

**REMARKS OF RAFAEL HERNÁNDEZ COLÓN
GOVERNOR OF PUERTO RICO
1973-76; 1985-1992**



**ON OCCASION OF A RECEPTION AND FUNDRAISER FOR THE
BENEFIT OF THE
FUNDACIÓN BIBLIOTECA RAFAEL HERNÁNDEZ COLÓN**

Wednesday, May 7, 2014
At 8:00 PM

Place: At the home of Silda Palerm & Richard Hall

ECONOMIC GROWTH IN THE COMMONWEALTH ZONE

Thank you so much for being here tonight and supporting the Foundation and Library that bears my name. Thank you very much Richard and Silda for serving as our hosts in your wonderful home. As you have heard tonight, the Library will house the records of my years in public service including those of the many public servants, advisors and others, some of whom are here tonight and who I am forever thankful for having worked with me. We also want the Library to be current at all times by serving as a center that provides ideas in real time for Puerto Rico's progress.

New York, particularly Wall Street, is well aware of the travails that have beset Puerto Rico's economy in recent years, of the tribulations with our bonds, and of the manifold devices used in the past to balance our budget. We have gone through difficult times but there is light at the end of the tunnel.

Last week Governor Garcia Padilla laid out the road map in a well thought out state of the Commonwealth message to the Legislature. Coming after the successful sale of 3.5 billion of our bonds, he presented the first budget in 22 years that has been balanced by recurrent revenues without refinancing debt and including debt service in the budget itself. A formidable cost cutting achievement by his economic team under his leadership. The sustainable recurrent revenue side of the budget will be the subject of tax reform to be submitted later on to the legislature.

At the same time he outlined a strategy for job creation and economic growth drawing on the existing sophisticated manufacturing sector, targeting knowledge and business process outsourcing, , under the flag industries, and the aerospace and defense sectors for which he is developing a cluster in former Ramey Air Force Base in Aguadilla for companies devoted to repair maintenance, and operations for private and military aviation. Companies such as Lufthansa,

Pratt & Whitney, Honeywell, Lockheed Martin, and Infotech are already in the area. This cluster will attract local small business an important sector in accordance to another policy of the governor directed towards development of a sustainable economy by coupling local industry and services with foreign direct investment. Together with these initiatives in manufacturing he outlined others already being successfully implemented in agriculture and tourism plus others in K to 16 education to bring our schools and universities into the development of a knowledge economy.

These policies aimed to set the fiscal house in order and to foster economic development are decisive meaningful steps being taken on the Puerto Rican front to address the predicament in which we find ourselves since Congress did away with Section 936 turning sour our economy and since our own local government turned to deficit financing rather than facing the music as Alejandro García Padilla is doing today.

In the light at the end of the tunnel of Governor García Padilla's actions, I want to speak to you tonight about economic growth in the Commonwealth zone. By Commonwealth zone I mean the distinct Constitutional and policy making area occupied by the Commonwealth that is different from those of the States of the Union that grants more flexibility for policy making suitable for Puerto Rico and mutually beneficial for the United States. Foremost, our status as non-state entity in US federalism excludes us from the US Constitution uniformity clause requiring uniform federal taxes across the states. We also, as a matter of policy and law, need not be subject to the automatic application of federal laws and regulations in the same way to all states. This is critical because there is a wide gap between our level of economic development and those of the states.

The sharp focus here in the New York financial world to Puerto Rico's fiscal challenges and their effect on our public debt has resulted in an unparalleled level of scrutiny of our finances and laws responding to such challenges. A parallel, but

equally sharp focus, however, is needed on the actions or inactions of the federal government regarding Puerto Rico. Economic policy for Puerto Rico is set not only in San Juan but also in Washington, DC. So far all the scrutiny seems to be on San Juan.

