

More urgency and effectiveness is required to get economy growing

Puerto Rico needs economic action and it should be the administration's No. 1 priority



Members of this year's roundtable on the economy included, from left, Jorge Galliano, president of Gatsby and the Puerto Rico Chamber of Commerce; Josen Rossi, president of Aireko Enterprises and of the Puerto Rico Manufacturers Association; William Riefkohl, executive vice president, Puerto Rico Manufacturers Association; Federico Stubbe, president of Prisa Development; José Joaquín Villamil, chairman & CEO of Estudios Técnicos Inc. and board chairman of BBVA Puerto Rico; Jaime Morgan Stubbe, president of Palmas Del Mar Real Estate; Ignacio Veloz, president of Inmobiliaria Neutro Servicio and president-elect of the United Retailers Association; Carlos Pesquera, president of PG Engineering Solutions; and Miguel Sabater, president, Bird Construction

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A year after Gov. Luis Fortuño and his team took power, representatives from the private sector feel the administration has failed to adequately address Puerto Rico's battered economy, which is in the midst of a fourth year of recession.

The CARIBBEAN BUSINESS Private-Sector Roundtable members understand Fortuño inherited a cash and credit crunch but believe

that, in addition to trying to fix the government's fiscal woes, other areas should have been addressed with more urgency and effectiveness.

CARIBBEAN BUSINESS' Private-Sector Platforms were submitted to all political parties in 2007 and 2008 prior to the elections urging action and airing concerns on a host of issues.

At the top of the list was a call for the winner of the November 2008 general election to make the ailing island economy the No. 1 priority.

Although the 2010 roundtable members have noted positive changes in high-level government attitudes and public policy toward the private sector, the structural framework of the government still impedes economic development, they agreed.

"The ideas and the intention are there but so far the execution and implementation has been very poor," one roundtable member said.

"Most of the things and recommendations that we proposed in the 2007 Private-Sector Platform can

be repeated here with very little change," another roundtable member said.

The roundtable members cited the importance of improving the perception of Puerto Rico to win back the trust of the private sector and investors.

"The government has failed to regain the confidence of the private sector, improve the potential of return on investment and improve the conditions not only of the lower

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and the middle classes but also of the investment climate. There are a lot of words and public relations, but scant results so far.”

“Puerto Rico needs economic action. We must improve our competitiveness. Puerto Rico’s economy can’t even grow at a pace needed to sustain its population. A massive program to develop a sense of competitiveness must be designed and implemented.”

Fortuño has promoted, as recommended in the CARIBBEAN BUSINESS Private-Sector Platform, a clear pro-investment public policy, the panelists conceded. However, they graded his administration at 4.3 out of a potential 10 on its handling of the general economy so far.

“Compared with past years, the government’s work is more than satisfactory. What is happening is that the challenges of 2009 and 2010 require much more. So in light of the challenges that we have, the government’s work is less than satisfactory.”

On the positive side, the roundtable members said, the permits law has been revamped, the closing law amended and a public-private partnership law enacted.

“On the positive side a new law was approved to streamline and accelerate the permits process. It is supposed to end the government permit nightmare that takes years and millions of dollars to navigate to obtain the permits required even for the simplest project. It is supposed to provide certainty to the permitting process but we will still have to wait to see how it works.”

“Even if you get the permits, who is going to build now? Where is the market and where is the financing?”

Even with the permits overhaul, there are more obstacles to economic development and doing business in Puerto Rico that need to be cleared, the panelists said.

“Puerto Rico still needs very badly to address the obsolete labor legislation and a new energy law.”

“Tax incentives are helpful, but to be competitive other considerations are essential to attract investment. Tax incentives are of no value if a business is not profitable. We must

raise productivity and make Puerto Rico user friendly and measure performance.”

“We have said don’t increase taxes, don’t impose new ones. But the government has dedicated itself to increasing taxes or fees wherever it can. They say it is only temporary, but there is definitely an attitude of increasing taxes and costs beyond the urgency needed to fix the critical fiscal situation the administration found when they took over the government.”

“Lower and fair taxes would increase government revenue, make the island more competitive and ignite economic growth and job creation.”

“What we are doing to correct the errors that date back more than a decade, at the slow speed that we are doing it, is not going to convince foreign capital to come or local capital to invest or stay.”

“The bottom line is that costs of doing business keep increasing at a higher rate than sales, particularly energy and labor costs.”

