the need to push forward and capitalize on the demand of those who left.



Puerto Rico has always been a beacon for tourism in the Caribbean, especially for Americans who find it less expensive and easy to get to the island since they don't need a passport to travel to Puerto Rico. Plus, they can find many native English speakers, cultural similarities and the use of the same currency.

While other sectors downsized jobs, decreased investment, or completely halted production, the tourism sector invested more than \$7 billion in remodeling, new construction, and overall investments. Proving it can increase revenues with the already established tax credits.

Graph 2: Tourism Company

The tax credits provided to the sector – which are already in place and the Oversight Board doesn't need to provide additional incentives – has benefited the sector into expanding its investment during the dire times of the recession by investing in construction and creating jobs.

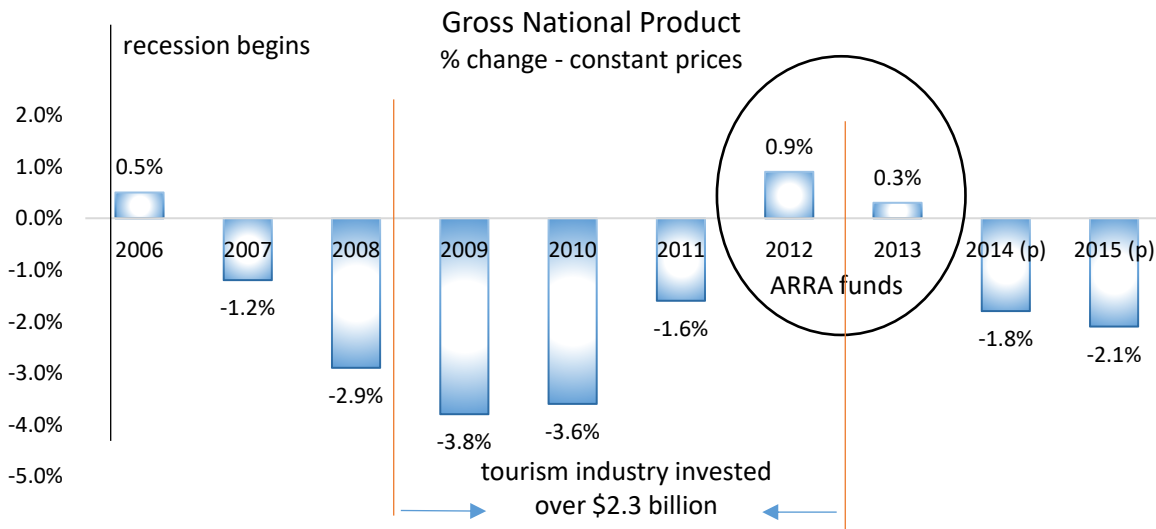
### Economic Impact of the Sector

Period	Investment (millions)	Tax Credits (millions)	Rooms (new and remodeled)	Jobs
<b>2004-2014</b>	<b>\$3,509.7</b>	<b>\$272.6</b>	<b>9,563</b>	<b>13,822</b>

Source: Tourism Company

## A neutral sector where everyone wants growth

Puerto Rico lags behind the United States in economic growth, and there is no short term recovery in sight. The decoupling effect has affected growth, investment, and social tendencies in the island. In the midst of economic and political turmoil in the island, the Task Force needs fiscally neutral policies to promote economic growth. Tourism is a sector that provides great advantages for everyone by bringing new money into the island, give great P.R., and encourage locals to partake in the sector. During the height of the recession the industry invested over \$2 billion in construction, employment, etc. in improving the industry.

