



Puerto Rico-USA Foundation

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September 1st, 2016

Honorable Senator Orrin Hatch
Chairman of Congressional Task Force on Economic Growth in Puerto Rico
United States Senate
104 Hart Senate Office Building
Washington, DC 20510

prtaskforce@mail.house.gov

Dear Senator Hatch,

My most sincere appreciation to you and members of the Congressional Task Force on Economic Growth in Puerto Rico for the opportunity to express our comments and recommendations on Puerto Rico's financial and economic situation and some comments on its future.

I write this letter as President of the Puerto Rico-USA Foundation, an organization dedicated to improving Puerto Rico's economic development and U.S-Puerto Rico relations, and as a private small businessperson with close ties to the islands business environment.

There are many reasons why Puerto Rico reached the poor financial condition the island is experiencing. There are numerous testimonies and I am sure the Committee has considerable data to quantify the existing situation. The important point here is the fact that the economic model possible as a territory using manufacturing tax breaks has not and will not any longer work. During the 936 era Puerto Rico economy was not growing ahead of the U.S economy. In fact, between 1980 and 2000 the mainland U.S. GNP rose 90%, while during the same period the GNP for Puerto Rico grew only 60%.

The important issue now is where do we go from here? What items must be put in place so that we can correct the present economic catastrophe as quickly as possible, and what must be put in place so that the present economic situation does not reappear.

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There are however three factors not frequently considered and probably contested by past administrations that severely affect Puerto Rico's ability for economic growth and sound financial decisions. We want to concentrate our participation to these factors which we consider of great importance, and then offer several ideas for economic development:

- 1- The first item is that the present economic model is obsolete and it has proven it does not work.
- 2- The second item is the highly polarized political atmosphere that creates incompetence, dishonesty and highly unsound financial decisions,
- 3- The third item is that to achieve economic growth, and to comply with Article 402 of PROMESA, any approach or legislation should and must be status neutral.

AN OBSOLETE ECONOMIC MODEL- Puerto Rico operates as a territory under an obsolete economic model that does not work. Puerto Rico's high debt and poor financial conditions is largely the result of the island's poor economic development. Puerto Rico's economy once thrived based on economic incentives once offered to manufacturing plants doing business in the island. That was of some help during the early years when the island had high levels of poverty. However, the world's economy has significantly changed due mainly to the implementation of NAFTA, CAFTA and numerous FTA's under the WTO and liberalized trade treaties in past years, increased communications and transportation, the automatization of manufacturing plants reducing the job creating effect and the expiration of patents, all reducing significantly the competitive advantage that Puerto Rico once enjoyed within the United States common market.

Through the years the United States Government tried to help the Puerto Rico's economy with tax incentives that benefited much more the manufacturing companies than Puerto Rico's wage earner or the island's economy. During the last years that 936 was in effect, 936 corporations saved nearly 4.5 Billion dollars a year in tax payments. Between 1970 and 2000, the Puerto Rican economy expanded by 2.7% annually, while the U.S. economy grew by 3.3% annually. That is, over this 30 year period, the U.S. economy grew 17% more than the Puerto Rican economy. In the 936 era then, Puerto Rico was falling further and further behind the states.



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An even more dramatic comparison: In 1970, per capita gross national product (GNP) in South Korea was 65% *less* than in Puerto Rico. By 2000, per capita GNP in South Korea was 9% *larger* than in Puerto Rico.

By 2010, with the Puerto Rican economy in deep recession, Korean per capita GNP was 62% above that in Puerto Rico.

From the era when Rexford Tugwell governed Puerto Rico in the early 1940s, Puerto Rico has sought provisions in the U.S. tax code that provide special incentives for U.S.-based firms to operate on the island. These provisions, according to Tugwell and later Puerto Rican governments, would create a basis for Puerto Rico to catch up economically with the states. Special tax incentives have thus long been a central element in governments' economic development programs, and they are touted as promoting economic growth and increased employment.¹

In the 1950s and 1960s, the era of Operation Bootstrap, federal as well as local tax incentives may have played a role in the rapid growth of the Puerto Rican economy. While 936 did not exist in those years, similar provisions were put in place, implementing Governor Tugwell's concept that Puerto Rico needed special tax treatment to attract investment to the island. In this early period, however, the major factors pushing the expansion of output and employment were low-wage labor and privileged access to the U.S. market. As wages rose and privileged access largely disappeared (as many lower-wage parts of the world obtained virtually equal access), the tax incentives remained but economic growth faltered. Since 1980, economic growth in Puerto Rico has lagged substantially behind that in the states.

