

Puerto Rico Tourism:
An Opportunity Waiting for Action
By
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Dear Members of the PROMESA Task Force:

First of all, I want to express my appreciation to the U.S. Congress and Mr. Barak Obama, President of the United States of America, for enacting a law to provide Puerto Rico the opportunity to restructure our economy, which will have a positive impact among the 3.4 million U.S. citizens residing on the island, and to you for accepting this challenge. I am positive the objective will be achieved. This will not be an easy task and will require some sacrifices, but at the end of the day we all will have a much better place to live, and everybody will be satisfied with the achieved results.

In my case, I am a U.S. citizen, born and raised in Puerto Rico, and am not planning to move another place. Therefore, I feel it is my obligation to provide the Task Force with some ideas of initiatives that should be implemented to improve our finances and quality of life.

I served as a Federal Government employee for 32.5 years, 28.5 of which were served in Puerto Rico. I worked for the U.S. Internal Revenue Service. I had the opportunity to occupy several positions, mainly in the compliance area, and for 10.5 years was assigned to the Government of Puerto Rico, mainly to the Departamento de Hacienda, where I served in different positions within the Internal Revenue Area. As a Tax Administration Advisor for four former Secretaries of the P.R. Treasury, I actively participated in the implementation of the first Collection Division, an Automated Call Site, as well as many compliance initiatives, which resulted in successful implementations. In addition, I directed a change management process for the entire Internal Revenue Area. I was also the Project Manager for the implementation of a computerized master file, which is the system Hacienda still uses to run their tax system.

I was also honored to serve as the Puerto Rico Secretary of Treasury for two years. During my tenure I implemented free electronic filing of individual income tax returns, expediting processing of income tax returns, and refunds as well. I was later on appointed by the Governor as the First Inspector General for the Government of Puerto Rico. In addition, I was the Governor's Personal Representative in the Morales Feliciano Case (a class act case at the U.S. Federal Court). During my tenure we were able to, after over 30 years, to take initial steps to finally close the case at the satisfaction of the U.S. District Court. I also served as an Advisor to the President of the P.R. Senate for two years, conducting analysis and making recommendations for proposed legislation, mainly in the economic arena.

While I served as Secretary of Hacienda, I was also a member of the Tourism Board. I had first hand exposure to the tourism related activities. I had the opportunity to evaluate the potential our island has to present a very attractive opportunity for both, investors, and tourists.

Today, our island is faced with many challenges, therefore we have to evaluate all potential opportunities to revamp the economy. Tourism is an industry which should be closely evaluated to explode the possibilities our island has to offer.

The following is related to the tourism industry, which should be one of the main areas of economic development on the island.

ABSTRACT

Climate, beaches, an enticing natural environment, culture, and proximity to population centers—Puerto Rico presents a grand opportunity for tourism. Today, thousands of hotel rooms, condominiums, and houses are vacant. These facilities allow a quick expansion of the tourist industry; visitors and local business will be able to take full advantage of the island's wonderful natural resources. This existing capacity, along with established tax-based incentives, means that high returns can be obtained quickly. It is a grand opportunity that cannot be passed up.

Well-focused government action can lay the foundation for a burgeoning of private activity in tourism. Success will come with the Puerto Rican government allocating more funds to promote tourism and the federal government (particularly the PROMESA-created Task Force) backing ways that the Puerto Rican government can obtain these necessary funds.

In the development of tourism, Puerto Rico has long lagged behind its neighbors and the rest of the world. Yet, while the opportunity presented by tourism has been missed in the past, the opportunity still exists. Expansion of the tourism industry can make a significant contribution to Puerto Rico's economic growth.

Tourism has been the missed opportunity in Puerto Rico. It is, however, an opportunity that still exists. With appropriate government actions, the foundation for a burgeoning tourist industry can be established. Strong, extensive, and immediate action is needed. These actions could best be formulated and directed by a special tourism commission, insulated from the short-run vicissitudes of the political situation.^{*} Then, with a firm foundation in place, private initiatives can take advantage of the tourism opportunity and make a significant contribution to the recovery of the Puerto Rican economy. What's more, under current conditions, the tourism industry can grow with relatively low new costs and obtain quick returns.

The attractiveness of Puerto Rico, the island's advantage in the development of this industry, is clear. The climate, the beautiful beaches, the rain forest, the other scenic and remarkable aspects of the natural environment, and culture (to say nothing of the casinos) offer

^{*} This commission should be appointed as soon as possible after the November election and should stay in place for a fixed period, perhaps three years.

strong draws for tourists. Moreover, Puerto Rico's proximity to population centers in the states means easy access. While many of Puerto Rico's favorable features are shared with other Caribbean islands and parts of Central America, Puerto Rico has the special advantage of being a territory of the United States—U.S. laws, no passport, no visa, and no customs.

