Puerto Rico’s Debt: A Conjunctural Overview

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In this brief essay we offer a general and immediate overview of the socioeconomic situation in Puerto Rico. We do it while recognizing that such an analysis is incomplete if the historical, institutional, and political dimensions within the uneven development of capitalism are left out. In this particular case we do not explicitly deal with the colonial relationship of the island with the United States or provide a structural analysis of the economy (these dimensions will be treated in a forthcoming comprehensive article).

Our immediate purpose here is to present a conjunctural picture that can serve as a starting point for those interested (i.e. activists, academics, party militants) that want to approach Puerto Rican reality and insert themselves in the debates surrounding potential solutions

An Economy in Crisis

The economy of Puerto Rico entered its ninth year of contraction—with the expected negative effects on government revenues, public spending, and public debt as the result of a variety of factors: the collapse of a construction bubble, the dismantlement of the industrial model of development, and the approval of the CAFTA-DR. The situation was aggravated by the financial crisis of 2008, which led to the reduction of credit for small and medium firms, many of which had to cease their operations given the cancellation of their lines of credit and their inability to engage in self-financing. The Gross National Product fell dramatically (on average -2.0% annually for the past 8 years), 270,000 jobs have been eliminated, crime reached record levels, and migration to the United States became the immediate alternative to those wishing to escape the crisis.

Expansive Austerity

In 2009 a conservative administration of the New Progressive Party entered government and argued that the economic problem of Puerto Rico was based on the “distortions” generated by the public management of the economy that, according to them, limited the competitiveness and productivity of the local “factors of production.” This new government anchored its public policy on the private entrepreneurial sector, both domestic and foreign, that had demanded a better environment for business and private investment. This petition from the private sector was accommodated with structural adjustment policies like the firing of 30,000 public employees (Law # 7 of 2009), favorable tax reform for the highest incomes, increases in the fee for public university registration, the privatization of public assets, etc.

The policies applied did not have the desired effect. Part of the problem with their application in Puerto Rico, apart from the well known theoretical issues, was that the economy is characterized by being peripheral and dependent on the economy of the United States. Various instances exist of wealth being extracted and not reinvested. The most illustrative example can be seen in the disequilibrium in the balance of payments caused by the repatriation of profits of manufacturing firms to the United States, which amounts to approximately a third of the GNP (close to $35 billion).

Public Debt

The cuts in public spending had a negative multiplier effect in the economy given that they did not have a counterbalance with an increase in private sector investment. The deepening of the crisis led the government to issue $16 billion in debt, which represented 22% of the total debt and the gross domestic product. In other words, more than one fifth of the total debt of the country was constituted by bonds and lines of credit opened by the public sector to contain the economic free fall that was in effect created by the same government who applied expansive austerity.

It is also important to point out that, apart from the debt, that government had access to $6 billion dollars (8.6% of GNP) assigned via the Obama administration's American Recovery and Reinvestment Act, and to liquidity injected to the local banking sector to prevent its decapitalization. The most conservative estimates calculate that around $25 billion were injected into the Puerto Rican economy, which leads us to believe that the austerity policies could have had worse consequences.

Degradation of credit: Increase in the debt service

In 2013, the conservative government of the New Progressive Party was substituted by an administration of the Popular Democratic Party that at the time seemed to have more of a socio-liberal bent given that it had promised to stop laying off public employees. Still, it had left everything else (collective bargains, wage increases, consolidation of agencies) on the negotiation table. With the arrival of the new administration, immediate degradations of credit by Moody's, S&P, and Fitch followed, which provoked the closing of doors in primary debt markets to Puerto Rico's government and a fall in the value of its bonds in secondary markets. Apart from this, many of those bonds contained "acceleration clauses" that complicated the outlook given that this particular debt that matured at the moment of degradation was not considered in the books as an expense. Rather, it had a direct effect on the budget, given the impossibility of refinancing the debt with a new issuance of bonds.