LOCAL CONTRACTS, GLOBAL STANDARDS

“We have to realize that the Puerto Rico government is inefficient,

“We have to realize that the Puerto Rico government is inefficient, not very innovative and obsolete. Puerto Rico keeps giving contracts only to friends with outmoded hiring methods. It is important to insert ourselves into performance contracting. It forces you into a solution of planning, financing, design and construction. But local contractors must realize that our industry needs global standards.”

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“Our challenge is to explain the importance of using local talent and not to look for outside resources when they can be supplied locally. The



Manuel A. Casiano, chairman of the board, Casiano Communications Inc. and publisher & editor in chief, CARIBBEAN BUSINESS



Miguel Sabater, president, Bird Construction

government does not understand this. The local market needs to participate in all available local opportunities so that the money earned will further impact the local economy and not flow outside. This is more important now than ever.”

“Puerto Rico suffers from a colonial syndrome; if you don’t bring a big

should not feel inferior. The action is now in Washington D.C. and we can’t leave this to the government sector, to our one representative to undertake this effort alone. He can’t possibly deal with hundreds of government agencies and more than 500 members of Congress by himself.”

“The private sector in Puerto

name from outside and hide behind it you don’t get the big government contract. We have a local image issue here that we aren’t good enough, and we created that image ourselves.”

“We need to create an entity sponsored by a group of local companies and investors that gives permanence and continuity to these issues.”

PUT FEDERAL FUNDS TO WORK

“Federal funds are currently the prize of all the jurisdictions in the U.S. We

Rico has more credibility and more probability of success than the voice of only one person fighting for this. Without any guilt, we have to understand that this is where the money is today to create jobs. Now is the moment to do it. The environment might change a year from now, and then this might not be the forum.”

“The government has its limits, but it has to knock on President Barack Obama’s door to let him know that this U.S. territory in the south will

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become another Haiti quickly if we don't do something about it. We need federal help. We don't have a money-making machine."

"Out of \$6.4 billion in ARRA (American Reinvestment & Recovery Act) funds committed to Puerto Rico, only about 22% has been disbursed into the economy and Puerto Rico can't afford that luxury."

SOBERING ECONOMIC GROWTH PROJECTIONS

The economy contracted 3.7% in Fiscal 2009 after initial projections of a 5% contraction. Economic indicators continued to contract during the first half of fiscal 2010 (July 1, 2009 to December 31, 2009). All major indicators continue to deteriorate although there has been a leveling off in the rate of decline.

"Nevertheless, the unemployment rate continues to increase while the workforce participation rate decreases."

"More than half of the able workforce is not actively producing. Instead, they depend on a welfare system. The situation is critical. The participation rate hovers around 42% vs. 60% in the mainland U.S. If everyone who wanted to work either applied for a job or for unemployment compensation, our unemployment rate would be close to 35%. The unemployment rate during the Great Depression was 25% in the U.S. This situation has not been addressed."

"We must motivate entrepreneurship and innovation. Puerto Rico must get its people out of the morass, the stagnation, the dullness and the productive inactivity in which most are living. The entrepreneurial spirit and the capacity to work and innovate must be motivated; work culture and ethics must be improved. It all starts with good government, streamlined procedures and the ease of doing business."

"A further contraction between 1% and 2% is expected for FY '10. Finally, modest economic growth of 1.2% is projected for FY '11. Puerto Rico needs to grow more than 6% a year to gain ground, which has not happened since the administration of Gov. Luis Ferré in the late 1960s."

The present administration hopes for a sustainable growth of 3%

after FY '12 according to Government Development Bank (GDB) documents.

"That will not be enough."
"This decade, the annual rate of growth will be 0%. This is the first decade that the gross product (GP) per capita will be lower at the end of the decade than when it started."

"FY '12 presents a big challenge when the federal stimulus package (ARRA) runs out, meaning that the local government must have major investment projects in the pipeline and economic development plans in place to promote economic development and growth."

EVOLVING TO LURE VITAL INVESTMENT

"The first challenge to fix the economy is to increase investment in the short term; to create jobs and promote growth. If there is no investment, there is no growth. Investment represented approximately 28% of the island GP 20 years ago, today it is less than 17%. That is a big drop. An economy does not grow at that level of investment. As a frame of reference, Singapore is at 28%, and Ireland is at 27%."

"With no money or credit the government must rely on public-private partnerships (PPPs) for infrastructure investment."

"The economy can be maintained through consumption; it develops through investments. Our first challenge is to increase productive investments."

"With no money or credit the government must rely on public-private partnerships (PPPs) for infrastructure investment."