As evidence that tax incentives do not sufficiently work, in IRS Code 951-964, the Controlled Foreign Corporations program, under this program federal taxes are paid when income is repatriated to the U.S. To avoid paying federal taxes these CFC's use these funds to finance their global growth. Even under these conditions manufacturing plants are not growing in Puerto Rico in numbers. The remaining plants are mostly pharmaceutical companies that because FDA's regulation they must manufacture in U.S. soil (Puerto Rico being U.S. soil) in order to market their product in the mainland.

Puerto Rico's economic model as a Commonwealth (a territory) based on tax incentives, freebees and give a ways does not work any longer. Economic development has been strapped, helping in a big way to the present economic situation causing over seventy thousand (70,000) residents moving to the mainland last year alone in search of jobs and better opportunities. At the same time the tax base is further reduced. Our labor



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participation rate is 41.2%ⁱⁱ while that in the mainland is 62.4%ⁱⁱⁱ. A new economic model is required.

It is our opinion that the economic model is directly related to the islands political status. It is time to face reality and commence a process to culminate the present Commonwealth into full participation as a State of the Union. Divergent theory studies project the island could be revenue neutral to the US Treasury within 10 to 15 years.

Puerto Rico needs to build on its strengths in the same way that Utah, Florida, and the remainder of 50 states has. Puerto Rico cannot develop, with Mainland CEO's waiting on government handouts to invest in Puerto Rico. We need a free market environment for a Puerto Rican Bill Gates to grow a firm. In the meantime we need an environment so that island residents will feel comfortable investing on the island. We appreciate and require federal assistance, but that cannot form the foundation for a sustainable growing economy.

Puerto Rico needs the stability and certainty that comes from being a state. Much can and needs to be done immediately, but becoming a State of the Union is the only solution to achieve sufficient economic development and growth. Changing status cannot wait; it cannot wait for straight economic and financial reasons.

A HIGHLY POLITIZED ENVIRONMENT HAS HANDICAPPED FINANCIAL AND ECONOMIC DECISIONS.

On the second hand, this little spoken about non-quantitative factor has severely affected our ability to make sound economic decisions. This highly politized environment, which is highly magnified by the highly divisive status question, has our two main political parties and administrations in an eternal conflict and tug of war. When one political party is in power they act more like a state of the union, while then when the other party is in power they try to act or behave more like and independent sovereign nation and legislate more conforming to the territory's fiscal autonomy. This is a highly polarized environment with political parties working with the intent or purpose to firm up or solidify each party's political status positions.

Frequent past changes of administrations went as far as eliminating the English language as an official language, while English was restored as an official language within days of another administration coming into power.



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One party promotes the restoring of the former 936 tax incentive program (erroneously believing it is a hedge against statehood), while the other party tried to promote the use of 30-A and other domestic incentive programs.

Throughout the years, different administrations have developed 10 and 20-year economic development plans, while four years later the next administration will discard it completely and develop new 20 year plans.

This highly polarized and combative environment produces uncertainty, poor stability, poor investment confidence and a very poor base for economic development.

The implementation of a Fiscal Control board under HR-5278 or PROMESA will eliminate all political issues and overtones and concentrate in making decisions based on purely and sound financial and economic principles.

STATUS NEUTRAL LEGISLATION AND APPROACHES.

Section 402 of H.R. 5278 PROMESA, states that "nothing in this Act shall be interpreted to restrict Puerto Rico's right to determine its future political status." Puerto Rico's long-term economic development has been severely handicapped by the frequent changes or flip-flops of administrations with very different political agendas. As explained above some administrations have legislated in a way as to prevent changes of status.

In order to provide for any possible status changes all laws and regulations under PROMESA should be status neutral, meaning laws and regulation would equally apply under the current status, or that of statehood.

One huge advantage of status neutral legislation is that it would eliminate the risk that some investors would consider when establishing in Puerto Rico. Through the years the statehood movement has continued to grow and it is the opinion by most, that Puerto Rico would eventually become the 51th State of the Union. If some legislation would be specific to Puerto Rico, then investors might decide to invest elsewhere where they do not face the risk of losing their benefit if the status would change.