Nonetheless, while world tourism has grown and other sites in the Caribbean have rapidly expanded tourism, Puerto Rico has lagged behind. And tourists from the east coast of the United States flock to Hawaii instead of Puerto Rico—an eleven hour flight each way from New York and at least an \$800 air fare, as compared to four hours and \$300 to Puerto Rico. There are ways this situation can be changed, ways that Puerto Rico's position in the tourism industry can be dramatically improved. *The opportunity for change* today is especially favorable. *Government action* can make it possible for the private sector to take advantage of this opportunity. And the *historical context* that has held back Puerto Rican tourism progress can be understood and overcome.

Opportunity for Change

Though in the past the development of tourism in Puerto Rico has been neglected, this inaction need not be the blueprint for the future. Today the opportunity may be even more promising than in the past. Puerto Rico is a most convenient vacation site for perhaps half the U.S. population, closer and more readily accessible than other sites in the Caribbean and Central American and, for that matter, Hawaii. Yet, among the U.S. population there is limited awareness of the island's attractions. The potential demand needs to be transformed to an actual demand, which will require an all-out effort.

Now is an especially advantageous time to build up the tourist industry because returns can be quickly achieved through a rapid expansion that can be achieved with relatively little investment. While existing tourist facilities are by no means empty, neither are they under constraints of near-full capacity. As to hotels, according to the Puerto Rico Tourism Company, the average hotel occupancy rate in the first eleven months of FY2016 was 70%. (Along with the small rise in tourist arrivals, this figure was slightly higher than in recent years.) This figure is lower than those for several U.S. cities. For example, in Florida, Orlando had a 77% hotel occupancy rate in 2015 and Miami's rate was 78%. In New York City and Boston the 2015 occupancy rates were 89% and 82%, respectively.

Hotels, however, are only one category of available tourist facilities. As is well known, the long-lasting recession has generated a large exodus—some ten percent reduction of the population in the last decade—leaving many homes, houses and condominiums, vacant. Real estate prices have plummeted. A February 2016 *CNN Money* article titled “There's a big sale on Puerto Rican homes” underscores the point: “And it's a buyer's market right now. You can get a 3-bedroom home near the beach for under \$100,000.” Other examples abound. Two particular cases illustrate the phenomenon: the asking price for a penthouse condominium in San Juan's Mirador del Parque, which had a pre-construction price of \$890 thousand, is on the market for half that; a home purchased for \$177 thousand in 2009, well below its assessed value at the time of \$215 thousand, is on the market for \$100 thousand.

The combination of under-utilization of hotel rooms and extensive low-cost availability of condominiums and houses in Puerto Rico means that tourist facilities are available without extensive investment. Supply does not present a constraint in building up the island's tourism industry. The existing facilities (the empty condominiums and houses) could be prepared for tourists quickly, in a matter of a few months, and the preparation could be accomplished at relatively low cost. (Construction of new facilities could take three years or more and require large investments.) Government initiatives are needed, however, to facilitate the organization of a marketing and management system that will allow the condominiums and houses to be readily available to tourists (regarding which, see below).

Furthermore, in recent years the government has taken some steps to reduce costs for the tourism industry. In particular, Act 74 of 2012, "The Tourism Development Act," established several tax-based incentives for investments in tourism. The most substantial of these is a tax credit equal to 10% of the total project costs, or 50% of the cash investment made by investors (whichever is less). There are also exemptions (to various extents) from excise taxes, sales and use taxes, income taxes, and property taxes. This form of incentives has long been used in Puerto Rico to support traditional industrial activities—i.e., manufacturing. Since the burst of activity in the 1950s and 1960s, however, it has not produced much success.

With tourism, there is as yet no indication that these tax-based incentives are having a significant impact. The weakness of tourism was apparent before the onset of the current recession, as growth in the pre-2006 years was slow in Puerto Rico compared to other sites. And the level and rate of growth in subsequent years—including the years since the adoption of Act 74 in 2012—has been poor.

The expansion of tourism, as with other sectors of the economy, is not only affected by costs, though costs are important, but also by demand. As is the case with low interest rates in the states, without an anticipation of sufficient demand, low costs alone—whether because of low taxes or low-cost facilities (as described above)—will not generate strong increase of economic activity.[†] Tax-based incentives might be a useful part of an industry-promotion program, but without sufficient demand they are likely to have little impact. The demand for tourism on a world-wide basis and in parts of the Caribbean is strong, poor economic growth in many countries notwithstanding. Yet, in spite of the opportunity presented by the current circumstances on the island, demand for Puerto Rico tourism remains anemic.

