



**REMARKS BY THE GOVERNOR
OF THE COMMONWEALTH OF PUERTO RICO
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In 1986 I had the pleasure to talk to you about Puerto Rico's plans for economic growth. Now I am ready to report to you the success and achievements of the longest economic recovery in Puerto Rico since the OPEC oil crisis.

In 1985 I took office with a commitment to redress the consequences of the mistaken policies of the last administration. Guided by a strong belief in the benefits of private sector development, my administration undertook a campaign to renew the strong ties with industry which had proven so successful earlier in our history.

You all know that Puerto Rico is the most successful example of the virtues of stimulating thru tax incentives the forces of supply of the economy.

Puerto Rico's economic history is one of a poor, agrarian island with high population density and lack of natural resources which has undergone rapid industrialization and dramatic economic growth in the past forty years. Between 1950 and 1970, Puerto Rico's real GNP grew at an impressive annual rate of 6 percent, one of the highest in the world. In 1952, there were only 82 industrial

plants in Puerto Rico, by 1970 there were more than 1,000, and by 1990 there were more than 2000 plants in operation.

This impressive growth is the result of the pioneer and most successful private sector driven economic development program in America. Free access to U.S. markets, local self-government, and a flexible and dynamic relation with the United States, provided the framework from which the Commonwealth of Puerto Rico developed a tax incentive program which exempted foreign manufacturers from federal and local taxes and attracted the influx of capital investment necessary for our economic development. In 1950, manufacturing accounted for 16 percent of Puerto Rico's gross product; by 1989 this share had grown to 40 percent. Alongside industry, Puerto Rico grew and our citizens have come to enjoy the highest and most equitable per capita income in Latin America. To be precise, per capita personal income in Puerto Rico has grown more than nineteen times since 1950.

In the 1970's a different administration jettisoned these successful policies raising corporate taxes which coupled with the OPEC oil crisis decimated our economy. As a result the number of industrial promotions declined by 50% and unemployment levels rose to an unprecedented 25%.

In 1985 we returned to the sound policies of promoting private sector investment thru lower taxation. I informed you of our plans for tax reform, primarily tax reduction. It is now a reality.

As part of the new comprehensive economic plan, Puerto Rico lowered personal income tax rates from 65% to 36%, capital gains taxes from 65% to 17%, and taxes on interest income from 65% to 17%. In addition, we completely eliminated inheritance taxes and separate corporate taxes for some economic development activities. This tax reform led to a six year economic recovery, the longest in Puerto Rico since the OPEC Crisis.

Puerto Rico also approved a new Industrial Incentive Plan in 1987 to restore and perfect the

low-tax environment conducive to investment. The Industrial Incentive Act allows manufacturing and export service firms to qualify for tax exemptions of up to 90 percent of their operating income for a period of 10 to 25 years, depending on location. The Act entirely exempts from income tax the interest earning of specified financial assets in Puerto Rico. In recent years, the provisions of the Industrial Incentives Act have resulted in Section 936 corporations paying effective Puerto Rican tax rates of 5 percent or less. A similar incentive plan was approved for projects that promote the tourism industry.

In addition, we introduced limited partnerships, tax credits to individuals investing in Venture Capital Funds, and significantly reduced excise taxes.

Many of these incentives worked because of the complementary federal tax exemption uniquely available to Puerto Rico under Commonwealth. In its present form, Section 936 effectively exempts from U.S. tax almost half the income arising from

the active conduct of business of section 936 corporations. In addition, all the passive income arising from qualified investments is free of federal tax. Section 936 corporations are responsible for 300,000 direct jobs in Puerto Rico, and 150,000 jobs in the United States.

You will be interested to note that C.B.O., no bastion of supply-side views, examined the consequences of imposing federal taxes in Puerto Rico and concluded that our productive economy would be decimated. Puerto Rico would suffer a permanent drop in GNP of 10-15% by the year 2000, accompanied by a loss of 50-100,000 private sector jobs. A complementary study by KMPG Peat Marwick concluded that such massive unemployment would increase federal outlays to Puerto Rico by \$2.4 and \$3.4 billion annually, net of any additional federal taxes.

