

Puerto Rico Manufacturers Association

INDUSTRIALES
PUERTO RICO
MANUFACTURA ■ SERVICIO ■ COMPETITIVIDAD ■



PRESENTATION TO SENATE FINANCE WORKING GROUP ON INTERNATIONAL TAX



March 31, 2015

PUERTO RICO



- ▶ Became a U.S. Territory after Spanish American War
- ▶ U.S. Citizenship awarded in 1917 by Jones Act
- ▶ Population of 3.56 million U.S. Citizens is larger than 20 States
- ▶ Elects one (non-voting) Delegate to House. No Senators.
- ▶ U.S Laws apply the same as elsewhere in the States.
- ▶ Federal Tax Code treats Puerto Rico as a foreign tax jurisdiction.

PUERTO RICO MANUFACTURERS ASSOCIATION



- ▶ Largest business organization with 1,200 members.
- ▶ Founded in 1928, PRMA represents businesses that generated well in excess of 250,000 direct and indirect jobs in 2014.
- ▶ Many member companies are subsidiaries of U.S. Corporations
- ▶ Manufacturing and service sector members of the Association include mainland firms with supply chains that generate jobs and economic activity throughout the U.S.
- ▶ PRMA is well aware of its responsibility for the overall social and economic well being of the Island's population and economy

PUERTO RICO'S ECONOMY IS DEPENDENT ON MANUFACTURING



- ▶ Manufacturing makes up one-half of Puerto Rico's GDP and is responsible, through direct and indirect jobs, for approximately one out of five jobs.
- ▶ The manufacturing sector in Puerto Rico is almost 48.6% of the Gross Domestic Product - higher than any State.
 - ▶ Compared to agriculture 1%; tourism 6%, Finance, Insurance, Real Estate 19.4% and 12.5% services.
- ▶ Over 90% of production serves the U.S. market.

CONGRESS HAS HISTORICALLY USED THE TAX CODE TO REDUCE POVERTY AND CREATE JOBS IN PUERTO RICO



- ▶ Beginning in 1921 and continuously for 83 years, both Congress and the President have used the tax code to attract U.S. Companies to invest and create jobs in Puerto Rico with the goal of reducing poverty.
- ▶ These efforts began with the Revenue Act of 1921, Operation Bootstrap in 1948 and the creation of Section 936 in 1976.
- ▶ The goal was to replace high poverty and an agrarian economy with better paying assembly and manufacturing jobs in order to reduce poverty thru assertive economic growth.