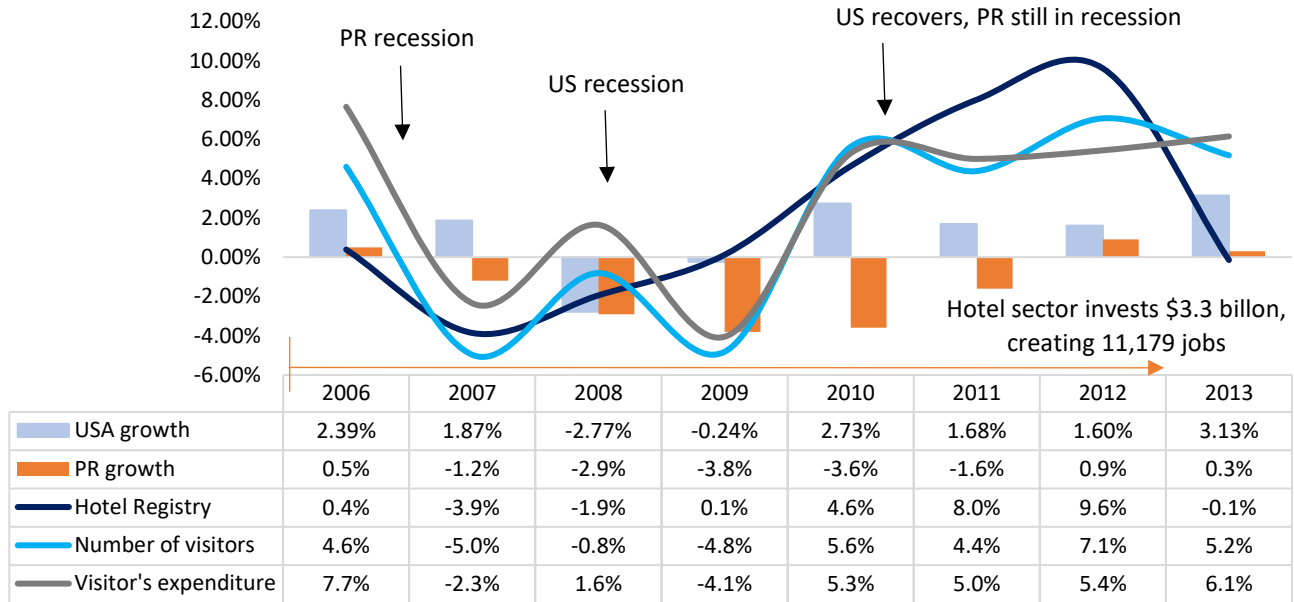


Graph 3: Planning Board, Statistical Appendix 2015

### Additionally, this sector already has the necessary incentives to boost short-term growth.

- In over a decade the sector has generated almost \$3 billion in new investments.
- Job growth in the sector is solid at a moment when many Puerto Ricans flee the island in search of jobs in the mainland. New investments created over 25,699 direct and indirect jobs.
- Benefits are already in place under the Ley de Incentivos Turísticos which received over \$374 million in tax credits but gave back over \$3.3 billion in the last decade. Puerto Rico's tourism is closely linked to the US economy.

### US growth and tourism sector in Puerto Rico

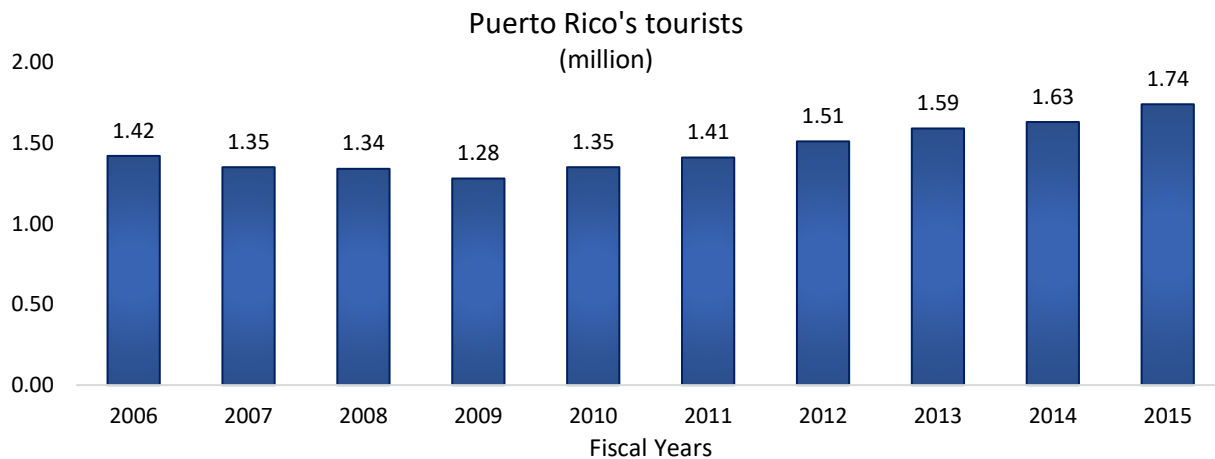


Graph 4: Tourism Company, Planning Board, BEA

Puerto Rico’s tourism is closely linked to the US economy. Over 1 million visitors come from the US, and as seen in the graphic above, the number of visitors, same as the number of hotel registrations, decreased during the U.S. recession and gradually increased as the U.S. recession improved.

