

Voz y Acción de la Empresa Privada



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August 20, 2018

Mr. José Carrión III
President
Fiscal Oversight & Management Board for Puerto Rico
PO Box 192018
San Juan Puerto Rico 00918-2008

Dear Mr. Carrión:

Recently Governor Ricardo Rosselló signed Executive Order Num. OE 2018-033 (EO 2018-33). This order immediately raises the minimum wage for construction employees working on government projects to \$15.00 per hour. It also requires that a Project Labor Agreement be reached and submitted for every construction contract that exceeds two million dollars. The Puerto Rico Chamber of Commerce (PRCC) has expressed its opposition to such measures because of the adverse impact they will have on the Puerto Rican economy.

The PRCC is a nonprofit organization grouping more than 1,000 businesses, professionals, and associations in Puerto Rico. These businesses are the base and support for our local economy. Our mission is to promote the growth of private enterprises and multisector integration to reach sustainable economic development in Puerto Rico. The PRCC's Affiliates Council is a multisector group of private entities and associations representing every sector of the economy. After discussing the matter, the Council supports PRCC's opposition and asks the Fiscal Oversight & Management Board for Puerto Rico (FOMB) to review the impact that EO 2018-33 will have on the economy and on the fiscal plan in order to avoid the loss of jobs and a greater inflation in construction costs and the economy overall.

The PRCC does not oppose initiatives that provide economic relief to our working force. In the past we have recognized that increased salaries would mean more resources and economic means that would booster our local economy. However if the increase is too high, we understand that it would be harmful to the local commercial sector. We have proposed, regarding the Executive Order, that a further study on the impact of any such measure is needed prior to making any final decision. As of today our position remains the same. Furthermore, we have not received any documentation from the government that justifies or explains how the amount of the increase was determined.

The need for information and further study on this matter is evident. EO 2018-033 states that “[i]n the United States, it is typical for construction workers to earn over \$70.00 per hour (...)”. But according to the U.S. Bureau of Labor Statistics, the mean hourly wage for construction laborers is \$18.71. Percentile wage estimates for this occupation are as follows:¹

Percentile	10%	25%	50% (Median)	75%	90%
Hourly Wage	\$10.71	\$13.18	\$16.60	\$22.24	\$30.48
Annual Wage	\$22,280	\$27,410	\$34,530	\$46,260	\$63,400

Therefore we remain unclear as to what information was used to reach the conclusion that a raise of the minimum wage for construction workers to \$15.00 an hour was appropriate at this time.

I. Minimum wage general considerations

Many states of the Union have implemented a higher minimum wage in recent years; the raise depends on different factors for every state. Alaska, Florida, Minnesota, Missouri, Montana, New Jersey, Ohio, and South Dakota increased their rates based on the cost of living, for example. Most of these increases in the minimum wage will take effect over time and have been approved by legislation. Arizona, Colorado, and Maine, approved November ballot measures to raise their respective minimum wages to \$12 an hour by 2020. Washington on the other hand will increase its minimum salary incrementally to \$13.50 an hour by 2020.²

While some states have chosen to raise the minimum wage to \$15.00, they have done so in a calculated incremental way. Massachusetts for example enacted a measure (HB 4640) to increase the state minimum wage to \$15.00 over five years, from \$11.00 where it stands now. California, on the other hand, is scheduled to reach a minimum wage of \$15.00 by incrementing its \$11.00 minimum wage annually until the year 2022.³ Even though these economies are not comparable to ours, they are good examples of how the legislation handles this subject on a gradual manner.

In a study published in 2014 by the Employment Studies Institute, Dr. Joseph Sabia of San Diego State analyzed the impact of a higher minimum wage in periods of strong and weak economic growth. The results of the study suggest “that across the business cycle, minimum wage increases reduce employment of teenagers and younger individuals without a high school diploma.” The results of the study suggest that raising the minimum wage is particularly risky in times of weak economic growth.⁴ Also bear in mind that such high increase, could trigger the immigration of construction workers from the United States.

¹ <https://www.bls.gov/oes/current/oes472061.htm>

² <http://www.ncsl.org/research/labor-and-employment/state-minimum-wage-chart.aspx#1>

³ Id.