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SUPPORT OF THE RECOMMENDATIONS OF THE WHITE HOUSE AND TREASURY DEPARTMENT.

On a short term basis we also support the recommendations made by the White House and the Treasury Department, mainly the equal treatment or parity of the Medicare, Medicaid and other health programs, the implementation of the Earned Income Tax Credit, and the Child Credit Program as tools to combat poverty and promote job creation, and the approval for Puerto Rico to take advantage of Chapter 9 of the U.S. Bankruptcy Code so that Puerto Rico has the ability in the future to work out any possible situation under the same terms as any other state.

Further the recommendations by the White House and Treasury Department called for the need for immediate investment in infrastructure. The island needs jobs to stimulate the economy. The U.S citizens on the Island should not be subject to third world standards of frequent brown outs and turning off water 4 days a week when a drought occurs. The recommendation points to pockets of federal funds that are available. As a businessman I must confess to be suspicious of bureaucracy. It might take months if not years to gain access to the funds that the letter pinpoints. Puerto Rica's economy needs the infusion from infrastructure investment yesterday. The task force should arm the Revitalization Coordinator with a significant fund so that he can begin investing January 1, 2017, even while the debt problem is in the process of resolution.

SUGESTIONS FOR ECONOMIC DEVELOPMENT

There are a number of strategies for quick and long term economic development.

IRS Code 30-A is a tax incentive that includes the creation of jobs as a requirement. While the corporation would benefit from locating in the island, the island would also

benefit by the much needed job creation. The code is in the books, and it would only require inclusion to implement it.

IRS Code 30-A is a domestic code and completely status neutral if implemented.

National Empowerment Zone Act is an extremely interesting legislation proposal that delivers economic development to specific underdeveloped pockets of population thought the nation. Basically there are three qualifications to be included in the program; population size, level of unemployment and level of poverty. When a sector qualifies, there will be an attractive tax reduction to bring business and industry to that area. An explanation paper and text of bill are included. This bill was introduced in the 111 Congress by Congressman Paul Ryan in the House and Senator George Brownback in the Senate.

This is a GREAT bill that will be of great help in promoting investment of all kind to Puerto Rico, and will help bring economic equality throughout the nation.

Under any conditions, PROMESA or otherwise I suggest that the attached literature is considered.



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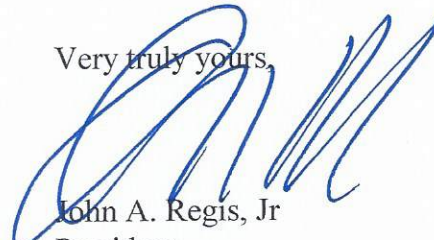
The Empowerment Zones is status neutral as it would apply equally to all states.

A change of status to STATEHOOD is the only and ultimate solution to Puerto Rico's economic problems. Under statehood Puerto Rico would be subject to federal income tax, a tax that at present only applies to federal employees and income earned in the mainland (residents of P.R. do pay into Social Security, Unemployment taxes and others), the island would have the benefit of equal representation electing the President and having two senators and six house voting members when now we have none. We would have equal treatment and equal participation in all federal programs including Medicare, Medicaid, EITC, public works, etc., and we would not be dead last by a huge stretch in federal expenditures and procurement.

Let me make our opinion very clear. Puerto Rico must become a state for the economy to grow. Neither local nor other investment will come to Puerto Rico with the uncertainty of its current "colonial" status. In the meantime the playing field must be leveled. The choice is clear: statehood or a worsening more of the same...

We sincerely appreciate the opportunity to express our opinion in the subject of Puerto Rico's present financial position and some of the strategies necessary to bring Puerto Rico back to a sound economic and financial condition. We are at your service and available if you have any questions.

Very truly yours,



John A. Regis, Jr.
President

Cc: Senator Marco Rubio
Senator Bill Nelson
Senator Robert Menendez
Congressman Sean Duffy
Congressman Tom MacArthur
Congressman Nydia Velázquez
Congressman Pedro Pierluisi.



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¹ The exception was the government of Pedro Rosselló, who held the governorship from 1993 to 2001. Rosselló was in favor of statehood for Puerto Rico and opposed 936 because it treated Puerto Rico differently, and outside of, the states, while the preferred IRS code 30-A was believed to be more beneficial.

¹ Puerto Rico Labor Department

¹ Bureau of Labor Statistics