It has been close to 20 years since Congress has taken any meaningful action regarding economic policy for Puerto Rico. Some people ask how is Puerto Rico different than Detroit? Short answer: Washington did not change the rules of investments for Detroit. It did so for Puerto Rico. Congress changed the investment rules for Puerto Rico in 1996 when with the thumbs up of Puerto Rican statehooders, it enacted a ten year phase out of the so called 936 tax provision which was the linchpin of American companies establishing themselves in Puerto Rico. Congress did not heed the warning of the Commerce Department report to President Carter which stated that “continuation of the present exemption from federal income tax of repatriated dividends from Puerto Rican enterprises,

however, is virtually a sine qua non for attracting more U.S. investment capital to Puerto Rican industry.” Doing away with 936 had very serious consequences as recognized even if in muted terms by the White House Presidential Task Force Report and the New York Federal Reserve Report. It should have been obvious to Congress that our caribbean island economy poorer than Mississippi’s saddled with the federal minimum wage, U.S. shipping costs, federal environmental requirements, OSHA and other costs of production and distribution coming from Congressional legislation cannot compete with Mexico or countries in the Caribbean Basin if we do not have a federal incentive to attract industries in to Puerto Rico.

As former three- time Governor, I have seen cycles of recession in the 1970s and cycles of growth up to the 1990s. What we are seeing in Puerto Rico, after the demise of 936 however, I have never seen before. Puerto Rico’s economy is no longer fully aligned with that of the United States. By that I mean, the usual

pattern of the Puerto Rican economy largely rising and falling with that of the United States is no longer the case.

That is directly traceable to Congress elimination of 936 which needs to be urgently revisited so that a suitable alternative is found. The thinking back in 1996 was that a gradual phase out of such provisions would provide significant revenues to the US Treasury while not really hurting Puerto Rico. Both assumptions proved seriously wrong. American companies relocated elsewhere and otherwise engaged in tax planning that negated the expected US Treasury revenues. Meanwhile, as the phase out progressed tens of thousands of jobs were lost in Puerto Rico, our economy was sent into a tailspin and became untethered to the US economy.

What are we to do about this? The first and most important step is that policy and legislation in Washington should focus on the re-alignment of the Puerto Rican economy with the rest of the United States, particularly through tax policy encouraging investment in Puerto Rico of American companies that are now

operating outside of the United States or targeting expansion abroad. Since American companies and investors are key drivers of the Puerto Rican economy, as the Commerce Department pointed out in 1972 and as the New York Fed recognized recently, without policies geared to them, economic growth in Puerto Rico cannot rise to the level needed to provide employment for our unemployed and the thousands out of the labor force that have stopped looking for jobs.

Re-alignment assures growth in Puerto Rico in cycles of growth in the US. Measures in San Juan would build upon that or interact with it in positive ways. Past governors of different political stripes have been able to achieve growth rates higher than in the US. This provided encouragement that at some point in the future we would begin to close the gap that separates us in personal income with the poorest state: Mississippi. But that has not happened since the two economies parted ways.

We are all fully aware that the fiscal situation in the US calls for revenue neutral or near revenue neutral policies. But let us learn the lessons of the past, the 936 repeal not only did not result in the projected federal tax dollars but it had the unintended consequences of throwing thousands of Puerto Rican into welfare rolls, which is revenue negative for the US Treasury and the emigration of 100s of thousands to US which is revenue negative to the Puerto Rico Treasury. The spike in the level of Puerto Rico debt and the strains to sustain it are yet another unintended consequence traceable in large measure to the blows inflicted on the economy. I have no doubt that the realignment of the economies and the measures being taken in Puerto Rico would restore investment grade status for our debt.

Tax policy is of course a technical matter when it comes to projected revenues and needs to be looked at closely but we need to be mindful of what levels of revenues we are talking about. This is sometimes called “sizing” in business parlance.