"For a long time the recurrent theme has been how to recuperate our capacity to compete and bring investment to Puerto Rico. We have had a horrible time in restructuring ourselves to be productive and competitive. The problem is how we organize ourselves to get out the uncompetitive morass that impedes our growth."

"The traditional structures of government and our companies have really not changed. The key now is how we transform government and



*Josen Rossi,
president, Aireko Enterprises and the
Puerto Rico Manufacturers Association*

our organizations to attack the local problems."

"We don't come together because we think it does not directly affect our industry, but if we don't, we are all going to fail. There lies the fault in most of us."

"The government can't solve the problems we have in Puerto Rico. We need people who are strong enough to break political, social and image obstacles. Our challenge is to organize ourselves. We talk about it, but we need to produce, we need to create deals, we need to move the money. Our challenge is how to get companies to reorganize to have the strength to compete locally and glob-

ally. The past few years have proven that the government administration alone is incapable of doing it."

"It is essential to motivate the traditional productive sectors of the island—the entities, firms and families that traditionally have had the productive leadership of Puerto Rico—to have trust in Puerto Rico to invest again."

CAPITAL EROSION CONTINUES
"Lack of confidence in the long-



*Jorge Galliano,
president, Gatsby and the
Puerto Rico Chamber of Commerce*

term prospects for the island economy continues to cause local investors to put their money not in Puerto Rico, but elsewhere. That is a threat to the development of local capital and the ability to attract capital from the outside."

"Without capital the economy can't grow. Puerto Rico needs more capital to grow; otherwise stagnation will continue. Capital is essential to provide jobs, infrastructure and adequate living standards."

"Without capital investment there will be no job opportunities. The government can't collect taxes from the unemployed and businesses that are struggling just to break even and

have to keep cutting costs and laying off employees. With the highest corporate tax rate in the world, Puerto Rico's economy is increasingly unable to attract investment capital. Up to now nothing has been done to address the issue."

"Net-worth loss in the capitalization of local banks has been more than \$20 billion over the past five years. It will take years for investors to get

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that money back, if ever. We have beaten the people down with 30 years of inefficient public policy.”

“We have to look for fresh capital. Out of eight publicly traded local banks, three have cease and desist orders from the Federal Deposit Insurance Corp. (FDIC). No local bank has the capacity to absorb these. Among its top priorities, the government should be making sure we have a healthy banking system. The economy can’t move forward without it.”

SHORING UP BANKS

AND BUILDERS

“One of the biggest problems impacting the economy is the crisis involving the construction sector and the banks. It has not been dealt with yet.”

“The estimated housing inventory is three and a half years. In some segments, such as high-priced condos and commercial real estate, it is up to six or seven years. It will drop because the prices will go down. But it is a serious problem and regulators are being stricter with banks in requiring reserves and the valuation of collateral.”

“While the construction situation remains unresolved, the capital of the banks will continue to be affected. Banks will be hampered in providing financing, which will continue to negatively impact the rest of the economy.”

“The exposure of banks in construction loans is \$4 billion and of that amount, approximately half is nonperforming. We need to generate \$2 billion to be able to mitigate the situation.”

“Banks cannot expect to collect 100% of the dollar. The solution is a concerted effort by the banks, private investors and the local and federal governments to start addressing the situation through some type of ‘bad bank’ structure. There have been talks about it at the local and federal level but until the federal government seriously moves in there is little hope that the issue can be adequately addressed as the GDB can’t deal with it alone.”

“Saving the Puerto Rico banking system must be a top government priority.”

Meanwhile, the glut of high-end



*Jaime Morgan Stubbe,
Palmas del Mar Real Estate president*



*Carlos I. Pesquera,
PG Engineering Solutions president*



*Federico Stubbe,
Prisa Development president*

units is exacerbating the lack of social-interest housing, panelists indicated.

“There is a very limited inventory of social-interest housing and the need is huge.”

“Of the cost of a social-interest housing unit, almost 30% goes to the government coffers in taxes and fees. Reduce half of it and you will see how feasible it is.”

“Under the present government fee scenario most developers will have to wait at least five years for the inventory of other types of housing to be absorbed by the market to be able to begin building social-interest housing.”

“There won’t be new housing construction in the middle- and high-income sectors for the next four or five years.”

GOVERNMENT STRUCTURE STILL AN OBSTACLE

“Our major problem continues to be the need to improve the institutional framework.”