Government Action

Although individual firms and associations of firms can act to generate demand for their services, in the tourism industry there is an important role for government support in raising demand for a particular site—a country, territory, or region. The data on government spending for more successful sites suggests government spending—on various forms of tourism promotion and visitor information services, for example—makes a substantial difference in the growth of

[†] In the jargon of economics, to expand the tourism industry in Puerto Rico, it is necessary to shift the demand curve outward as well as to shift the supply curve downward.

the tourism industry. By comparison with other sites—the Dominican Republic stands out—the Puerto Rican government’s spending in support of tourism has been relatively low. This relatively low level of government spending in the past shows up in the very limited advertising campaigns in the states for Puerto Rican tourism (to say nothing of the quality of those campaigns) and other forms of demand promotion.

The implication for Puerto Rican government policy is clear: more funds must be allocated to support the expansion of tourism. These funds can be used to support an intensive and sustained advertising campaign, especially along the east coast of the states and at least as far west as Chicago (which is virtually as close to Puerto Rico by plane as is New York City). However, advertising is a relatively passive form of promotion—based on the idea that “if we show it to them, they will come.”

To obtain quick results, to take full advantage of the current opportunities, more active tourism promotion is needed. Puerto Rican government officials along with representatives of the tourism industry—from large and small types of enterprises—should meet with airlines firms, tourist agencies, Airbnb, and others to boost demand for the island’s tourism. Combined with a well-designed advertising campaign, strong connections with these groups can fill out a promotion effort.

This effort must be forceful and extensive to be the game-changer that is needed for tourism in Puerto Rico. It cannot be smothered by existing bureaucracy, but would best be organized and directed by a special commission (as noted earlier), which would be given adequate funding and allowed to act relatively independently.

With the existing availability of hotel rooms and the potential offered by empty condominiums and houses, promotion funds, if spent effectively, can yield relatively quick results in terms of an increase in demand for Puerto Rican tourist accommodations. This increase of demand will lay the foundation for a surge private activity.

Yet, while the capacity in terms of hotel rooms, condominiums, and houses exists, there is no effective system in place to market and manage the condominiums and houses for tourists—either through rental or purchase. The government must facilitate the creation of a means to place the marketing and management of these facilities under the auspices of firms—e.g., hotels or Airbnb—with tourism experience and capabilities. For example, control of a few hundred available condominiums and houses could be transferred by sale or lease to a large hotel firm, which would then market and manage them. Establishing such a system of marketing and management will require some government resources, funds in addition to those needed for promotion of tourism.

Government funds, however, are not readily available, to support tourism or other new activity in Puerto Rico. Without funds, the Puerto Rican government cannot build on tourism opportunities or take other actions—a general infrastructure investment program, in particular—that generate economic expansion. A recognition of this need for funds is apparent in PROMESA, and the Congressional Task Force on Economic Growth in Puerto Rico is addressing the general point. The tourism issue does not explicitly appear in PROMESA or in the

PROMESA charge to the Task Force. Yet, the opportunity for tourism expansion, which can make a significant contribution to Puerto Rico's economic expansion, needs to be addressed. It needs to be explicitly addressed.

In finding ways for Puerto Rico to raise the availability of funds, the Task Force should recommend and the PROMESA Oversight Board should assure that a significant share of funds are set aside for tourism support. In a sense, government support of tourism promotion is an element of the economy's infrastructure, a foundation for private sector activity, and it is justified by the same principles as developing the funding for physical and social infrastructure. Also, as the PROMESA-created Revitalization Coordinator will oversee investments, this coordinator would have a major role in the use of funds for tourism, for assuring that Puerto Rico takes full advantage of its marvelous natural resources.

There are a variety of ways that funds can be obtained for the initiation of economic expansion in Puerto Rico—through securing guarantees for new borrowing, raising the effectiveness of tax collections, obtaining equitable provision for Puerto Rico in federal programs, or other means. Whatever proposals the Task Force makes to assure the availability of new funds, it should emphasize that an appropriate portion is to be directed to support the tourist industry.