### The Tourism Sector stepping up

Amid a recession, Puerto Rico’s tourism has been able to attract more visitors, generate more revenue and create more jobs than ever before. It was the tourism sector that spurred critical economic growth and helped maintain the energy and vibrancy of the island when it needed it the most.

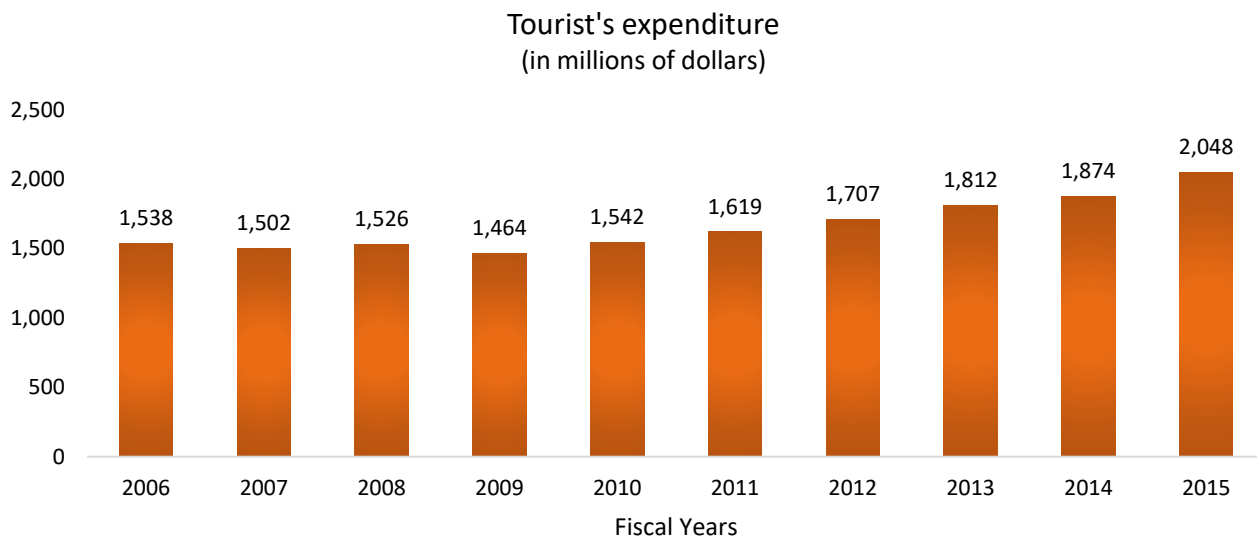


Graph 5: Planning Board, Statistical Appendix 2015



Those visitors who visit the island come from all over the world, mainly the US, arriving through the largest airport in the Caribbean, Aeropuerto Luis Muñoz Marín, or through the largest port in the Antilles in Old San Juan. As of 2013 the airport has seen an increase of 20% in visitors, a total amount of 5 million visitors who came through the airport, and 1.5 million who came through cruise ships. Old San Juan Port is estimating a goal 1.7 million visitor through cruise ships in 2016 Hotel occupancy rate averaged about 70% with more offer in hotels rooms.

All these visitors have an economic impact in the local economy and are a driving force for many local businesses. In Old San Juan, many restaurants are highly dependent on tourism in the area which has given a boost to the main street in Old San Juan.