“The institutional framework (the laws, regulations and government processes) is a major drawback. The government has beaten the small productive sector of the island economy down during 50 years of inefficient public policy and public corporations. This administration has tried to correct this but has accomplished very little.”

“We are now going through a painful process of reducing the amount of government employees.

The key here is that it really needs to work. It needs to be done right. In other words, if we are making these painful adjustments that impact many families, it is necessary for Puerto Rico to resolve the problem of an inefficient government. We should not have to go through this and not resolve the government inefficiency.”

“Around the world the economy is moving toward advanced services such as engineering services, design services, financial services, telecommunications, etc. In Puerto Rico, the entities that deal with these sectors are regulators, not promoters.”

“The Financial Institutions Commissioner’s Office, Insurance Commissioner’s Office and the Telecommunications Regulatory Board all regulate; no one promotes. That mindset in this sector has to be changed to one of promotion and attraction of capital and investment.”

Roundtable members cited the hundreds of unused government properties as a symbol of official inefficiency and stagnation.

“Where is the priced inventory of government-owned land? Where are the auctions so that those who want to can buy them? If the price needs to be lowered, lower the price. If the government needs cash, then try to sell them. There is very limited effort in this regard. They talk about trying, but they are really not selling them.

“Sell the thousands of Puerto Rico Industrial Development Company (Pridco) properties and 718 school

buildings that are empty. Nobody knows the inventory of properties of the Transportation & Public Works Department. The Puerto Rico Electric Power Authority (Prepa) and Puerto Rico Aqueduct & Sewer Authority (Prasa) have hundreds of properties they don’t need or use. Not to mention the obsolete small airports around the island that just cost money and don’t contribute to social or economic development.

“Neither the land nor the unused buildings are contributing anything to the government, to society or economic development. They just have a maintenance cost for the government (the taxpayer) or are simply abandoned. They could be helpful to the viability of many projects.”

“The Lands Authority is the biggest landlord in Puerto Rico. They sell land only when they need cash to subsidize their activities, not when it is best for Puerto Rico. Cities like Chicago and Boston have sold land for \$1 if the development plan is right. People here would complain about selling a \$1 million property for \$1, but it would create jobs, ignite economic activity and give money back to the government.”

TIME IS RIPE FOR ENERGY SYSTEM OVERHAUL

“Our energy industry could bring foreign investment, help resolve environmental issues and address

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the current economic situation but it continues to be regulated as it was 50 years ago. I don't see the willpower to fundamentally change this."

"The whole world knows Puerto Rico and won't believe us if we say Puerto Rico will be good for business in the next five, 10, 15 years knowing the instability and volatility in the price of electricity in Puerto Rico given its oil dependence and Prepa's operational obsolescence."

"No one will invest serious money in this economy with this type of volatility, and much less if we do not have the willpower to achieve a fundamental change."

"The business of the future is energy—waste-to-energy, wind, solar. ARRA funds are earmarked for this but the sense of urgency is not there."

"Renewable energy creates many more jobs than fossil-fuel plants in all sectors at a local level, from lawyers and financiers to technicians. Managing these projects requires an infrastructure of people and project development that would bring much more money to the island."

"Energy is an area that is crucially interrelated with every economic activity. It has to do with the cost of food, transportation, manufacturing and our capability to attract investments."

Roundtable members raised the issue of Prepa's mounting debt, the prospect of a credit downgrade for the utility and the powerful union at the public corporation. Those factors could combine to hobble the modernization of the island's electrical system and efforts to move past Prepa's detrimental monopoly on the market.

Energy reform aimed at introducing competition this year is easier said than done, panelists agreed.

"Changing regulatory frameworks for competitiveness implies recognizing that this will bankrupt Prepa and that we will have to pay the stranded costs, at least \$5 billion in debt without the assets to back it."

"On the other hand, the Utier union will complain that Prepa would be left with only its grid and that is true. That is what we have to do and do it this year. It is a monumental political and technical task and the government is not up to it alone. The



José Joaquín Villamil, chairman & CEO, Estudios Técnicos Inc. and board chairman BBVA Puerto Rico



William Riefkohl, executive vice president, Puerto Rico Manufacturers Association



Ignacio Veloz, president, Inmobiliaria Neutro Servicio and president-elect, United Retailers Association

private sector has to find the way to achieve it in collaboration with the government."

"To change from the regulatory framework of the last century to a framework that other countries already have implemented requires a private industry with a much more strategic and powerful organizational capacity than the one we have right now. This is how the foreign and local investments will flow into the economy."