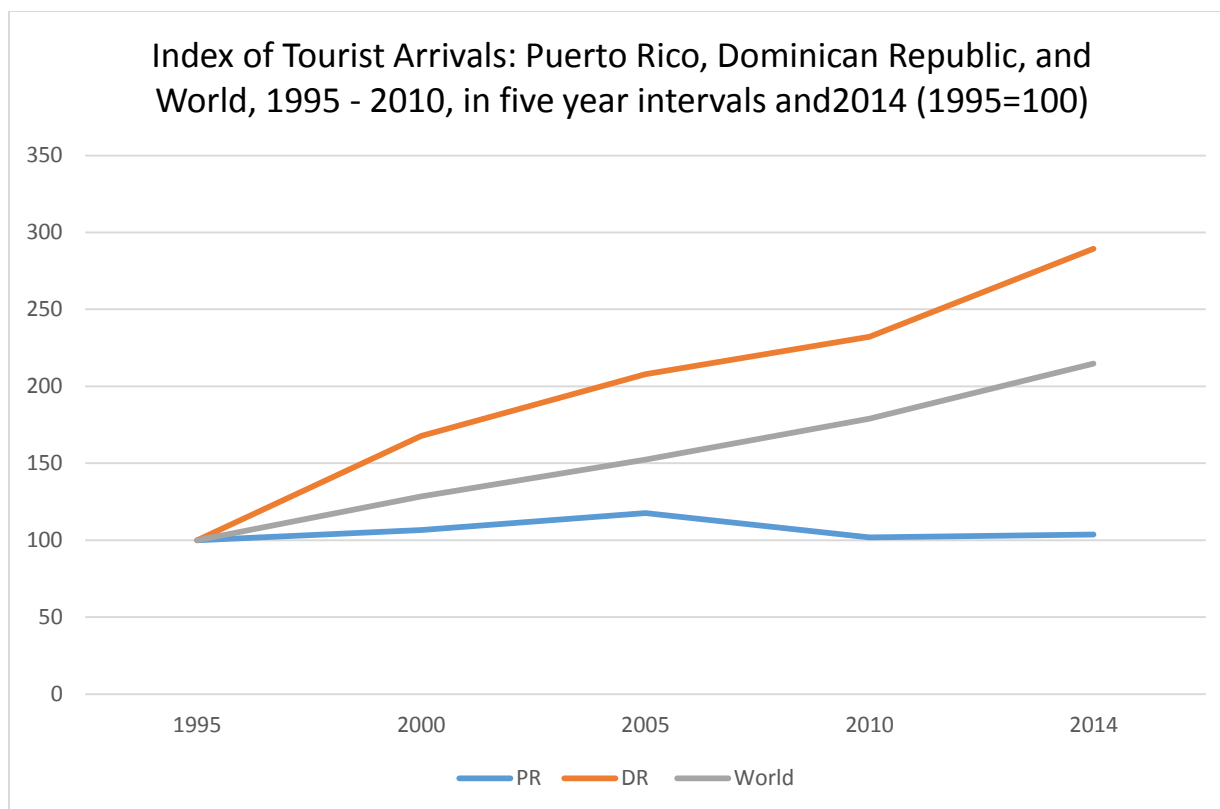
Thus, putting Puerto Rican tourism on a path to expansion will involve action by both the Puerto Rican and federal governments.

Historical Context

The analysis that has been presented here and the action proposals that have been offered will be persuasive only if the up-to-now weak performance of the Puerto Rican tourism industry is understood, which requires information on the background context of the current situation.

In the last twenty years, international tourism has grown rapidly, in spite of the problems in many parts of the world economy. Measured in terms of tourist arrivals, world tourism grew by 115% between 1995 and 2014, an annual average growth rate of 4.1%. In Puerto Rico's neighbor, the Dominican Republic, tourist arrivals increased by 189% in this period, an average rate of 5.75% per year. (See the graph below.)

In Puerto Rico, tourist arrivals in 2014 were virtually no higher than in 1995, having risen by less than 4%. There were some better years for Puerto Rican tourism in this period. In the peak year of 2006, arrivals were almost 19% above the 1995 level. Nonetheless, even in this pre-recession period, Puerto Rico was doing poorly relative to the Dominican Republic, where arrivals had grown by 123% between 1995 and 2006, and relative to the world, with arrivals growing by 61%.



Source: World Tourism Organization, Yearbook of Tourism Statistics, Compendium of Tourism Statistics and data files as reported by the World Bank,
<http://data.worldbank.org/indicator/ST.INT.ARVL>.

The numbers on tourist arrivals translate to economic impacts. Data on “inbound tourism expenditures” for 2008 and 2014 are reported by the World Bank. These data show that for the Dominican Republic the figure rose from \$4.2 billion in 2008 to \$5.6 billion in 2014, while for Puerto Rico the figure fell in these years from \$3.5 billion to \$3.4 billion.