⁴ https://www.epionline.org/wp-content/uploads/2014/05/140120_EPI_MinimumWageStateBusinessCyclev2.pdf

II. Minimum wage Puerto Rico

Looking more closely to Puerto Rico, we find that a 1992 study from the National Bureau of Economic Research found that subjecting Puerto Rico to the federal minimum wage reduced employment in the territory by 8 to 10 percent. The study also concludes, like much other research on the matter, that employers are less likely to hire low skilled workers when minimum wage raises.⁵

A few years later, in 2012 a study by the Federal Reserve Bank of New York argued the following:

“Puerto Rico’s minimum wage may well contribute to the lack of jobs for lower-skilled workers. Most economists agree that a binding minimum wage reduces employment relative to levels that would exist in the absence of such a constraint. In Puerto Rico, the U.S. federal minimum wage applies even though the U.S. level is quite high relative to the wages the average worker could expect to earn on the Island. To put the level of the minimum wage in perspective, the annual salary of a full-time minimum wage worker is around \$15,000—roughly equivalent to Puerto Rico’s income per capita in 2010, and similar to the median household’s total income of about \$19,000. Overall, workers in Puerto Rico tend to earn about half as much as workers on the U.S. mainland and the median household income is 60 percent lower. **Given this disparity, the level of the minimum wage is on a different scale in Puerto Rico than on the U.S. mainland. Further, the minimum wage is high relative to average worker productivity.** According to a 2012 World Bank study, Puerto Rico ranked 160th out of 186 countries when judged by the ratio of the minimum wage to value added per worker. Puerto Rico’s ratio was nearly double the ratio for the Bahamas and Jamaica, about three times that of the U.S. mainland, and roughly 6 times that of Mexico.⁶

To deal with the high unemployment and low labor force participation, the study recommends “focusing on policies that address problems related to the Island’s relatively high minimum wage and that improve incentives to work.”⁷

The minimum wage may be especially damaging to the prospects of young and relatively unskilled workers. In fact, the 40 percent unemployment rate and 36 percent labor force participation rate among 16-to-24 year olds suggest that the effects of the minimum wage may be particularly detrimental to this group. Clearly, opportunities for young workers are quite limited, and they are in danger of becoming disconnected from the labor market over the long term.

In 2015 economists Anne Krueger, Ranjit Teja and Andrew Wolfe studied Puerto Rico’s economic and fiscal outlook and concluded, among other things, that in some cases the employers are

⁵ <http://www.nber.org/chapters/c6909.pdf>

⁶ <https://www.newyorkfed.org/medialibrary/media/regional/PuertoRico/report.pdf>

⁷ *Id.*

disinclined to hire workers. This is because the federal minimum wage is very high compared to the average in Puerto Rico where full time employment at minimum wage is equivalent to 77% of per capita income versus 28% on the mainland.⁸

That same year an article published in Bloomberg Businessweek compared the increase of minimum wages across the U.S. and a proposal by Senator Sanders to rise federal minimum wage to \$15 and concluded that:

“[a] \$15 minimum is just 67 percent of the median wage in high-cost Alaska, so it would have a modest effect if implemented today, lifting pay of people at the bottom but not affecting the middle rungs of the income ladder. In Puerto Rico, though, \$15 is 155 percent of the median wage. If the federal minimum were raised to \$15 today (rather than in 2020, as Sanders proposes), it would be 55 percent higher than the midpoint of what all Puerto Ricans earn. That would cause severe stress in a financially struggling territory already squeezed by the \$7.25 minimum. Even within a single state, it’s hard to come up with a minimum that works everywhere. In California, the median wage varies from more than \$28 an hour in Silicon Valley (technically San Benito and Santa Clara counties) to less than \$14 in Visalia-Porterville, a farm town 190 miles away by car.”⁹

The article quotes economist and leading researcher on minimum wage Arindrajit Dube, who believes “[a] good rule is to set the minimum at half the local median wage”.

A year later, renowned economist Dr. José Caraballo published his own study on the matter. In “Is There a Minimum Wage Biting in Puerto Rico? Updating the Debate” Dr. Caraballo analyzes the effect a minimum wage increase would have on Puerto Rico. Dr. Caraballo disagrees with the study previously mentioned that the minimum salary as it stands is too high but argues that an increase to \$15.00 per hour would indeed be too high for Puerto Rico. The study concludes that the adequate minimum salary for Puerto Rico is \$8.61 per hour and that it is important to have an adequate minimum salary revision to improve economic inequality on the Island.