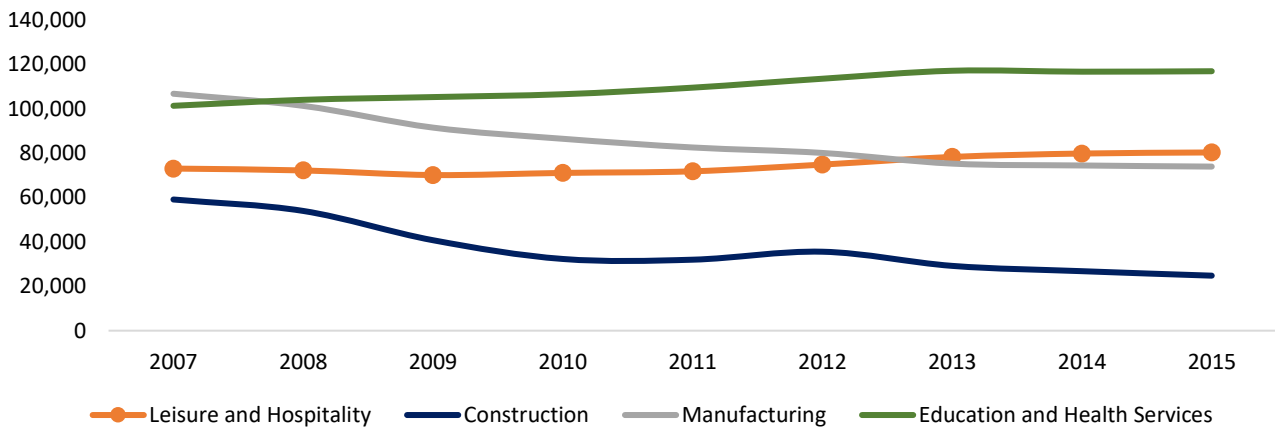


*Graph 6: Planning Board, Statistical Appendix 2015*

Visitor expenditures is extremely important for the local economy and the government. In 2015, visitor spending generated more than \$215 million in state taxes and almost \$20 million in city taxes. This doesn't include all the additional expenditures made by visitors in miscellaneous spending, room taxes, and casino taxes, which will obviously increase the amount generated by the government.

The tourism sector has a high multiplier effect. For every dollar invested in hotels, an additional 63 cents is generated in the economy. The multiplier effect also impacts the labor industry, for every one direct job created in the hotel industry, a .72 indirect job is created. While other industries continue to suffer and lose employment, the tourism sector continues to bloom.

## Employment in different sectors



Graph 7: Bureau of Labor Statistics

The FED's report (mentioned above) stated the tourism sector as a notable pocket of relatively brisk job creation "where total employment now far exceeds its prerecession peaks"<sup>5</sup>.

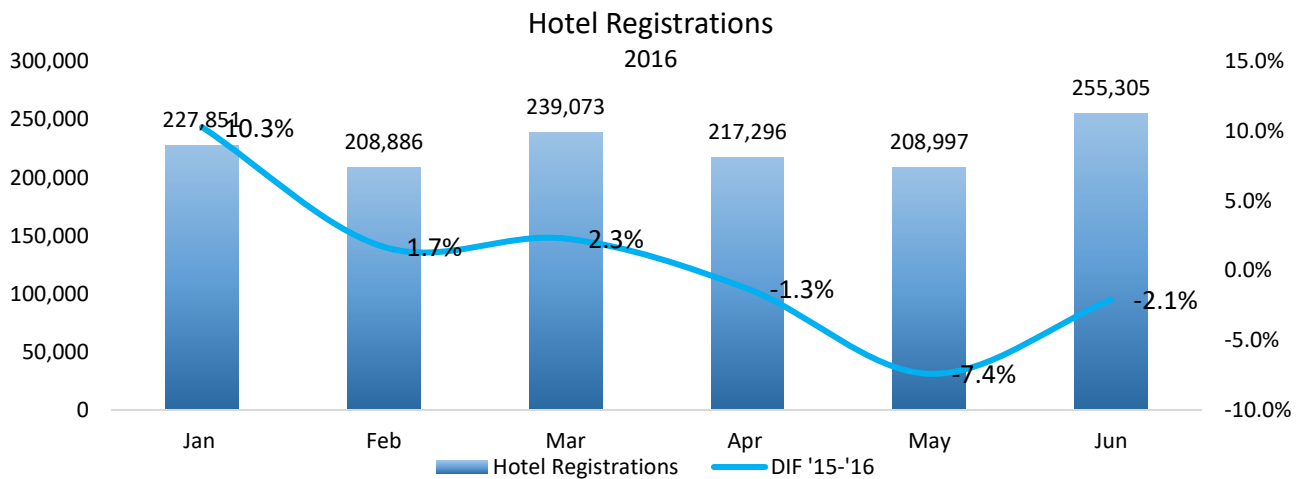
## Zika and how it has affected tourism

In 2016 the local mosquito transmission of the Zika virus infection was reported in Puerto Rico. Because the Zika virus is primarily spread by mosquitoes, the CDC recommended that travelers to Puerto Rico protect themselves from mosquito bites, and recommended that women who were pregnant or were aspiring to become pregnant, avoid traveling to Puerto Rico. Puerto Rico wasn't the only destination to be affected by the Zika virus, 25 nations in the Caribbean, 12 countries in South America and in Mexico, including Florida in the United States, were affected by the news. Nonetheless, travelers were upset by this information and many decided not to travel due to the unknown sickness.

