



Statement of the Puerto Rico Manufacturers Association
Fiscal Oversight and Management Board
March 31st. 2017
Rodrigo Masses
Chairperson

The Fiscal Oversight and Management Board is aware of the depth of the fiscal crisis and its implications for the Island's future. We don't need to go into its details. But the Puerto Rico Manufacturers Association ("PRMA) wants the Board to appreciate the role that the manufacturing sector has played in maintaining the Island's Government afloat and in securing a better future for all Puerto Ricans.

Manufacturing is responsible for at least 33% of General Fund income, Law 154 alone is now 23% of this income. Should we include income and sales taxes paid by the industry's employees, it's obvious that the number increases substantially. The average wage in manufacturing is more than \$40,000 per year, much higher than the local average salary. In addition, the manufacturing sector in Puerto Rico has been instrumental in promoting the Island globally, not only through its exports but also by helping classify Puerto Rico as a center of manufacturing excellence.

Although the PRMA supports efforts to increase tax income and

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reduce government expenditures as a way of stabilizing the fiscal situation, we are convinced that the most effective and quick route towards this objective, and for providing the foundations for sustained economic growth, is to reactivate the manufacturing sector. A quote from a recent MIT report makes this clear:

“Recent years have brought a renewed focus on the importance of manufacturing to the health and future growth of the U.S. economy. Specifically, several studies have highlighted the need to maintain and build manufacturing capabilities to support economic growth, good jobs, and national security. Most critically perhaps, they have linked America’s strength in manufacturing to its ability to innovate.” (*Strengthening the Innovation Ecosystem for Advanced Manufacturing*, MIT Industrial Performance Center, 2016)

Our position that stimulating manufacturing is the quickest and most effective way towards resolving the fiscal situation and advancing Economic Development is supported by the industry’s contribution in export sales, its multiplier effect, its impact on the business environment, and positive rate of return on existing incentives.

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- Much of the manufacturing done in Puerto Rico is export oriented and thus can benefit from expanding external markets. Exports have continued to grow all through the economic contraction that began in 2006, which is certainly a sign of the huge potential for manufacturing to impact the economy.
- Manufacturing also has the largest multipliers and thus, a dollar invested in manufacturing will have the greatest impact on other sectors in terms of indirect employment, income and, of course, fiscal income. Much greater impacts than any other sector.
- Thirdly, it is impossible for Puerto Rico's economy to move to a knowledge based economy without a strong, highly productive and innovative manufacturing sector. In fact, Puerto Rico would not have a dynamic technology sector if it had not been because of the existence of a strong manufacturing foundation.
- The return of investment and value added from manufacturing is such that, even with existing tax incentives,

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fiscal income generated for the government from manufacturing cannot be matched by all other sectors combined. Therefore, stimulating manufacturing growth is by far the most effective route towards fiscal stability and economic growth.

The PRMA understands that no major new manufacturing investment has occurred in the last decade and that we have lost in the competition for new investments, primarily to non-US jurisdictions like Costa Rica and the Dominican Republic. What this tells us is that the general uncertainty that has prevailed over the last ten years has had a very negative impact to say the least. Ireland, a country that also went through a deep contraction, although perhaps one that did not last as long as ours, made sure that the conditions for investment in manufacturing remained unaltered and it was that investment that turned things around for them.

What needs to be done for a manufacturing renaissance in Puerto Rico?

- First and foremost, we need to create certainty because if there is one thing that scares investment, its uncertainty. The

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rules of the game need to be clear and there must be assurances to that Rules will not be changed abruptly as has customarily happened in recent years. This is one area in which the Board can act proactively to assure that this is achieved.

- Incentives and subsidies need to be carefully evaluated and rebalanced towards industrial production and other high impact and productive activities. PRMA is very concerned that manufacturing incentives are bunched together with a host of others that do not generate productive investments.
- Puerto Rico must move to a tax system that incentivizes production, not consumption, which has been the orientation so far. We need to put in place measures such as accelerated depreciation for manufacturing investment, even making it possible to immediately expense certain investments.
- The World Bank *Doing Business 2017* and World Economic Forum *Global Competitiveness* reports highlight the very high transaction costs of doing business in Puerto Rico as a major obstacle. These costs are the result of a very inefficient government and costly infrastructure related services,

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particularly electric power. We welcome Governor Rossello's efforts to improve transactional efficiency and right sizing of the government. Taking transactional burdens away from business can maintain revenue streams to the government, while promoting investment. With respect to electric power generation and distribution, the PRMA's position has been clearly expressed in our frequent exchanges with Congress.

