

# ECONOMY

Transforming Puerto Rico through economic development



THINK STRATEGICALLY:

## The \$15.5 Billion Transformation of Puerto Rico

BY FRANCISCO RODRÍGUEZ-CASTRO | frc@birlingcapital.com

Puerto Rico closed 2020 with a 6 percent contraction. Let us imagine how Puerto Rico would look with real GNP growth of 4 percent. If Puerto Rico had grown at 4 percent, adjusted for inflation, the economy would have practically increased by \$2.8 billion.

Suppose for a moment that we grew our economy at that rate for five years, Puerto Rico would create about \$15.5 billion in additional revenue during that period. These are approximate numbers, but they provide targets that are reasonable and achievable if we develop a plan to reach our goals.

We have developed a path to transform Puerto Rico that would create more than \$15.5 billion in economic activity, wealth creation, job growth and education.

The \$15.5 billion transformation of Puerto Rico contains the following elements:

- High levels of well-paid and stable employment in the non-governmental sector.
- A social culture focused on economic development.
- The ability to insert itself into the global economy effectively.
- Flexible governance structures adapted to the requirements of the worldwide economy.

- A competitive, innovative local business sector with export capacity.
- A diversified economy with high levels of productivity.
- Levels of social welfare comparable to those of the most advanced countries.
- High environmental quality and excellent quality of life.

The journey to implement the \$15.5 billion transformation begins with Puerto Rico's FIRST Goals, which are a vision that must be communicated, discussed and implemented, and which every citizen of Puerto Rico must understand, respect and protect.

### Puerto Rico's FIRST Goals

Transform Puerto Rico into a country with robust economic development and sustained growth of 4 percent in 10 years. This growth rate is similar to the average annual real growth of the Puerto Rico economy from 1950 to the present. That and the fact that it is a growth rate that our peers and competitors have surpassed in recent years suggests it is an achievable goal.

Transform our industrial structure in which manufacturing, R&D and employment activities are focused on the knowledge-based economy with 25 percent of the gross national

product in 10 years; our direct employment in high technology manufacturing (approximately 5 percent of total employment) and employment in advanced services directly related to knowledge production (about 10 percent) is close to 15 percent of full employment. The goal of reaching 25 percent within 10 years is not unrealistic, mainly when the existing advanced services base is considered. A knowledge economy that grows at least at the assumed general economy rate of 4 percent would generate an additional \$3.5 billion per year.

Create 300,000 new jobs in the private sector in the next 10 years.

Increase our labor participation rate to 55 percent in 10 years.

Reduce the unemployment rate to 5 percent in 10 years: Goals 3, 4 and 5 work in tandem.

Close the "development gap." This means the percent of GNP that represents consumption and the percent that represents an investment that in Puerto Rico far exceeds that of our peers. The structure of income in Puerto Rico (65 percent of people's revenue arises from three sources: public employment, federal transfers and the informal economy) and how the tax system has been structured has stimulated consumption and not savings and investment. Placing ourselves at the same levels as our competitors will require profound changes in the tax system and an educational effort that transforms the culture of consumption into one of investment.

Move to a government structure characterized by the following: employing no more than 15 percent of the workforce and a Consolidated Budget that does not exceed 25 percent of GNP. Currently, these two figures are around 28 percent and 50 percent, respectively, taking into consideration that the Consolidated Budget includes public corporations. Although this objective could be interpreted as aimed at reducing the government's size, which should be a social objective, the mere fact of growing at a 4 percent rate would facilitate its achievement.

Increase the average per capita income by 30 percent in 10 years, from \$20,873.00 to \$27,134.00: translates into \$7.2 billion of additional revenue and policies to improve the workforce's quality and facilitate market entry.

Transform the educational system from primary to university level into one focused on entrepreneurship, trades and transformation. This is critical to achieve a more focused educational system based on entrepreneurship and wealth creation, rather than educating students to seek work.

Measure ourselves with all international metrics to maintain competitiveness.

There is a need to have a clear vision of the economic future of Puerto Rico and to consider not only the size of the economy, but also its essential characteristics. This vision

must be implemented and followed by every citizen.

### Week in Markets: Bazooka Stimulus, Rising U.S. Treasuries, Massive Vaccinations, Wall Street with mixed results

The U.S. stock market managed to reach new highs last week but ended the week with mixed results.

There is a diverse set of variables influencing investor sentiment, including:

The path of approval of the \$1.9 trillion Bazooka Stimulus.

Weakening economic data, including jobs losses affected by the surge in virus cases.

GameStop is now part of a Congressional hearing determined to understand the trading hysteria.

Massive vaccination effort to achieve herd immunity in the United States.

While most of the market participants have been focusing on equities, we have noted the rise of the U.S. Treasury 10-year note, which reached 1.34 percent last Friday. These rates are rising for a reason, and not a bad one. First, inflation is now at its highest level since 2013, and higher inflation expectations determine a rebound in economic activity.

Secondly, rates are just adjusting to where they were in February 2020, so as the market normalizes, it is about time these rates went back to where they were a year ago.

Finally, we do not think that the rise in interest rates is at a level that will derail economic growth. If history serves as a good predictor, we must note that since 1945, a recession began with the Treasury 10-year notes are even as high as 3 percent; historically, 10-year interest rates averaged 6.7 percent at prior stock-market peaks.

In conclusion, we believe that the fundamental outlook remains stable and positive with an enormous sense of optimism that is the correct frame of mind.

*Francisco Rodríguez-Castro is president and CEO of Birling Capital LLC. Think Strategically© is a publication by Birling Capital LLC that summarizes recent geopolitical, economic, market and other developments. This report is intended for general information purposes only and does not represent investment, legal, regulatory, or tax advice. Recipients are cautioned to seek appropriate professional counsel regarding any of the matters discussed.*

Weekly Market Close Comparison	2/19/21	2/12/21	Return	YTD
Dow Jones Industrial Average	31,494.32	31,458.40	0.11%	2.90%
Standard & Poor's 500	3,906.71	3,934.83	-0.71%	4.01%
Nasdaq	13,874.46	14,095.47	-1.57%	7.65%
Birling Puerto Rico Stock Index	2,170.65	2,152.75	0.83%	6.14%
U.S. Treasury 10-Year Note	1.34%	1.20%	11.67%	0.40%
U.S. Treasury 2-Year Note	0.11%	0.11%	0.00%	0.50%