After record growth in 2015 the tourism sector this year could see the numbers slightly remain the same due to the months after February as a result of the Zika scare. In January, hotel registrations grew 10.3% but decreased in the following months with cancellations. By all means this doesn't mean that the tourism sector is struggling, but it took a jab a couple of months. So far, clients seem to be continuing their travel plans. According to CheapCaribbean.com bookings across the site are up 17% and Puerto Rico seems to mirror that growth<sup>6</sup>.

<sup>5</sup> See "An Update on the Competitiveness of Puerto Rico's Economy" by the Federal Reserve Bank of New York, July 31, 2014, p.3.

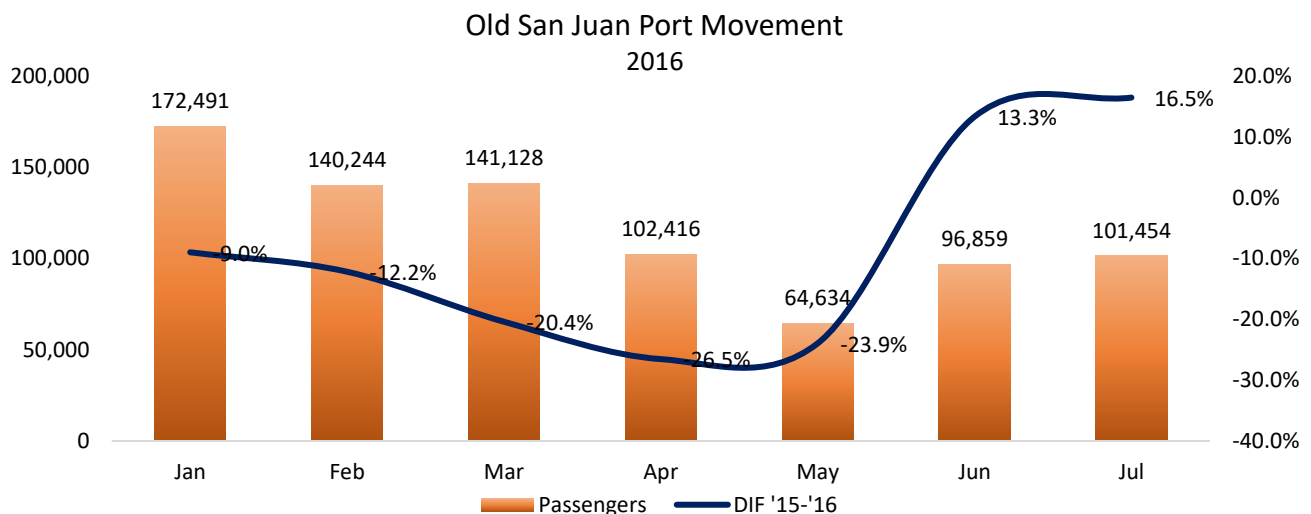
<sup>6</sup> <http://www.travelweekly.com/Caribbean-Travel/Puerto-Rico-tourism-drops-as-Zika-infections-accelerate>



Graph 8: Tourism Company

The Zika scare is only temporary, Puerto Rico has battled other scares such as chikungunya, AH1N1 known as “porcina”, and yet many people want to continue to travel to the island. Besides, mucho of the hype around the Zika virus is over estimated. The CDC had said that many Puerto Ricans will get infected, when in reality, less than half of 1% of the population was infected by the virus<sup>7</sup>.

Port transit also took a hit after the warnings of the Zika virus but has managed to increase in the past couple of months the amount of trips made by cruise ships, with an increase of 8.7% in July in the amount of passengers.



Graph 9: Tourism Company

<sup>7</sup> <http://www.cnn.com/2016/08/18/puerto-rico-tourism-chief-pushes-back-on-zika-virus-warnings.html>

## A new threat to revenues: Video Lottery Terminals

While many in the industry consider the opening of Cuba and Airbnb as main threats to the islands tourism, the industry has targeted Video Lottery as its main threat. Cuba's opening and tourism will have a boom in the upcoming years but Cuba still doesn't have the infrastructure to hold the demand. While Airbnb can be an opportunity for healthy competition in the industry.