- We are convinced that an independent regulatory entity, such as the Energy Commission created by Act 57, should be strengthened to enforce a modern regulatory framework that protects energy consumers and enables an energy generation, distribution, transmission and commercialization structure that drives socioeconomic development.
- Nothing less than a total rethinking of PREPA will achieve the lower costs that are so necessary for our competitiveness. Beyond initiatives to improve the utility's finances, immediate steps must be taken to improve its efficiency and to wean the Island from fossil fuel dependency. We are convinced that any initiative geared towards the lowering of costs for energy in the Island should aim to be well under the \$0.15 cents average per kilowatt hour, which can allow us to compete on a level

playing field with respect to energy prices in other jurisdictions. Achieving this goal will give Puerto Rico a true competitive position with respect to utility costs for current and new investment in the Island.

- A single player in the energy game which has serious economic and infrastructure problems has led us to the current circumstances; onerous energy prices and an unreliable system. Energy is an essential service and other essential services are dependent on the reliability of energy service, such as water, health and safety of the Island. It is vital to revitalizing our economy that we restore confidence in the energy system and its cost structures.
- Restoring said confidence and the system's reliability must come, not only from independent regulation, but it also must come from within PREPA. The talents acquired through the recent reorganization of PREPA's Governing Board should be maintained. A Governing Board comprised of professionals, chosen by an independent head hunter, based on their individual experience in utility entities is an excellent step in the right direction. The experience and expertise of these professionals is impressive and the remuneration received for

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being members of said Board is minimal. It is imperative that PREPA's Governing board continues to be comprised of these experienced professionals that can transform PREPA from within.

- PRMA has led the charge in Congress to obtain federal measures targeted to enhance the competitiveness of Puerto Rico as a manufacturing site within the US Multinational manufacturing networks. This is not an arbitrary position but one that has developed from a clear understanding that Puerto Rico has a substantial US multinational footprint that competes with other foreign jurisdictions in unfavorable conditions due to the fact that we have to deal with federal regulations that increase costs in Puerto Rico. These include labor related costs as well as environmental regulations that are very constraining. What federal incentives will do is make it possible for Puerto Rico to play in a level global playing field while bringing non-US manufacturing closer to shore.
- Of course, although we are committed to making the Island an attractive location for external investment, we are keenly aware that no economy can be called developed if it does not

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have a strong locally owned productive sector. Aside from the incentives and tax system that must be put in a place to make it possible for developing a strong local industrial sector, we must focus on having local manufacturers become part of multinational value chains and to be able to substitute product imports. Focusing governmental and private product sourcing decisions towards locally manufactured products instead of imports will help local manufacturing grow and compete globally.

- Finally, we strongly support the economic development ideas and strategies proposed by the Private Sector Coalition. We must stress the fact that without economic growth there are no feasible solutions to the restructuring and revitalizing of our Government. These are ideas and strategies that support our position and will foster the sustainable economic growth that Puerto Rico desperately needs.

We are aware that there are no simple solutions to all the elements that must be placed in order to reach the many goals that must be achieved. We don't have the perfect solutions as we know that the Oversight Board doesn't have them either. But the will to find these solutions, and the willingness to work with the private sector to

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achieve them, is a step towards fiscal recovery through sustainable economic development.

We are also aware that the Oversight Board's primary responsibility is to resolve the fiscal morass and not the creation of an economic development plan. Further, the design of an industrial policy for the Island is even less the Board's responsibility. Nevertheless, the Board can play a crucial role in establishing the foundations for sustained economic growth through its influence on the design of Puerto Rico's tax system through its oversight of the budgetary process and by creating an environment characterized by certainty and respect for the rule of law. Puerto Rico can be a very attractive and globally inserted jurisdiction for external investment if the conditions outlined above are met.