

Suggestions for the Economic Development of Puerto Rico

Author: David A. Ashe, San Juan, PR.

Preface

Thank you for soliciting these submissions. I won't go into the Island's current fiscal problems, as they are all well documented and known to you, but will take a stab at suggesting solutions to some of the issues I have seen here in my 11 years living in the "Island of Enchantment" (*isla del encanto*) as the locals call it.

I. Stopping the bleeding

The first order of business should be to find some breathing space for PR to reorganize its fiscal matters. PROMESA does a good job of essentially enabling a bankruptcy environment that can allow the deferment of loan payments, while a balance is sought between revenues and expenses. It also contains ample provisions to allow the Advisory Board to work on economic development, which is the key.

Business is my area of expertise, so I will leave the governmental fiscal matters to the experts. I would just like to caution against the **wholesale firing of thousands of government workers**; we all agree that by most measures, the size of the Puerto Rican government (including municipalities, state agencies and state corporations) is excessive and unsustainable. But creating even greater unemployment would harm the economy, driving even more private enterprises out of business. Government *must* be reduced, but gradually. Otherwise, even more people will leave the Island in the near future, deepening our crisis.

Do not just look at restructuring governmental agencies. Also look at restructuring **how we are governed**. Why should Puerto Rico have a bicameral legislature, staffed with **full-time** Senators and Representatives, when states such as Texas make do with part-time legislators? In 2005, the people of Puerto Rico spoke in a referendum, with over 80% of voters approving a move to a unicameral legislature. The politicians ignored the will of the people. The current structure costs money and fosters corruption.

In the near term, the debt needs to be restructured; agreeing with bondholders to postpone interest and principal payments, and restructuring pension plans will provide liquidity that should be invested in immediately shoring up the Island's flagging infrastructure. So, what can be done, quickly, to foster **economic development**? Here are some suggestions.

II. Economic development suggestions

- A. **Provide Parity on Medicare Reimbursements to Puerto Rico.** This is a quick and easy way to bring in about \$1.0 billion per year into Puerto Rico's economy and should be your first priority. Puerto Ricans pay the same in Medicare withholding as do mainland contributors, yet receive about 60% of the Medicare allocations they would receive if on the mainland. Fixing this disparity would (a) put a stop to the flight of doctors and the closing of clinics and hospitals on the Island, (b) help improve the dismal state of our medical infrastructure (our hospitals are not even up to third world standards of care), and even (c) generate investment in medical facilities, designed to attract medical tourism.
- B. **Overhaul our Income Tax System.** On a corporate level, our taxes suffer from the worst of all possible worlds. On one hand, they are too high. On the other, the tax collection authority (i.e. Hacienda) is woefully inept at **collecting them**, creating an atmosphere of easy evasion. Here are a couple of solutions.
 - a. Lower **corporate** taxes. We currently have a mix of very high local corporate taxes, especially when you factor in minimum tax rates and limitations on applying net operating losses (NOLs). Compared to other jurisdictions (states in the mainland, or other countries), PR's high corporate taxes create an incentive to shift profits away. On the other hand, certain selected industries/companies pay very low taxes under incentives such as Act 20. While this is very good at attracting *outside* investors, the brunt of *local businesspeople* suffer under a heavy and complex tax structure.

