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Market Commentary

Trump Opportunity, Puerto Rico, Pharma

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My friend Dennis Gartman had a guest commentary in the wonderful and comprehensive monthly research publication offered by Gary Shilling (www.agaryshilling.com) and thoughtfully assembled and edited by Fred Rossi. I thank both Gary and Fred for permission to quote their work.

Dennis wrote:

“Puerto Rico shall be a huge winner, for it was only a bit more than a decade ago that the Commonwealth was a massive supplier of pharmaceuticals to the US for a number of reasons, not the least of which was the tax model that applied to the pharmaceutical companies located there. Congress would do well to reinstitute those tax laws; and if Congress does, Puerto Rico’s economy will benefit... greatly.”

Dennis and Gary published on this topic before I did, so they must be credited here. We agree and must add that PR holds the key to the resurgence of domestic American pharmaceutical manufacturing. If President Trump and his advisers want to return the safety of US medical manufacturing to America, they can do it with the stroke of a pen (with congressional help).

The history is simple.

For years the American pharma companies manufactured in PR. They were there under a special tax provision known as Section 936, which had been in the law for years. President Clinton launched an initiative to repeal 936. That repeal took effect in 1996, and the incentives were phased out over a ten-year period. So the full impact hit after 2006. While a 2006 GAO study reported data that overall manufacturing activity had grown during the phaseout, with pharma manufacturing being more than replaced by other business development in the chemical



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industry (GAO, 2006, <https://www.gao.gov/products/GAO-06-541>, pg. 17), the more telling statistic is that Puerto Rico's overall manufacturing job base fell by more than 40% during the phase-out and today is more than 50% lower than in 1996. Overall labor force growth was flat to negative for the past half-decade, while in the US mainland it was strongly upward (until COVID-19). See "Here's how an obscure tax change sank Puerto Rico's economy," CNBC, Sept. 26, 2017, <https://www.cnbc.com/2017/09/26/heres-how-an-obscure-tax-change-sank-puerto-ricos-economy.html>.

PR's financial decline landed it in the present dire circumstances. The situation was then made far worse by damage from Hurricane Maria in 2017, and now COVID-19 has hit.

Pharma moved to India, China, and elsewhere. Now the US policy makers want to move things back. White House trade adviser Peter Navarro announced on March 16 that he was bringing to President Trump an executive order that would require US companies to relocate their medical supply chains back to the United States. Big Pharma immediately pushed back hard, and Navarro counterattacked ("Trump advisor Peter Navarro slams Big Pharma's lobbying against possible 'Buy America' executive order," CNBC, March 19, 2020, <https://www.cnbc.com/2020/03/19/coronavirus-trump-aide-peter-navarro-slams-big-pharma.html>). As of May 4, the order had still not been signed, and Reuters reported that the issue had divided some of Trump's key advisers, with Treasury Secretary Mnuchin and economic adviser Larry Kudlow opposing the order ("Trump order to buy U.S.-made medical supplies coming soon –Navarro," Nasdaq, May 4, 2020, <https://www.nasdaq.com/articles/trump-order-to-buy-u.s.-made-medical-supplies-coming-soon-navarro-2020-05-04>).

Congress could immediately undo the damage it did in 1996. Trump could then rightfully claim credit for restoring medical manufacturing and relocating it back to Puerto Rico, where there is still a residual of skills and some residual capital ("A Hotspot for Pharmaceutical Manufacturing," Government of Puerto Rico, <http://www.pridco.com/industries/Pages/Pharmaceutical.aspx>). The incentives that worked in the past would likely start an immediate inflow of capital, and America's medical supplies would be returning under the safe US umbrella of supervision and domestic manufacturing.

At the same time PR would likely begin to heal its economic malaise.

All it takes is concerted action from our politicians.

Disclosure: Please note that Cumberland has a number of clients with investments in certain insured PR debt instruments and has positions in ETFs with certain pharmaceutical companies.