OPERATION BOOTSTRAP SHIFTS EMPLOYMENT BASE

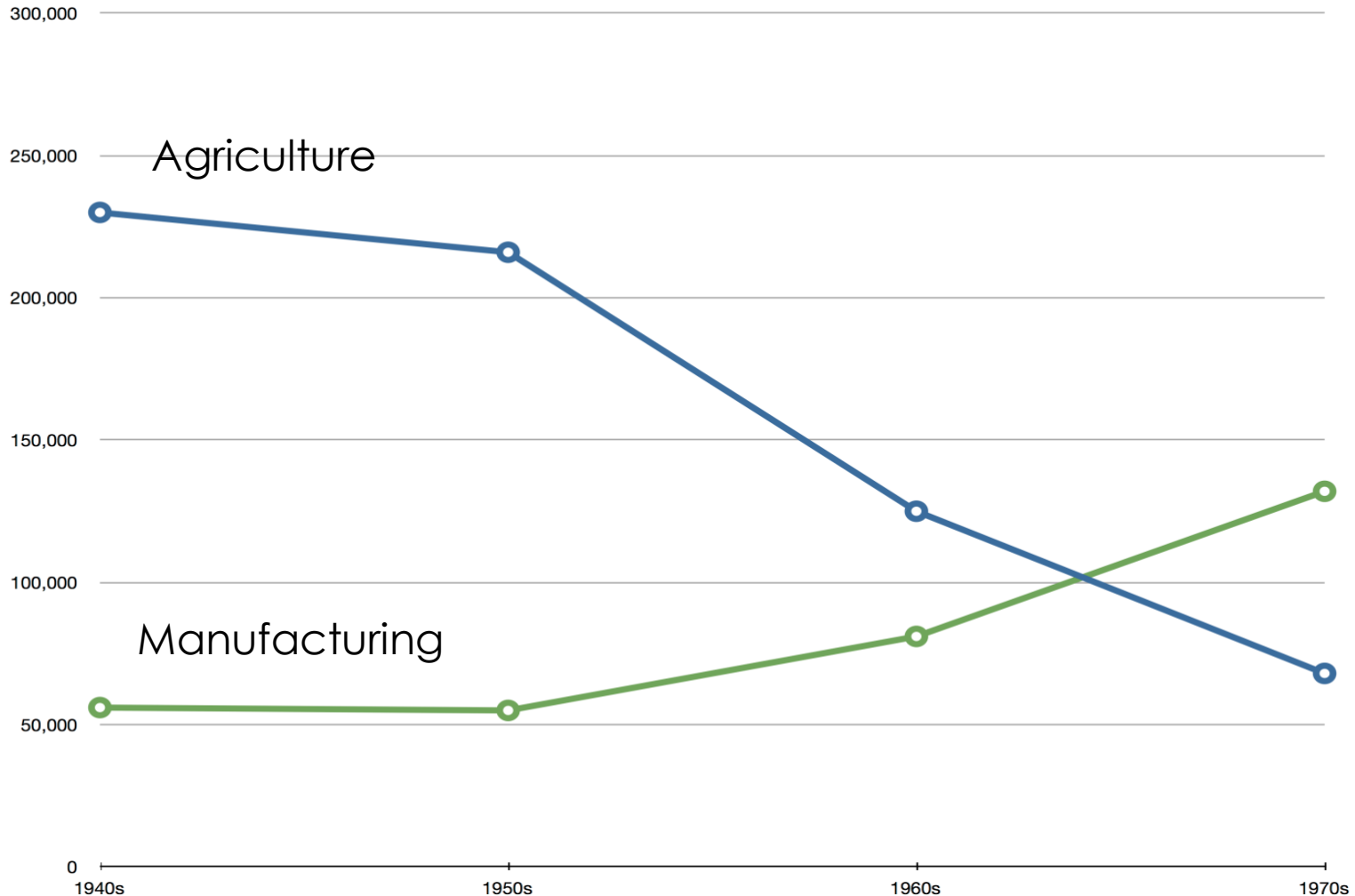


- ▶ Puerto Rico's success in attracting investment was based on low labor costs, tax incentives, access to the U.S. market and beneficial Federal tax conditions under Bootstrap and subsequently Section 936 of the US Internal Revenue Code.
- ▶ Low wage agriculture jobs were successfully replaced by higher wage manufacturing jobs.
- ▶ Manufacturing jobs pay 30% more than per capita wage in Puerto Rico.
- ▶ The result of these targeted tax policies was a healthy island economy heavily dependent on manufacturing.

BOOTSTRAP PERMANENTLY CHANGED PUERTO RICO'S EMPLOYMENT PROFILE (BLS)



Salaried employees in Puerto Rico during Operation Bootstrap



SEC. 936 TAX POLICY BOOSTED MANUFACTURING SECTOR



- ▶ It effectively exempted all PR source income from U.S. taxation, including income earned on qualified investment by Section 936 firms.
- ▶ Peak employment was 165,000 direct jobs in 1996.
- ▶ Estimated 2.6 indirect jobs generated per each direct job.
- ▶ Section 936 moved the Island's manufacturing sector from low wage activities to technologically sophisticated industrial sectors such as pharmaceuticals, electronics, medical devices, aerospace and others becoming an internationally recognized powerhouse.
- ▶ The manufacturing sector's growth creates major demand for inputs from Stateside suppliers.