- b. Do away with/revise the CRIM on inventories. CRIM is a municipal tax applied both on real property and on inventories. The **inventory tax** can be up to 8% (all in; municipal and state) of a corporation's average inventory. This is a huge dis-incentive to investment, and is essentially a double tax to property that most likely already paid tax when being imported into the Territory! Furthermore, the CRIM is levied by each of the 78 municipalities, and for businesses operating in several, as for example a retailer having multiple locations, this can be nightmarish to fill out.
 - c. Make local businesspeople **pay their taxes**. Due to the mix of a high tax rate with complicated filing procedures, and a very lax enforcement, many businesspeople, including service providers such as doctors, simply evade taxes. Hacienda is incapable of properly collecting sales taxes, much less policing corporate income taxes properly. Bring in IRS (or state sales tax) experts to set up a system to make sure everybody pays their fair share.
- C. **Overhaul the Permitting Process.** While PROMESA addresses this, it seems like it is meant to speed up major projects. Meanwhile, a business owner in Puerto Rico wanting to, for example, open an additional store, has to go through months of permitting red tape. It can take over six months, or a year, to get anything off the ground here. Governor Fortuño tried to address this, but failed. Making business and construction permits easier to obtain would help economic development.
- D. **Promote Investment in Existing Abandoned Real Estate.** If you drive around any Puerto Rican city, the amount of empty shells of abandoned buildings will strike you. Many of these are in prime locations for business and tourism development, and are eyesores. Not only are they not productive, they bring down the value of everything around them. Other jurisdictions in the U.S. have been successful in attacking this issue by (a) creating, or adding "teeth" to, public nuisance laws that force the owners of abandoned/unkept buildings to either put them to use, or force their sale at auction, and (b) creating tax incentives (and speeding up the permitting process) to anyone willing to buy and renovate/redevelop an abandoned/disused property. In PR, we already have Law 31 of 2012, which seeks to promote refurbishment of old/abandoned buildings, but to my knowledge, that law is almost impossible to get enforced. Owners of abandoned homes and commercial buildings have such low carrying costs, that it is very cheap for them to just leave them, waiting for the day in which their properties will reach the often outlandish values they think they are worth. In the meantime, they become magnets for mosquito breeding, drug users, and devalue the communities around them. If the owners are not willing to fix them, force their sale. At the right price, others will want to invest.
- E. **Attract Service Providers.** Act 20 should be doing a better job in bringing businesses that provide services, especially bilingual, to the Island. Promote Act 20 more actively to attract software companies, consultants, attorneys, etc., to create service centers in Puerto Rico for their mainland businesses.
- F. **Promote Agriculture.** Puerto Rico has some of the best agricultural land in the U.S. Ask Monsanto, or any of the other half-dozen seed development companies that have operations in the Puerto Rican southern side, why they are here. Sure, they have tax incentives to be here, but one engineer from Illinois I talked to recently told me their Puerto Rico operation was far more productive than their Hawaii one, as their seeds grow much quicker here. And speaking of **Hawaii**, there's a benchmark for Puerto Rico in terms of agriculture. Both are **coffee** producers. Yet while Hawaii's coffee production has been climbing for years, Puerto Rico's has been declining. Hawaii exports pineapples, nuts, and several other agricultural goods. They have Jones Act, they have the same Federal labor standards, and are even farther away from the mainland, yet their agricultural industries are thriving. The Hawaii example should be studied, and lessons learned applied to Puerto Rico. The Puerto Rican legislature should also be more aggressive in its liberalization of marijuana growing and consumption, it shouldn't wait until Federal deregulation and should take a stance similar to Colorado, in order to leap ahead of other states in taking advantage of this new, soon to be legal globally, crop. But the legislature here is too influenced by religious conservatives, which is why they missed the boat on gay marriage and the tourism development opportunities in serving the LGBTQ market. Do not let them miss the marijuana boat.

- G. **Tourism: An Industry with Huge Upside Potential.** Again, let's look at Hawaii. About 20-25% of Hawaii's GDP comes from tourism (Hawaii Dep't of Tourism data), while only about 5-7% of PR's GDP is tourism-related. Tourism is a growing global industry and PR needs to capture a larger share of it. A Master Plan needs to be drawn up, and incentives rolled out to seek to double PR's Tourism GDP share in the next 10 years. There are large areas of abandoned/undeveloped land around Old San Juan, the old naval base across the bay, and the old docks. This is an area visited, if only for a few hours, by **millions** of **cruise ship** passengers every year. What a great opportunity for an internationally branded (see Orlando for examples) theme park with rides, for example. Or a world-class museum, or even an aquarium. All these would be better than derelict dockyards. The interior of the Island is full of opportunities for adventure tourism, with the **Toro Verde** recent development being a great example. And the coastal areas and beaches have nothing to envy any other major tourist destination. This is a huge opportunity for major development.
- H. **Infrastructure Fixes are Needed.** Finally, the crumbling state of our roads, bridges, ports, power generation and distribution, and water utilities, are all great **opportunities** for economic development through a mix of Public Private Partnerships and yes, careful allocation of Federal funds. In many cases, Puerto Rico has been unable to find ways to receive even Federal funds allocated to it for infrastructure, therefore leaving money on the table. Help PR find the funding, and attract investment, to:
- a. Fix its power problems. This is a front-page news item, so little else needs to be said about this. Privatize PREPA. Again, look at how Hawaii has dealt with similar problems and is now investing heavily in alternative energy.
 - b. Fix its water problems. The AAA is another mess, and PR has even faced water shortages due to improper (or none) maintenance of our reservoirs. We are likely to face health issues as the water distribution infrastructure continues to break down. Privatize AAA/PRASA.
 - c. Fix our roads. We have a great road network (with an opportunity to extend the highway on the south to reach Mayagüez), but it is crumbling, too, as a result of shoddy construction and the fact that there are no penalties/costs for overloaded trucks that further damage the highways. Easy fix. I understand PR does not use its full allocation of Federal highway money, so that needs to be addressed.

I hope that someone reads this, and that it is useful in any way. I am sure there are many other things that can be, and should be, done, to help PR get back to growth. Final advice: Do not underestimate the amount of resistance from the entrenched establishment that any reorganization will face.

Thank you.

- David Ashe
- da.ashe@gmail.com
- 305-439-9903