On the other hand, **Videolotería can severely damage years of investment and growth within the hotels.** Many hotels depend heavily on the casinos and the tourists that visit these hotels for gambling purposes. If Video Lottery starts to randomly place slot machines in different places on the island, it will severely impact the casino and therefore the industry.

If the industry is severely affected due to the lack of income from casinos, this will mean:

- Less rooms available for tourists
- Less revenue for the government from casino taxes, room taxes, etc.
- Major instability in the sector which will lead to decrease in investment.
- Casinos and hotels will lay off many employees while Video Lottery doesn't hire any new employees as is not labor intensive.
- The government will likely default in bonds that depend on tourism taxes to be repaid.
- Local economies that depend on tourism and hotels, such as restaurants, taxis, tour guides, and others, will have drop in revenues, which will lead to decrease in investment, layoffs and so forth.

A study prepared by a private independent research group for the Puerto Rico Tourism Company about the impact of Video Lottery terminals on the casino industry analyzed the effect in the hotel industry and overall economy. The proposal that would allow for future expansion to 15,000 Video Lottery Terminals would have the following impacts<sup>8</sup>:

- Gross casino slot revenue would decrease between \$33.1 million and \$125.9 million annually, a decrease of between 10 percent and 38 percent.
- Educational Fund disbursements would decrease between \$5.9 million and \$22.8 million annually, a decrease of between 8 percent and 32 percent.
- General Fund disbursements would decrease between \$2.0 million and \$7.6 million, a decrease of between 8 percent and 32 percent.
- Tourism Fund disbursements to PRTC would decrease between \$5.1 million and \$19.7 million annually, a decrease of between 8 percent and 32 percent.
- Casino-related jobs would decrease between 203 and 773, a decrease of between 5 percent and 19 percent.

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<sup>8</sup> See "Economic, Regulatory, Social Analysis: The Impacts of Video Lottery Terminals on the Casino Industry in Puerto Rico" by Spectrum Gaming Group on May 28, 2009.

# A new policy approach to reactivate the tourism industry

We need the vision to create the most forward-thinking and dynamic municipal marketing organization has ever been designed. Indeed, the energy of our island and its tourism sector is there, and it needs the adequate tools to flourish. PRHTA has taken several key initiatives to reach these goals which are mentioned below.

This is an industry that already has the infrastructure and businesses in place for it to continue to prosper. What Puerto Rico needs is a vibrant promotional campaign to let the world know all that Puerto Rico offers. The Puerto Rico Hotel & Tourism Association (“PRHTA”), which represents over 530 corporate members comprised of hotels, restaurants, tour companies, suppliers of hospitality goods and services, airlines, cruise lines and educational institutions, has been recommending establishing a Destination Marketing Organization (“DMO”) to market the destination.

A Destination Marketing Organization (“DMO”) is an individual private organization that promotes a city, town, region or country in order to increase the number of visitors. Its main purpose<sup>9</sup> is to:

- Increase the economic benefits of tourism and group meeting to their respective destinations
- Inspire travelers to visit their destinations
- Influence travel throughout their communities to increase spending and enhance the visitor experience.
- Attract conventions, meetings and events to their destination.

Puerto Rico has all the amenities it needs to capitalize with not only tourists but other businesses who view the island as a getaway for conferences and events.

- Puerto Rico Convention Center: is the largest convention center in the Caribbean and one of the most technologically advanced in the Americas. It can accommodate up to 25,000 spectators.
- Puerto Rico Coliseum: It can accommodate up to 18,500 spectators and is ranked 8<sup>th</sup> in the top 50 Arenas in the world. Both these entities are managed by the Puerto Rico convention District Authority.



These are some examples **the DMO can actively promote to increase the number of events in both venues.**

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<sup>9</sup> <http://www.destinationmarketing.org/topics/about-industry>

The opportunities for investment and growth in Puerto Rico are huge:

- There are over 15,000 endorsed rooms
- Over 60 lodging projects in various stages of development.
- Over 212 hotels and paradors.
- Travel agents, nautical tourism, tourist guides, transportation, promotional endorsements, quality endorsements, green lodge facilities.
- Four beaches have been awarded & certified Blue Flag Beaches in Puerto Rico.
- Over 1,600 weekly flights to all over the world depart from Luis Muñoz Marín Airport.