The facts evince the strong success of a renewed partnership between government and industry focused on public incentives for private investment. Between 1985-90 the cumulative real

economic growth of Puerto Rico reached 19.6%. Growth which outstrips that of the United Kingdom, Germany, France, and the United States. Unemployment which had reached a level of 21.4% in 1985 decreased by seven percentage points through 1989. This drastic reduction in unemployment responded to the creation of 194,000 new job opportunities by an administration that knows how to work with industry. A positive trade balance was achieved and has been sustained since 1985. Puerto Rico has become the fifth largest exporter in the hemisphere surpassing much bigger countries like Argentina and Venezuela. In fact, Puerto Rico exports more than all of Central America and the Caribbean.

Puerto Rico has become one of the United States largest and most important trading partner with total exports/imports amounting to \$24 billion in 1989. Puerto Rico's purchases of U.S. products outstrip the combined purchases of Argentina, Brazil, Chile, and Colombia-the leading U.S.

customers in South America with an aggregate population of 228 million.

A stable democracy and sound economic growth has prompted Puerto Rico's leadership in the Caribbean region. As part of the Caribbean Basin Initiative and recently as part of the Partnership for Progress, Puerto Rico developed a twin-plant business venture plan and has channeled monies deposited in local banks by 936 companies into investment projects throughout the Caribbean.

Combining Puerto Rico's highly skilled labor force and infrastructure with lower labor costs in the rest of the Caribbean, Puerto Rico devised the twin-plant venture which promotes companies to share manufacturing operations between operations between Puerto Rico and our neighboring islands to further the objectives of the CBI. Our initiative has added 2,575 jobs to our economy and more than 19,500 throughout CBI participating countries. Investment projects promoted have ranged from phone companies, to pharmaceuticals and mega-resort hotels.

Low-cost funds are made available to companies that invest in Caribbean nations committed to democratic principles and free enterprise. Investment promoted by Puerto Rico in CBI countries amounted to \$678 million as of last month. Total investment promoted by Puerto Rico has more than eight-folded since the program's inception in 1985.

At present, Puerto Rico is in the process of further enhancing the environment for private economic opportunity. We are preparing to meet the new challenges to industry.

Puerto Rico pursues a general privatization plan of government services that includes the sale of our telecommunications system company, the largest utility sale in the United States, new energy sources, and important infrastructure. We are currently in the final negotiations of the phone company sale.

As part of a comprehensive drive to invest in long-term development activities, the two billion dollars expected to be raised by the privatization of the phone company will be invested in two

permanent trust funds which earnings will be used to upgrade the quality of education in Puerto Rico and continuously improve our infrastructure.

We also seek to lower the effective tax rates suffered by our welfare recipients trapped in poverty. They are no less entitled to the benefits of proper incentives and rewards of work and effort. Through creative use of funds, we seek to address this concern. Experimental projects like "Pan y Trabajo" that invests food stamp monies to temporarily subsidize wages in targeted industries will hopefully further incentive our economy.

Puerto Rico is also in the midst of internationalization. Among our plans are to open an office in Brussels and an exhibition center in Seville to continue opening European markets to products from Puerto Rico. Exports to the European community have grown by 118% during the last three years to over \$1 billion. As a result of our recent promotions in Japan, Puerto Rico's coffee is being for the first time marketed there. Coffee exports to Japan are expected to quadruple within a

year. Japanese investments in Puerto Rico already amount to \$100 million and is responsible for the creation of 2,100 new jobs.

Recent policy decisions to support industrial innovation and research through investments and scholarships in microelectronics, robotics and flexible specialization respond to this drive for internationalization. We are most interested in exploring the advantages of moving food production and agroindustrial investment to tropical zones in the hemisphere, and testing the commercialization of biotechnology applications to food production here.

We are confident in our potential to sustain growth. Our economy is expected to grow 2.74% during 1991 despite recessionary concerns. Private projects already in planning stages should result in \$2,718 million in new investments and 11,399 new jobs. Investment growth is, indeed, one of the most encouraging trends of the Puerto Rican economy. The real investment rate reached 19.2% in FY 1990.

As troops return home from a free Kuwait, U.S. policy makers will focus efforts on economic initiatives to spur growth and industry at home. Puerto Rico's example, though unique, can serve as inspiration and demonstration to those, like you,, who believe in the power of industry to lead, if allowed, and in the ability of governments to foment such growth thru low-taxation, free trade, and sound policy. Puerto Rico is thus ready and eager to compete and lead in the growing globalization of the economy and liberalization of trade.