On the other hand, Chief Economist of the World Bank and recipient of the Nobel Prize on Economic Sciences, Joseph Stiglitz, a fierce defender of higher minimum wages, has also weighed in on the discussion. For Stiglitz one major economic problem in Puerto Rico is that it has the same minimum wage as the rest of the United States, while the income per capita is less than one-third that of the United States. He thinks that while higher wages are generally positive, there are not enough jobs in Puerto Rico to sustain the minimum wage and that the only thing worse than low wages is unemployment. For the same reason Stiglitz recognized on his visit on April 2017 that an increase to the minimum wage in Puerto Rico would not have the same effect as it would on the mainland.

⁸<http://gdb.pr.gov/documents/PuertoRicoAWayForward.pdf>

⁹ <https://www.bloomberg.com/news/articles/2015-08-06/is-a-15-minimum-wage-too-high->

When people that regularly advocate for increases in the minimum wages, warn that increases in Puerto Rico cannot be made using US salaries as a point of reference, we understand that there is a concensus that Puerto Rico cannot blindly adopt US wages without the proper analysis. The Puerto Rico economic system cannot endure an increase that is not based upon our own economic reality and limitations.

III. Increase in construction costs

This discussion is crucial to understanding the negative impact of EO 2018-033. Not only are government projects going to be more expensive, private projects will have to offer higher wages to compete for workers, thus increasing the cost of the investment.

A preliminary study by the firm Estudios Técnicos found that the new minimum wage would impact construction firms and construction costs across the board.

By requiring a much higher minimum wage for the lowest-teared occupations in public sector projects, the relative wage increases will likely cascade across the entire organizational hierarchy, with higher ranking positions also demanding similar raises, else they switch occupations. At the same time, it is unlikely that a firm will have both equally-ranked employees gaining very dissimilar wages depending on whether one is selected for a public or private sector construction project: therefore, similar raises must also be expected for private sector projects. The net result is a significant cost increase in construction projects, which in the context of Puerto Rico's fragile economy will incur in significant losses of business activity.

The study also concludes that the new minimum wage allows the entrance into Puerto Rico of foreign firms to compete for government construction projects which can result in displacement of business activity. It adds that housing costs are expected to increase between \$45.8 and \$162.9 million and commercial/industrial buildings are expected to cost \$139 to \$494 million more.

A letter sent to the FOMB by our affiliate Builders Association of Puerto Rico perfectly describes the impact this order would have on salaries across the industry. They explain that benefits and mandatory payments associated with construction salaries add 40% to labor costs, thus the mandated \$15.00 per hour rate will cause a total hourly rate of 21.00 per hour. Of course, this increase in the minimum pay for the lowest tier of the payment scale will cause a ripple effect on that scale requiring construction companies to review and increment the salary of every other employee, affecting salaries for everyone in the industry as noted by the study.

This formula does not consider the raise in price for construction materials after hurricane Maria. According to some experts, construction materials in Puerto Rico have increased 30% to 40%. It also does not consider the impact President Trump's new tariffs on necessary materials such as steel and aluminum would have on the price of materials on the island. Please note that

companies such as Harley Davidson have announced the relocation of operations due to the new tariffs that would increase their production costs by \$100 million dollars a year.¹⁰

Finally, the Executive Order is extensive to all government contracts. So even though a portion of the projects would be financed by funds transferred by the federal government, the remaining portion would have to be paid by the local government. We understand that such increase in expenditure has not been included in the budgets proposed by the local government nor in the Fiscal Plan proposed. It appears that an inconsistent message is being delivered when we are saying to the creditors that there are not enough financial resources to pay the government obligation, but we are opting to increase salary related expenses.

IV. Project Labor Agreements

EO 2018-033 requirement of having a Project Labor Agreement (PLA) seems to have been copied from Executive Order 13502, signed by President Barack Obama in which agencies are encouraged to consider requiring the use of project labor agreements in connection with large-scale construction projects exceeding \$25 million. PLA's have been criticized for being excessively costly and discriminatory towards otherwise qualified contractors that don't want to sign them.

Two projects have been presented to the Senate and the House of Representative to preserve open competition and Federal Government neutrality towards the labor relations of Federal Government contractors on Federal and federally funded construction projects. Those projects are H.R. 1552 and S. 662. These projects do not prevent a contractor from voluntarily entering into a PLA, but they do prevent government from mandating the use of PLA's to win a contract.