As with the venues, the DMO can dynamically advertise these opportunities because they know the business since they are part of it. The private sector can manage the marketing for Puerto Rico.

In Puerto Rico, the PRHTA has already designed four pillars to separate the entity from government regulation, not to affect any fiscal decisions made by the Control Board, and its only key objective will be to propel the tourism sector. Those four pillars are:

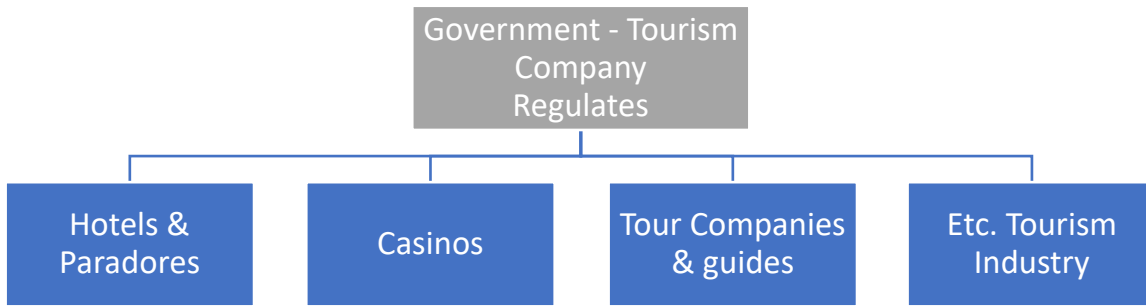
1. The DMO must be an independent entity from the government, and therefore,
2. The DMO will not be under the Puerto Rico Tourism Company (“PRTC”)
3. The majority of the DMO Board of Directors will represent the private sector, but will include designated members from the government
4. The DMO must have fiscal autonomy

A DMO will maximize the use of available marketing funds by investing strategically and by giving continuity to marketing and promotional efforts. As part of the efforts of reestablishing fiscal discipline in Puerto Rico, the creation of a DMO capable of implementing efficient marketing strategies and ensuring an adequate use of available resources is a goal that all Puerto Ricans should welcome.

The DMO will be self funded with income from the industry through casino revenues, room taxes, and others. This is another reason why Video Lottery should NOT be able to monopolize the gaming industry in Puerto Rico. The DMO is trying to implement a new type of model that will alleviate the government’s role and agencies from regulating an industry that can manage itself.

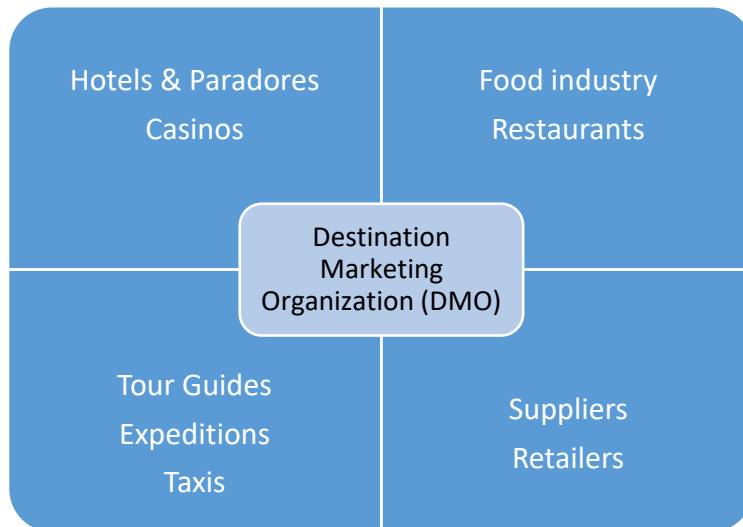
After implementing PROMESA, the government agencies are under scrutiny which will lead to austerity measures that will layoff many employees and probably unbalance the business model some agencies are running. Members of the tourism sector (including hotels, restaurants, taxis, and others) want to bring forward an opportunity to change the current model of regulation and give the reins of the marketing of the industry to them.

## CURRENT MODEL



The government regulates each sector independently.

## PROPOSED MODEL



An integrated organization where each sub sector within the tourism industry contributes to the DMO in order to improve its own area.