Hawaii provides another and especially relevant comparison with Puerto Rico. Although a third-as far by plane from the closest U.S. population centers than is Puerto Rico and more expensive (beyond transport costs), Hawaii receives tourist expenditures three times as great as those of Puerto Rico. Perhaps the beaches and other aspects of Hawaii’s geography are more attractive than those of Puerto Rico. Yet it is hard to believe that these factors, if real, explain the large difference in economic gains from tourism.[‡] Also, the experience of Hawaii

[‡] Surely one aspect of Hawaii’s advantage over Puerto Rico is that it is a state, while Puerto Rico is widely perceived as foreign. Illustrating the point, at the beginning of July, 2011, the Young Republicans held their national convention in Puerto Rico. On the website for the convention, a brightly colored announcement informed potential participants: “Guess What? No U.S. Passport Required.” In assuming that their members were ignorant of Puerto Rico’s status, that they were likely to view it as a foreign place, the organizers of the conference were simply recognizing the widely held perception—or misperception—about Puerto Rico among people in the states. The impact of this misperception is not trivial.

indicates that the cost disadvantage of Puerto Rico compared to its Caribbean competitors is by no means a decisive issue. Hawaii, in addition to the plane fare, is substantially more expensive than Puerto Rico, to say nothing of its cost comparison with other Caribbean sites.

The relatively poor tourism performance of Puerto Rico has its origin in various factors, but the limited government support for the industry is surely a leading limitation.

In recent years, during the severe recession, government spending (inflation adjusted) on tourism dropped by 5.3% between 2010 and 2015, following a 7.3% drop between 2009 and 2010.[§] However, the weakness of the Puerto Rican government's support for tourism, measured in terms of spending, pre-dates the recession. A comparison with the Dominican Republic is especially instructive. In 1995, the Puerto Rican and Dominican Republic governments were spending virtually the same amount in support of tourism. By 2005, spending in the Dominican Republic was 20% higher than in Puerto Rico, and by 2010 it was 75% higher. In subsequent years, while (as just noted) Puerto Rican government spending on tourism declined, spending in the Dominican Republic rose by 36% between 2010 and 2015. For the Caribbean area as a whole (including both Puerto Rico and the Dominican Republic), governments' spending to support tourism rose by 19% in this same period.

The relative lack of Puerto Rican government support for tourism has its origins in a failure to escape from the economic development ideas that guided the island's era of success in the 1950s and 1960s, in particular the idea that industrialization—that is, manufacturing—was the *sine qua non* of economic progress. The extreme emphasis on manufacturing was a common theme in ideas about economic progress throughout the low-income countries of the world in the era following World War II, and in Puerto Rico these ideas were put into practice by “Operation Bootstrap” (*Operación Manos a la Obra*). Operation Bootstrap did attract considerable manufacturing investment by U.S. firms, based on the low Puerto Rican wages, unrestricted access to the U.S. market, and extensive tax incentives by both the U.S. and Puerto Rican governments. This manufacturing investment led to a rapid rise of income from the late 1940s to the early 1970s, and transformed the economy from its rural, agricultural base to an urban, manufacturing foundation.

The Puerto Rican Industrial Development Company (PRIDCO), established as a government corporation in 1942, played a significant role in the buildup of the economy in this early period. PRIDCO today defines its mission as “foster[ing] economic development by attracting investment and the creation of jobs within the manufacturing, life sciences, information technology, aerospace, export services, among others.” Tourism, while not explicitly excluded from areas of support, does not appear on PRIDCO's website in the list of industries of focus. Tourism, from the beginning of Puerto Rico's post-World War II development policies, has simply not been an area of substantial concern, not part of “modern industrialization.” (There is, of course, the government's Tourism Company of Puerto Rico, among several government

[§] The figures are from the World Travel and Tourism Council, and the 2015 figure is an estimate and is virtually the same as for 2014. The spending data are for “Government Collective Spending,” which is spending in support of general tourism activity. This can include national as well as regional and local government spending. For example, it includes tourism promotion, visitor information services, administrative services, and other public services.

agencies. But PRIDCO is at the center of industrial development, and tourism, apparently, has not been viewed as an “industry.”)

Puerto Rico, however, has no particular advantage in manufacturing. The conditions that made the 1950s and 1960s so successful are long gone. Other parts of the world have much lower wages and virtually the same access to the U.S. market. Tax incentives alone have done little to induce development based on manufacturing. In any case, tax incentives do not alter a country’s or territory’s natural economic advantages. Building an economy on the basis of tax incentives is a poor, costly, and ultimately very limited path to progress.

Worse yet, in Puerto Rico, the focus on tax incentive induced manufacturing has diverted attention and resources away from activities where the island does have natural advantages—tourism, in particular.