"The government is willing to continue with a regulatory framework from 50 years ago simply because it is politically difficult to change.

are tying the hands of businesspeople and in ways that have exactly the opposite effect. They are hindering the growth of established businesses and scaring away many potential investors and the creation of jobs in what would be a growing economy."

"Nothing has been done about labor legislation. It has to be completely revamped to provide more flexibility to give businesses the opportunity to expand and create more jobs. It's another political issue as drafts are drawn up in some Hato Rey law firm and filed in some drawer of a Fortaleza advisor."

All federal labor laws apply in

for decreased productivity. Add double-time pay for everything over eight hours a day, months of mandatory severance pay and many other costly requirements and it becomes difficult to operate."

"Our labor laws are the most costly and restrictive in the U.S. and end up making our labor costs much too high compared with other jurisdictions. They force the private sector to give away money without regard to productivity or concern about how they will impact operational costs."

"A company has to spend thousands of dollars defending itself in frivolous labor cases because of all these labor

"How do you explain that the data from the Labor Department still indicates that the only sector in which salaried jobs has increased is the government?"

Puerto Rico will be crucified, labeled as unable to execute fundamental changes simply because we are timid and fearful, that we leave the hard things for later. What is stopping us is the problematic political issue."

ANTI-JOB LABOR LEGISLATION

Most of Puerto Rico "pro-worker" legislation is really anti-job legislation, according to roundtable members.

"In an effort to protect jobs and implement social justice, legislators

Puerto Rico, but when you add so many local labor laws on top, it strangles business with much higher operating costs than stateside, the panelists agreed.

"Puerto Rico's economy cannot become more competitive when it has twice as many holidays as the U.S. mainland, Latin America and many other countries. Add to these holidays a mandatory 18 days of vacation per year and the abuses of the State Insurance Fund and workmen's compensation and you have a recipe

laws that open the doors to costly lawsuits."

HELPING LOCALS

REACH OUTSIDE MARKETS

"We need to help our business owners to be competitive and take our products and services outside of Puerto Rico. That is something that we have to do, or we are going to disappear, and this impacts Puerto Rico and all the local businesses directly. Setting

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obstacles and isolating ourselves is counterproductive. What we have to do is compete, innovate and stimulate the people to be entrepreneurs.”

“There is a regionalist culture, and we need to look outside of Puerto Rico to bring money in.”

“Many local businesses can export, but we need to help them because they don’t know how to do it. The government has to help with the education to be able to improve the economy or support the private companies that have started providing that education. If we leave it all up to the government, they won’t know how to do it.”

“A big problem is that the money enters Puerto Rico and circulates twice before leaving partly because of our way of doing business. We take a little, but the money goes back to where it came from, circulating here very little.”

PPPs ARE NOT A ‘SILVER BULLET’

Roundtable members praised the Fortuño administration’s passage of a solid PPP regulatory framework, but agreed it was too soon to tell how well it will work to undertake vital projects that the cash-strapped government cannot afford on its own.

“The PPP law is an accomplishment of the administration as it provides certainty to potential investors and developers. But the devil is in the details. The concession contracts must be individually negotiated and they all will be different.”

The other important thing about PPPs that has not been understood is that the risk is shared. The government assumes a risk, and the concessionaire assumes a risk, panelists said.

“We have fallen into a time of underinvestment. Public corporations do not have the capability to invest and do not have the capability to maintain the infrastructure. The government and the public must understand that the user fees of the infrastructure systems need to be updated over time.”

“In simple terms, few of the PPP projects will prevail. All these projects have financial deficiencies. Public infrastructure, even with private capital, needs government to subsidize the projects. If we pretend that



Manuel A. Casiano, chairman of the board of Casiano Communications Inc. and publisher & editor in chief of CARIBBEAN BUSINESS (right), addresses the participants of this year’s roundtable on the general economy. Seated to his right is Carlos Márquez, executive editor of Economics for CARIBBEAN BUSINESS.

this will be done with 100% private financing, it will never happen.”

“I don’t know if there is maturity in the groups that are conducting these efforts. They are placing restrictions that are too strong and expectations that are not realistic. The people who can invest are going someplace else. The only things that will probably happen are road projects, which are the traditional route, and even so, if they are not subsidized, they won’t be viable.”

“The problem with the PPP law is that they see it as a financing mechanism. The premise was that PPP was free, that it wouldn’t cost the government anything. They created some expectations that were exaggerated, that there were billions of dollars out there waiting to come to the island. Look for a very small project that you can do well so that you can build up the trust in Puerto Rico.” ■

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