This issue is so important in the United States that a few weeks ago, U.S. House lawmakers wrote President Trump urging him to rescind Executive Order 13502. The letter indicates that:

To create the conditions for innovation and free enterprise, we must promote open competition, efficiency, fairness and equality in government contracting. Mandating, or even encouraging PLAs needlessly limits the pool of experienced and qualified bidders able to deliver the best possible product to taxpayers at the best possible price.

Reports have shown that government-mandated PLAs discourage merit shop contractors from bidding on taxpayer-funded construction contracts and drive up costs between 12 percent and 18 percent, which results in fewer infrastructure improvements and reduced construction industry job creation (...)

At the moment 24 states have passed policies restricting government-mandated PLAs on state and local construction projects to some degree.

¹⁰ <https://www.afr.com/markets/trump-trade-war-backfires-as-harleydavidson-moves-offshore-20180625-h11uls>

The issue in Puerto Rico is even graver because EO 2018-033 requires PLA agreements for every project over \$2 million dollars. This is particularly serious at this time where we are asking the federal government to provide funds for a much-needed reconstruction effort.

Our government can't continue to ignore the evidence that is available. The policies approved by EO 2018-033 will have an impact on job creation and will increase the cost of much needed projects and other economic activities in a way that was not considered in the Fiscal Plan approved by the FOMB.

V. Private Sector Participation

The private sector has been very active since the inauguration of this administration. On March 2nd, 2017, the Governor signed Executive Order OE: 2017-27 creating the Multisector Committee on Minimum Wage, with private sector participation, to study the possibility of increasing the minimum wage in Puerto Rico. The Committee commissioned the Puerto Rico Planning Board to study the impact of any increase to the minimum wage. The results of the study were discouraging. They show that an increase of the minimum wage in Puerto Rico should not exceed 13.8% of the current minimum wage, or \$8.25, and that this increase should be incremented over two or three years. The study also shows that increasing the minimum wage to \$7.39 in 2018, \$7.53 in 2019 and \$7.67 in 2020 could negatively impact the GNP by up to -15.4% for the 2018-2020 period. This implies an additional reduction of -0.4% if compared to the option of not raising the minimum wage. This study reveals that, without a doubt, an increase in the minimum wage will affect Puerto Rican jobs.

This information was not acknowledged by the Administration and the efforts and recommendations made by the private sector along with government officials on this subject have not been acknowledged by the the Government.

The Governor also named a Construction Advisory Board with participation of the private sector and government officials. This Board was not consulted or even informed about the executive order to raise the minimum wage for construction employees.

The impact of this decision on the private sector is still incalculable, yet we were not asked or advised of this decision. As of today, we have knowledge of at least four privately owned construction projects that have been halted because of this executive order. We expect more to come.

VI. Potential impact on reconstruction projects

Last week the Governor submitted to Congress the Economic and Disaster Recovery Plan for Puerto Rico which includes various projects deemed necessary for the economic development of the island and the total recovery from the effects of hurricane María. The Plan requires an investment of \$139 billion. But this plan, which includes multiple reconstruction initiatives was drafted before the mentioned executive order was signed. This leaves us wondering if the path designed by the government to ensure the rehabilitation and reconstruction of the island will be

achievable with the increase in construction costs this order will cause. We also wonder which of the priorities outlined by the government will be left out if raising costs make previous estimates about the cost of the projects insufficient.

VII. Final Comments and Conclusions

The PRCC Affiliate Council is composed of 34 private sector entities and associations. In a meeting of such group held a couple of weeks ago, all the representatives of the entities that attended the meeting expressed concerns with the Executive Order. Each sector is preparing additional information, to be submitted soon, on how the order affects their particular economic segments.

Therefore, we ask that the FOMB reviews this executive order with the power granted by the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA), and to consider the following factors:

- The mounting costs in general of construction projects in Puerto Rico even prior to the approval of EO 2018-33.
- The potential risk of displacement of economic activity.
- The impact this will have on current and future private investment on renovation and construction projects.
- The effect on lower paid, low skill industries whose employees will leave their jobs to try to get a higher paying construction job.
- The impact on the GNP and unemployment level.

Finally, would urge you to consider ordering the local government to revoke the Executive Order.

Furthermore, we respectfully ask for a formal meeting to discuss this matter in detail.

Cordially,



Kenneth Rivera-Robles
President
CCPR Affiliate Council