THE REPEAL OF SECTION 936



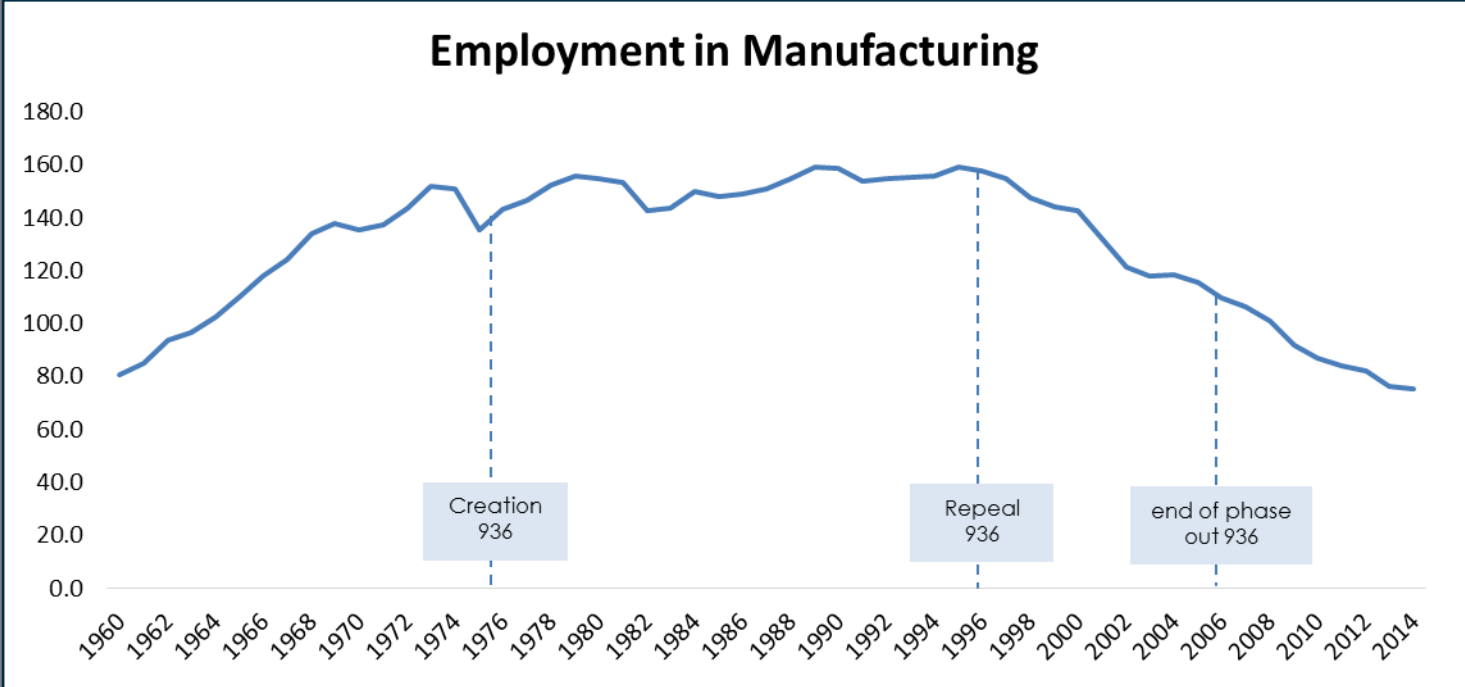
- ▶ Repealed in 1996, with a ten year phase out period that ended in 2006.
- ▶ Most firms previously operating under Section 936 converted to Controlled Foreign Corporations (CFC).
- ▶ Puerto Rico is now the only jurisdiction in the U.S. where CFCs employ U.S. Citizens and are subject to U.S. law.
- ▶ Although CFC status conferred tax advantages to U.S. companies, these advantages accrue to companies operating in any number of countries.
- ▶ Thus, the shift away from Section 936 has meant that Puerto Rico has lost a significant competitive advantage over competition from foreign countries competing for jobs.

PHASE OUT OF SECTION 936 IN 2006 HAS DIRECT IMPACT ON EMPLOYMENT



- ▶ Suffers brain drain as 300,000 or 7% of population migrated mainly to the mainland in the past decade in search of opportunity.
- ▶ Reduction of manufacturing employment followed in parallel the phase out of Section 936.
- ▶ Manufacturing direct employment has been reduced by one-half since 1996 when Section 936 was repealed.
- ▶ Almost 80,000 direct manufacturing jobs went away with no uptick when the U.S. manufacturing sector began to grow again after the recent recession.
- ▶ Indirect employment has also suffered as suppliers and service businesses experienced reduced demand.
- ▶ While Manufacturing continues to be a primary source of employment it faces major competition from foreign countries with lower labor and regulatory costs.