The debt service doubled from one year to another; its effect was a reduction in public spending. In the meantime, debates were taking place over the possibility of either restructuring the debt or continuing to pay it under the original conditions agreed upon with the creditors. From these debates, proposals by new political parties and bills were developed to provide the government in turn with the necessary powers to declare a moratorium on the payment of the debt, audit it, and to renegotiate it. Of these, the only one that was turned into a law was the bill pushing for the declaration of local bankruptcy, in which a legal and institutional framework would be created so that Puerto Rico could decree the renegotiation without the need to appeal to federal forums. This law was declared unconstitutional on July 6, 2015 under the argument of "preemption", given that the federal law for bankruptcy was explicit in excluding Puerto Rico and its municipalities from the federal protection to restructure its debt.

The strict and literal interpretation of the law leaves Puerto Rico with few options to maneuver around its high public debt and its low economic growth. In the current conjuncture, the threat of default is the only viable alternative to convene creditors for a renegotiation of the terms of the debt. The problem with this mechanism outside of the protection of the law is that it will, in all probability, end up in a lawsuit in the federal courts. This is so because the Constitution of the Commonwealth of Puerto Rico (article 6, section 8) clearly states that the debt will have privilege in the order of payments, and if it is not done, it would enter into contradiction with the clause of contractual obligations. It is well known that the argument regarding impairment of contractual rights was used by hedge funds in the case of the restructuring of the debt of Argentina to require compliance with what was agreed upon and to not accept the terms of the renegotiation. In Puerto Rico, a significant part of the debt is in hands of hedge funds, which could take the same course of action, as they did in Argentina, and try to force more cuts in spending and ask for tiered increases in the payment of the debt.

Proposal from IMF

Given the multiple failed attempts at renegotiating and restructuring the debt via legal and institutional mechanisms that require a specialized third party, the government of Puerto Rico commissioned a study that was prepared by three advisors associated with the International Monetary Fund. The proposals of the study followed a "supply side economics" approach, where measures of structural adjustment were recommended, such as: the reduction of costs of production (mainly labor costs), tax reform with more weight on real estate property and indirect taxes (direct taxes would be eliminated), and the continued cutting of the budget of the general fund. The conclusions are standard, given that they establish that these proposals would bring the economy closer to a market equilibrium and to a convergence in terms of payments to its "factors of production," outcomes that are said to have positive effects in the medium run and to bring welfare in the long run.

The current discussion of the report has focused on the fact that the majority of the proposals to reduce production costs (decrease in the minimum wage, reduction in labor protection law, coastal trade) are under the coverage of federal laws, which have applied in Puerto Rico via Law #600, which was approved in 1950 by the Congress of the United States. This limitation in what the local government can or cannot do determines the range of constrained alternatives, which implies that reaching the desired "market equilibrium" of the study is impossible. Still, and more importantly, the problems of the debt and the economic depression have continuing direct effects on the country's workers and firms.

Conclusion

The depression that has characterized the economy of Puerto Rico during the first decades of the twenty-first century is the result a variety of short-run, medium-run, and long-run factors, that span from the failure of industrial policy to the intrinsic limits of operating within the legal framework of the United States as a territory. All of these dimensions have given form to an economic model based on the extraction of wealth, where salaries do not move evenly with productivity, a substantial amount of the wealth produced and profits derived in the island is repatriated and not reinvested in the country, and where debt is used to loot the wealth that does remain in the country. Under these conditions it is not surprising that the economy has followed a downward spiral with a significant social burden.

The different political parties that have come to power throughout the years have demonstrated continuity by proposing and applying policies of a neoliberal bent that have contributed to amplifying the fiscal crisis and have undermined any potential for economic recovery. The attack on the public sector is the most noticeable outcome of these approaches and one would usually expect a social backlash, but the different escape valves available (emigration, federal transfers, informal economy, etc.) and the violence of the state have mitigated the type of mass protest that other countries, like Greece, Argentina, and Spain, have experienced in the last years. Still, more and more progressive voices of citizens against austerity policies have emerged, voices that want social spending to be prioritized over the payment of the debt. The question then is if under the current structure of relations of power can such claims be accommodated. Given the recent history, we believe that they cannot.