One indication of the size of the federal revenues equation comes from the General Accounting Office which just issued a report on the effects of Statehood for Puerto Rico. Part of such report addressed the effect of turning what are now so called Controlled Foreign Corporations into ordinary US corporations. The report, acknowledging the difficulty of the task estimated that the effect on US revenue intake could range from negative between \$50 million to positive \$3.4 in federal revenues and drew attention that companies are likely to relocate. The 3.4 billion best case difference compared to our more than 70 billion public debt in Puerto Rico is a single digit percentage number and compared to the US debt you would need a decent calculator to figure out the decimals. This mind you is without netting against the spike in federal assistance to the people that lose jobs and the huge negative effects on the economy of relocation. Simply put the issues associated with federal revenues from Puerto Rico related to the status of US

companies in Puerto Rico do not move the needle much if at all in the US Treasury and may actually hurt revenues--- but they have gigantic effects in Puerto Rico.

Getting Congress to focus on an economic policy of realignment with a new 936 like equivalent or Controlled Foreign Corporation special provisions is not going to be easy. As we know, passing legislation does not come easily in these days of acute partisanship. For it to work, we first need broad consensus in Puerto Rico around the policy. That is hard but not impossible. Former Governor Luis A Ferre, of the opposite Party, helped me in Washington with 936. We also need to engage the Puerto Rican communities here in New York, Orlando and elsewhere. The Hispanic caucus should also help as we have helped on immigration which is not a Puerto Rican issue due to our American citizenship but one with which we are in full solidarity.

We also need to engage US companies and investors so that their key roles and thinking are understood by policy makers in Washington. In short, we need a

large coalition to raise the level of attention and care in Washington to issues of Puerto Rico economic growth so that legislative action becomes possible. Within this setting, we should engage Congress and the Treasury Department in a major re-think of tax policy and other key legislation. The purpose is not to re-litigate 936-- it is to craft a policy in accordance with the times that works well for both sides. This is the work of experts and serious debate. The political will and policy direction, however, should frame the issue: Use the flexibility of the Commonwealth zone to re-align the economies, period. Very small and speculative dollar amounts, if any, for the US Treasury need to be taken into consideration but cannot trump the overall policy.

We should also start re-thinking laws that foster economic dependencies on the federal government social programs in Puerto Rico. I favor all kinds of help for the needy but superimposing programs based on the world largest economy to an Island in the Caribbean with a GNP of a developing nation, creates massive

distortions in the jobs market. Again, these are a matter for experts and subject to wide range debate. The framework, however, should be how can these programs be tailored to maximize economic growth in the particular case of Puerto Rico which has a per capita less than half of Mississippi the poorest state. In other words, tailor the programs to the Puerto Rico situation instead of automatic equal application. Governor García Padilla has moved in this area by securing the approval of the agriculture Department for food stamp recipients to work in farming and harvesting numerous agriculture products without losing their benefits.

Let me end these remarks with a bit of history. When I grew up in Ponce, Puerto Rico, we were an agricultural economy focused primarily on sugar cane. We were called the poor house of the Caribbean. Literally there were many Puerto Ricans without shoes, electricity and basic services, most of our population did back breaking work sun up to sun down in the sugar fields. Many Puerto Ricans

came here and took advantages of the opportunities brought by hard work and education of their children. The elections of José Serrano, Nydia Velázquez and Luis Gutierrez, the appointment of Sonia Sotomayor and the election of Speaker Mark Viverito fills us with pride. Meanwhile back in the Island when I was growing up and with US supporting policies, in the span of a generation we left that behind and became a shining example of economic growth, studied and followed in many respects around the world. We grew a substantial middle class and the path towards progress was felt by everyone. I entered public service along with many others inspired by those who set that path.

I want to see a renewal of that time where everyone in Puerto Rico has faith in progress. I want to see once again, the hard working class and middle class see their sons and daughters have a bright future full of opportunities both here and in Puerto Rico. I will not ask anyone who believes in a different relationship with the United States to give up their beliefs or to put aside their efforts towards those

ends. What I do ask, is that we also focus very hard on the here and now so that we can get Washington on board to overcome this crisis and restore economic growth by aligning once more our economies. This is a win-win for everyone and an urgent imperative for all who care for the Island.

We did it before and we can do it again.

Thank you very much for your support to the Foundation and Library.