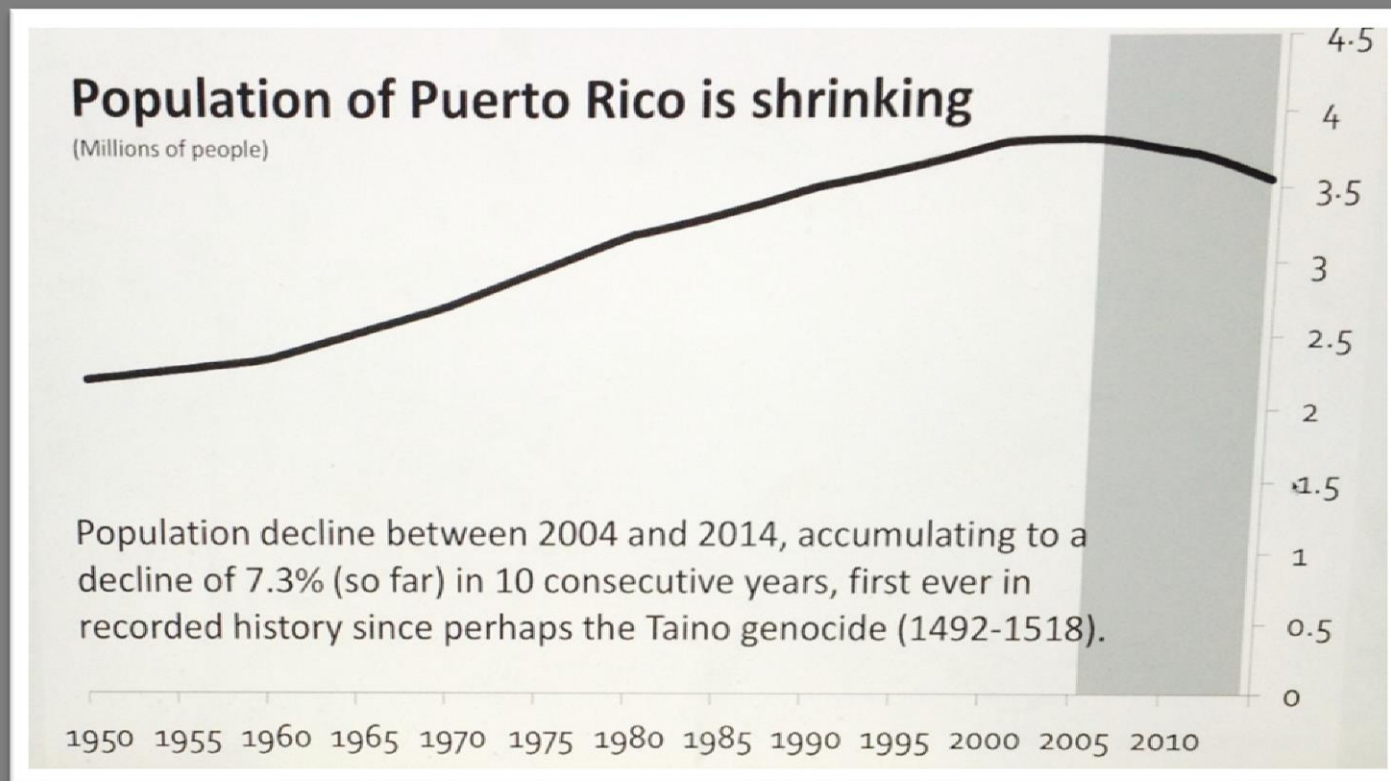
LOSS OF MANUFACTURING JOBS



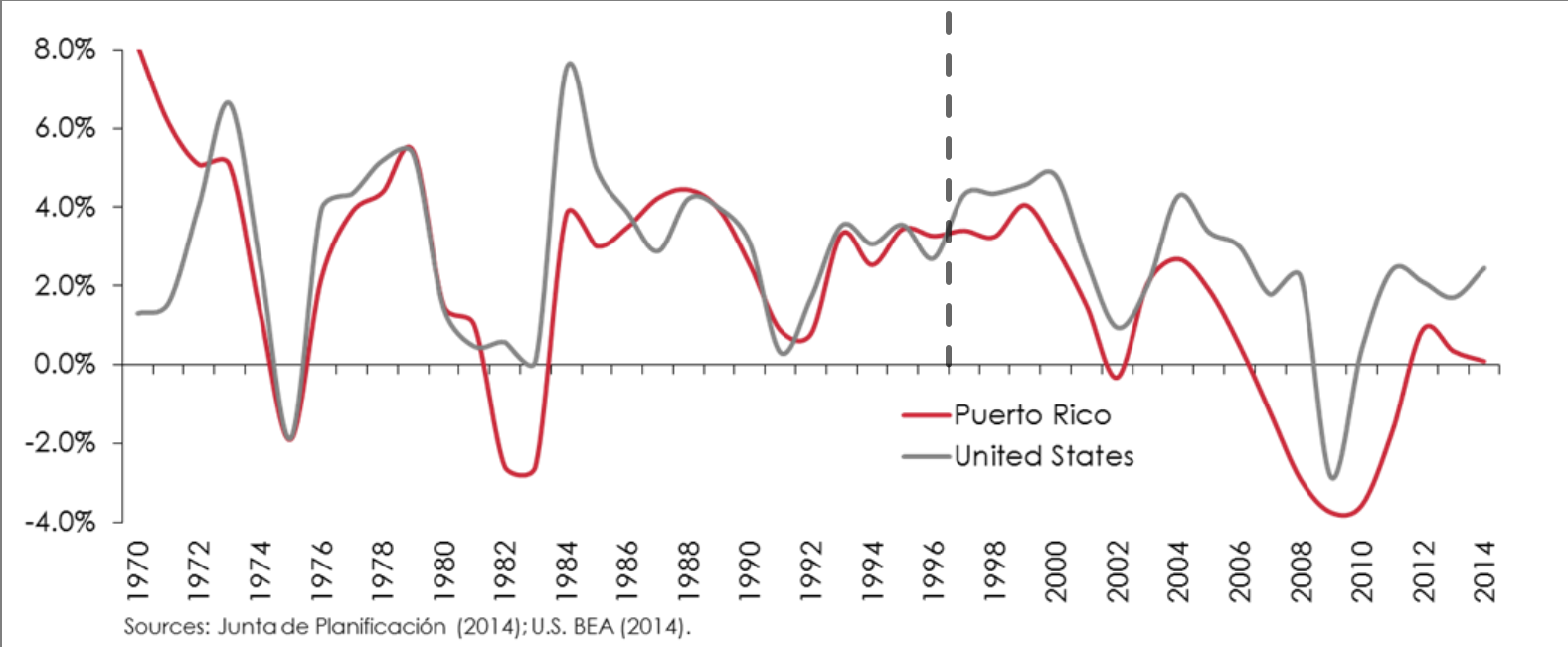
Years



POPULATION LOSS TRENDS



REAL GNP GROWTH : PUERTO RICO & U.S.



Since 1996 the Island's growth rate has been well below that of the United States and its economy has fallen further behind

TROUBLING SOCIAL AND ECONOMIC CHALLENGES



- ▶ Unemployment remains over 14% vs 5.7% U.S. average.
- ▶ Median Household income of \$19,518 vs \$ 51, 595 U.S. average (2012 Census).
- ▶ Puerto Rico's Labor Force Participation Rate is 40%, compared to 62% for the U. S.
- ▶ The employment rate for Puerto Rico is 34% with only one in three working age adults are actually working.
- ▶ 41% of Puerto Rico's households are under the poverty line, the highest percentage in the nation.
- ▶ Since intermediate and consumption goods must be imported, doing business in Puerto Rico is more expensive than on the mainland because of the Jones Act.
- ▶ Energy costs in Puerto Rico remain 3 times national average.

LOOKING FORWARD



- ▶ Is reducing poverty still a priority and can the tax code continue to help maintain and create employment base?
- ▶ Should companies incentivized to create manufacturing jobs in Puerto Rico be incentivized to leave?
- ▶ Can the tax system be changed without negative economic impact on Puerto Rico? (DO NO HARM)
- ▶ Can we work with you with the goal of developing a competitive Puerto Rico?